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Proposals for a Common Market in Latin America

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Proposals for a Common Market in Latin America

Economic integration, in some respects so far advanced in Western Europe, apparently is also gaining ground in Latin America. The small republics of Central America (excluding Panama) have negotiated an economic integration treaty, which has (January 1, 1960) been ratified by three of the governments concerned, and is therefore in effect with respect to those three countries. But of far more importance, if it were to become effective, would be the proposed common market for all of Latin America, whose chief--but by no means only--protagonist is Dr. Raul Prebisch, Executive Secretary of the United Nations Economic Commission for Latin America (ECLA). The ECLA staff, acting under authority granted to it by the Commission itself, has produced a sheaf of documents bearing on the issue, has sponsored meetings of an "expert group" which prepared two reports suggesting the bases on which a common market might be organized, and has been instrumental in holding meetings of country representatives at which actual negotiations have occurred. The latest such meeting took place in Montevideo, Uruguay, in September 1959, with representatives of the seven southernmost countries of South America--Argentina, Bolivia, Brazil, Chile, Paraguay, Peru, and Uruguay--in attendance. This meeting resulted in a "Draft Treaty of the Free Trade Area," which is still open for amendment and is yet to be ratified, and to which all other Latin American countries are invited to subscribe.

Some form of economic integration (aside from the Central American economic integration treaty) thus appears as a distinct possibility in Latin America. The object of this paper is to review briefly developments up to the present, to outline the elements of the proposed system, to consider the special problem of payments arrangements in the proposed free trade area, and to point up some of the issues and problems involved. The Central American agreement will not be considered in this paper. It involves a special case of a group of small countries which form a more or less natural economic unit, and which are all at about the same level of economic development. The conditions they face, therefore, are quite different from those confronting the larger group.

HISTORICAL BACKGROUND

The relatively low level of intra-Latin American trade, and the difficulties involved, have been the subject of several special studies by the ECLA secretariat. But official action leading toward the common market proposals began with the organization of the Trade Committee, authorized by resolution 101(VI) of the Commission at its sixth session in Bogota, Colombia, in August-September 1955. This Committee was formed "for the purpose of intensifying inter-Latin-American trade . . . through a solution of the practical problems which hamper or delay such trade and the preparation of bases to facilitate trade negotiation."

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The Trade Committee held its first meeting in Santiago, Chile, in November 1956. One of the resolutions adopted there requested the Secretariat to set up a group of experts to continue the studies already begun and to "project the possible structure of a regional market designed to contribute to the sound development of Latin American countries." This group was subsequently formed, held two meetings, and produced two reports. The second of these, issued after a meeting of the group held in Mexico City in February 1959 and entitled "Recommendations Concerning the Structure and Basic Principles of the Latin American Common Market,"1/ constitutes one of the two basic documents analyzed in this paper. It was discussed officially for the first time at the Eighth Plenary Session of the Commission held in Panama in May 1959. However, the delegates at this meeting had no power, nor were they requested, to do more than offer comments on the expert group's proposals, and on the idea of a common market in general.

In the meantime, actual events were moving rapidly for the southern tier of countries. Except for Venezuelan exports of petroleum, the bulk of intra-Latin American trade in recent years has been among the southern countries, mainly Argentina, Brazil, Chile and Uruguay. As a result of inflation, exchange and import controls, overvalued currencies, and similar factors, this trade had been maintained largely through a system of bilateral clearing accounts and related import controls. Under this regime, trade was forced into bilateral balance, generally speaking, and special concessions were frequently given by the creditor, or special restrictions were imposed by the debtor, in order to work off accumulated balances. In 1955, 85 percent of intra-South American trade (excluding petroleum trade) was financed through the clearing account system.2/

During the years 1950-1959, several of the countries in this group (by January 1959, all but Brazil and Uruguay3/) undertook drastic monetary and exchange reforms. These programs were, broadly speaking, similar, and had the following principal characteristics:

1. A declared intention to stop inflation, or at least to adopt monetary and fiscal policies much more restrictive than those previously followed.

1/ English version, mimeographed, appears in ECLA document E/CN.12/C.1/9, March 28, 1959. Also published in Spanish in El Mercado Comun Latinoamericano, United Nations, Sales Number 59.II.G.4.

2/ Economic Commission for Latin America, Inter-Latin American Trade; Current Problems, United Nations, Sales No. 1957.II.G.5., p. 22.

3/ In December 1959, a new monetary and exchange reform law was promulgated in Uruguay, which appears to provide for a free exchange system and the abolition of direct quantitative trade controls. However, it is not yet clear just how the new system will operate, and no account has been taken of it in this paper.

2. The abandonment of direct quantitative controls over imports, leaving importers free to purchase in the most advantageous markets. However, substantial export and import surcharges were frequently imposed, essentially on a nondiscriminatory basis as far as country of destination or origin is concerned.

3. The abolition of exchange control.

4. The unification of the exchange rate, usually on the basis of a flexible rate system. (But the surcharges mentioned above have some of the effects of multiple exchange rates.)

All of these programs were approved by the International Monetary Fund (IMF) and involved the provision of external assistance, including standby credits or outright drawings on the IMF. Several of the countries concerned have agreed with the IMF to give up bilateral payments arrangements with all Fund members which have free currency systems, thus recognizing that bilateral payments agreements are not consistent with convertible exchange and the absence of import controls.

The southern countries were, however, faced with the practical problem of finding a means to continue at least some of the trade that had been built up under the bilateral system. When Argentina joined the ranks of the free exchange countries in January 1959, the problem took on a new urgency. The decision has been to push forward with the common market idea, in the expectation that special tariff concessions might take the place of the special payments arrangements previously in force. Aided by the ECLA staff, several meetings were held during the course of the year, culminating in the meeting in September in Montevideo, Uruguay, to which reference was previously made. The draft treaty there adopted will be the second major document to be considered in this report, presumably being nearer to what might be the final outcome than any other document presently available. From these two documents--the Mexico City report and the Montevideo draft treaty--we can form an impression of the system that seems to be emerging.

ELEMENTS OF THE PROPOSED SYSTEM

Free trade area[4]

So far, the proposals refer only to a free trade area, and not to a customs union,[5] although the Mexico City report states (p. 43) that the juridical form contemplated was that of a "free-trade zone to be transformed gradually into a customs union." In fact, the expert group apparently did not envisage even a full-fledged free trade area, and--as will be seen below--there is also doubt that the arrangements contemplated in the Montevideo treaty would qualify for that classification, under the definition provided in the General Agreement on Tariffs and Trade (GATT), of which several of the Montevideo countries are signatories. (See p. 7.)

The expert group suggested that commodities be divided into three categories for the purpose of putting the common market into effect, as follows: (1) primary commodities; (2) capital goods, consumer durables, intermediate goods and others "for which demand tends to grow relatively intensively or a large import substitution margin exists"; and (3) nondurable consumer goods, for which demand tends to grow relatively slowly and "import substitution possibilities may become exhausted or considerably strained." It appears that category 3 comprises essentially things that are already being produced in Latin America while category 2 consists mainly of articles still being imported from outside the area by all, or at least almost all, Latin American countries.

The expert group proposed the following targets for the end of the "first stage" of the common market, which they thought might be in about ten years:

1. Full abolition of duties on intra-area trade in category 1, with possible special exceptions, especially in agriculture.

2. In category 2, reduction or abolition of duties to the "lowest possible average" within the category.

4/ In the discussion which follows, references to the second report of the expert group (Mexico City report), including page references, will apply to the mimeographed ECLA document E/CN.12/C.1/9, of which the report forms a part. References to the draft treaty (Montevideo draft) will be to specific articles and sections; only a reproduced typed copy of an unofficial English translation is available at the time of writing.

5/ The difference between these two forms of economic integration is that a customs union provides for a common tariff against the rest of the world, while members of a free trade area may maintain their own individual (and therefore differing) tariffs against third countries. In either case, trade among the member countries is free.

3. In the third category, a lower target for reduction (i.e., not so much, or slower, reduction), "to ensure that the specialization of existing industries and their adaptation to common market conditions is effected gradually and without creating difficulties which impede the regular employment of the productive factors involved." (p. 45) (Underscoring supplied.)

The limited nature of the experts' proposals is clear. No fixed goals are suggested, only the reduction of tariffs to some unspecified average level (presumably based on the effective average rate on actual imports) by the end of ten years, with new negotiations at that time to fix further goals. Within each category there would be ample room for keeping specified individual tariff items high, offset by lower tariffs on other items to attain the agreed average. Since the weighting for the calculation of the average would presumably be based on actual trade (either total, or trade with member countries), duties so high as to be prohibitive would not enter into the weighting, and hence need never be reduced. The special treatment for category 3 items, if applied to a significant degree, would also substantially limit the applicability of the tariff reduction program.

In some respects, the Montevideo treaty goes further in the direction of a full free trade area than the experts' report recommended. The contracting parties agree gradually to eliminate, within a period of twelve years, all charges (of a customs or other nature) for substantially all of their reciprocal trade. These objectives will be attained by a succession of annual negotiations, which shall, "on a basis of reciprocity of concessions," result in two lists of commodities.

1. Individual lists, for each country, showing the duty reductions to be granted by that country that year. Such reductions shall average 8 percent a year, cumulatively, from the level of tariffs applicable to other countries. Only goods actually imported from other countries of the area in the 3 years preceding each negotiation need enter in the calculation, although other items can be included in the lists by negotiation. However, the duty on each commodity so included shall be

weighted by imports of that commodity from all sources.[6]
Apparently, no specific duty need be reduced by any particular amount in any one year as long as the over-all average is achieved; some duties could be completely abolished in the first year, for instance, and others changed not at all.

2. A Basic List, agreed to by all countries, of specific products, the charges on which shall be abolished on all trade within the area by the end of the 12-year period. These lists shall include, by the end of the first 3-year period, items which account for 25 percent of the value of all intra-area trade; 50 percent in 6 years; 75 percent in 9 years; and essentially all of the trade in 12 years.

The relation between these two lists is not completely clear from the draft of the treaty itself. Obviously every country is obligated to eliminate charges on the Basic List commodities by the end of the period, whether or not it has imported any of such items from a member country (and therefore whether or not it has in any case had to include the item in calculating the percentage reductions for the individual lists). However, the rate at which the tariffs on the Basic List items are reduced over the period does not seem to be determined.

However the rate of progress over the 12-year period is to be determined, it is clear that the members undertake a commitment to remove all restrictions and duties on the essential part of their

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6/ For instance, let $x_1, x_2, \ldots x_n$ be the value of imports from all sources of those commodities imported from member countries in at least some quantity; $a_1, a_2, \ldots a_n$ the rate of duty to be imposed on $x_1, x_2, \ldots x_n$ when imported from the area; and $b_1, b_2, \ldots b_n$ the rate of duty imposed on the same products when imported from other countries. Then, after one year,

$$\frac{\sum_{i=1}^{n} a_i x_i}{\sum_{i=1}^{n} b_i x_i} \text{ must equal } 1.00-.08=.92$$

reciprocal trade by the end of that period.[7] This, if accomplished, would indeed produce a real free trade area--except for one thing.

Allusion has already been made to the fact that in determining the 8 percent per annum reductions, only products in which actual intra-area trade has occurred need be considered. Presumably, the intent of the treaty is to apply the same criterion in determining whether "substantially all" of the trade has been freed from restrictions.

The General Agreement on Tariffs and Trade (GATT) provides an exemption from the obligation of signatory governments to grant most-favored-nation treatment to other signatories for "the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area." /Article XXIV (4)_7 The same article of the Agreement (paragraph 8(b)) defines a free-trade area as "a group of two or more customs territories in which the duties and other restrictive regulations of commerce (with certain exceptions not here material) are eliminated on substantially all the trade between the constituent territories in products originating in such territories." A similar definition is given for customs unions, except that in the case of the latter, all members must impose substantially the same barriers against imports from third countries.

The text does not further define what is meant by "substantially all the trade between" the member countries. A common sense interpretation would certainly be that "trade between" meant both actual and potential trade; that is, that as far as trade between members was concerned, restrictions would have to be eliminated on "substantially all"

7/ Note that the Basic List applies to every member country, whether or not it has imported any of the items on the Basic List from any other member country (or from any nonmember). A given country, therefore, might have fulfilled the requirement of the individual lists completely (since this requirement is determined by using actual imports of the country concerned as weights) and still have suddenly to abolish duties on other products at the close of the 12-year period--if such products were on the Basic List. And whether or not a product were on the Basic List would depend mainly on whether there had been any significant trade in that product between <u>any</u> member countries. For example, if the Brazilian refrigerator industry were so completely protected that no imports occurred, Brazil would not be compelled to include refrigerators on her individual lists. But if there were intra-area trade in refrigerators elsewhere in the area, presumably refrigerators would sooner or later be included in the Basic List. Of course, Brazil would have had to agree to their inclusion; and she could soften the burden of adjustment for her domestic refrigerator industry by insisting on, and taking advantage of, a period of some years at least to permit elimination of the duty in stages.

the categories in the tariff schedule. If this should be the official interpretation, the weighting procedures for determining the Basic List stipulated in the Montevideo Treaty would not meet the GATT definition of a "free trade area."

What then can be said about this essential feature of the proposal? If the objective of complete elimination of all charges on products moving in intra-area trade were achieved in 12 years, this would represent considerable progress toward economic integration. But, aside from the basic defect discussed in the two preceding paragraphs, the device of having annual negotiations leaves the way open to bickering, misunderstandings, and the application of political pressure to delay tariff reductions on specific products, and leaves the individual businessman in a state of uncertainty. All he can know, if his product appears on the Basic List, is that by the end of 12 years there will be no duties on his product, in his own or any of the member countries. But he cannot know in advance what the level of duties will be at any time in the intervening period. And he may not know whether his product will be on the Basic List until near the end of the 12-year period, if the product is in the last "25 percent of the trade" to be included.

The Montevideo treaty thus seeks to provide what could prove to be a substantial measure of protection to industries already established, although in a somewhat less direct manner than that suggested in the Mexico City report, and therefore more uncertain in its effect. But in view of the relatively small amount of employment and income provided in any specific industry in any one country, it might prove to be politically easier to go ahead with across-the-board reductions in all tariff items. On balance, the damage to injured industries might well be offset by the advantages to those which are enabled to increase their exports. And in this way a truly integrated market would more nearly be assured from the beginning.

Judgment on this matter depends on one's views as to whether the advantages of a wider market will be greater if that market is freely competitive, or if some effort is made to protect, at least for a time, the existing industrial structure. Political realities must, of course, be taken into account. But if the free trade area were to be fully effective by the end of 12 years, or at any future time, it would seem to each country's advantage that investment in the intervening period be geared to that expectation. The best way to ensure this is to open all industries to the same degree of competition from the other members at the same time. Only in this way will capital be directed, from the beginning, to those industries which will have the best chance of surviving in the open market that will exist at the end of the period.

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Special concessions for less developed countries

A novel feature of the Latin American proposals is that countries at a lower stage of development would receive special treatment. As outlined in the expert group's report, these concessions might take one of two forms. First, the more advanced countries (there would be three levels of "advancement") would grant concessions to the less developed ones which they would not generalize to countries at a higher level of development than the grantee. Secondly, the less developed countries might be permitted to reduce their tariffs (by the end of the first 10-year period) to a lesser degree than the more developed countries. However, in return for these special concessions, the less developed countries "may in turn grant facilities for imports (from the more advanced countries). . . either by reducing customs duties below or within the average level fixed for them or by increasing their duties vis-à-vis the rest of the world if that should prove necessary to establish an effective preference in respect of given items."

The Montevideo treaty retains this idea, but in a very general form, which could mean much or little, depending on subsequent negotiations. The essential provision is that the Contracting Parties "may authorize one of the contracting parties to concede temporarily to another of the contracting parties, of relatively lesser economic development within the Area, advantages which shall not be extended to the other contracting parties, with the object of stimulating the installation or expansion of specified productive activities." Also provision may be made for one of the less developed countries to carry out the reductions "in more favourable conditions, specially agreed upon." The restricted character of this provision is evident not only in the fact that special treatment must be authorized by the other members, but also that it be temporary in nature and apparently limited to specific products, the production of which is already under way, or is planned, in the lesser developed partner.

From the outset it seems to have been taken for granted that special concessions would have to be given to the less industrialized (and smaller) countries to persuade them to join. Whether such concessions would be of real assistance, however, would largely depend on the specific cases involved. Certainly no advantage would accrue to the presumed beneficiaries if they received special concessions on products they were not in a position to produce, and in return were compelled to give special preferences on capital goods which might divert purchases from cheaper third-country sources to Latin America.[8] The more limited provisions of the Montevideo draft should prove more workable, and useful, than the Mexico City proposals.

8/ Such an outcome, however, could presumably be redressed by virtue of the reciprocity principle, to be discussed below.

An objection to such special concessions might be raised on purely practical grounds. First, it could create a hodge-podge of tariff levels for a single product, depending on the country of origin within the area. Secondly, it would multiply the opportunities for profitable transshipment (sure to be a problem in a free trade area in any event), and thus increase the difficulties of policing the agreement.

The Reciprocity Principle

Another unique feature of the Latin American common market is the idea that no country should benefit more from its membership in the area than its membership benefits the others; benefits in this sense to be measured strictly in terms of increased exports. Some expressions of this principle seem to mean that each country's trade with all the other members as a group should be in balance; other formulations indicate that any increases in a country's exports to other members resulting from the common market arrangements should be offset by increases in its imports from the area.[9] To give the reader some idea of the persistence of this notion, a few quotations are offered.

From a report prepared by the ECLA secretariat for the 1959 Panama meeting (E/CN.12/C.1/9) (p. xlix):

> "In any event, if a country imported from other Latin American countries goods which it had formerly received from the rest of the world, whether it had or had not a deficit in its aggregate balance of payments, its ability to finance such imports with additional exports would be a decisive factor in the smooth operation of the common market. Otherwise, it might be to the advantage of the country in question to refrain from joining the common market and continue the process of import substitution in watertight compartments, which would be extremely regrettable from the collective standpoint.
>
> "Parity between the advantages which a country effectively offered to the other members of the common market and those it was accorded by them would be of crucial significance for industrial development and the rate of economic growth. This point deserves very special consideration. The possibility must of course be recognized that one or several countries might be competitively powerful enough to dominate the market

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9/ Since such a balancing could not, of course, be easily obtained in the short run, a payments system with automatic credits is also proposed; this idea will be discussed later.

of the others without these latter having been able to achieve a correlative expansion of their exports. Steps would have to be taken to prevent situations of this kind from bringing restrictive measures in their train; it would be preferable for the former more privileged countries to promote their own imports from the common market by accelerating the rate at which they abolished and reduced their customs duties or restrictions."

From the same report (p. lii):

"The fact that countries with a persistent credit balance would be under the obligation to expedite their liberalization measures and even to increase the degree of preference accorded, is of primary importance for the implementation of the principle of reciprocity."

From the Mexico City report:

"For the success of the common market it is important that all the member countries should have the opportunity of expanding their exports at the same time as they take action to reduce their duties, taxes and other restrictions on imports. To this end, member countries which, as a result of the facilities granted to them, increase their exports to the common market without a proportionate increase in their imports, should accelerate the rate at which they reduce their duties, taxes and other restrictions." (p. 49.)

"Member countries whose over-all balance-of-payments has improved as a result of the reduction policy will accelerate the rate at which they lower their duties, taxes and other restrictions. The Committee will make recommendations for the achievement of this objective.

"Those members which, as a result of this reduction policy, have incurred a deficit, or increased an existing one, may temporarily slow down the rate of reduction after consulting the Committee. However, this slowing down will not absolve the debtor countries from the obligation of taking action to correct this disequilibrium." (p. 51.)

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Again the Montevideo treaty is somewhat less categorical; Article 4 reads:

> "The reciprocity foreseen in Article 3 (which stated that the lists referred to above would be negotiated on the basis of reciprocity of concessions) refers to a balancing of the trends of reciprocal trade encouraged by the concessions to be made between each of the Contracting Parties and by the remaining parties as a whole.
>
> "If after a reasonable period of observation the balancing of the trends of reciprocal trade is not achieved, re-establishment of reciprocity will be the subject of negotiations at the future meetings of the Contracting Parties _either by an amplification of the concessions already authorized, or by the adoption of other adequate measures of a non-restrictive character_, in order that reciprocity may become effective at a maximum level of reciprocal trade." (Underscoring supplied.)

An annex to the treaty provides that a country may use its balance of payments with the area as a whole as a reason for invoking escape clauses, but only while the payments between that country and the other members are not made in "freely convertible currency." This would seem to deny convertible countries the right to use the escape clause action, but would not seem to vitiate the provisions of Article 4, under which the objective to be sought is complete balance of payments equilibrium of each country with the area as a whole.

This desire for equilibrium of trade within the area has very little to commend it from a theoretical point of view, and seems not to be appropriate to a system of convertible currencies.[10/] The objection to using U.S. dollars to settle trade imbalances within the area represents, at best, a cultural lag; it reflects the analysis prevalent in the days of inconvertible currencies and the so-called dollar shortage. It is closely related to the tendency--which also developed during that period--to assume that a balance of payments deficit, no matter what the cause, in itself constitutes sufficient justification for a request for external assistance.

The objections that can be raised against this attempted "reciprocity" are closely related to the problem of payments, to be

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10/ As indeed seems to be recognized by the annex to the Montevideo Treaty, just mentioned.

discussed in a later section. But those that are specifically applicable to the problem of trade balancing will be discussed here.

1. If reciprocity is desired, certainly all that is called for is reciprocity of opportunity, not reciprocity of results. It takes two to make a bargain; as much responsibility lies on the seller to offer a marketable product as on the buyer to offer fair terms of exchange. Whether an exchange takes place, therefore, is not a measure of the benefit made available to the seller as a result of his participation in the market.

2. If the seller by virtue, say, of a more efficient industry, a more rational exchange rate, or other "fair" measures of competition, develops a surplus with the other members, is there any logical reason for asking him to make (or suffer) all the adjustments to bring the trade back into balance? Or if the surplus results in the main from inflationary policies in the deficit country, should there be any obligation on the part of the surplus country to liberalize (or inflate) in order to restore the balance? Yet both the Mexico City and Montevideo documents would place all, or almost all, of the burden of adjustment on the creditor (note underscored portion of Article 4 of the Montevideo treaty, p. 12 above).

3. It is freely admitted in the ECLA studies that the attempt to balance trade on a bilateral basis has led to uneconomic exchange,[11] and to restrictive policies directed toward reducing the imports of the debtor countries or the exports of the creditors. Surely the difference between bilateral and regional balancing is only one of degree and not of kind. If the first is uneconomic, so is the second--less so perhaps, but still uneconomic.

11/ One example, from Inter-Latin American Trade; Current Problems, p. 22: "As these (bilateral) accounts formed part of the system of selective and quantitative controls applied by each country to its imports as a whole, they served the further end, by protecting goods which the Latin American countries exchanged on a basis of overpricing--this being due to low domestic productivity or to overvalued export exchange rates--from the effects of foreign competition within intra-regional trade."

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4. Subject to some limitations, mainly of short-run validity, a country with a balanced internal financial situation and a realistic exchange rate will find its external accounts in balance as well. But this would not, of course, necessarily mean balance with any particular country or group of countries. Any attempts to force such a partial balancing by artificial means would tend to distort trade with the country's other trading partners, and would enhance the degree of discrimination already inherent in the common market arrangements.

5. Suppose that a member country increased its exports to other members but only at the expense of its exports to third countries, as could easily happen. No change in the exporter's over-all balance of payments would be involved. Here again, there is no reason why the exporter should be compelled to increase the pace of its liberalization within the free trade area.

6. By the end of the 12-year period, when all charges have been removed, if some countries are not in balance within the area (and there is no a priori reason why any of them should be) there would be no methods of adjustment left, except to reimpose some of the intra-area restrictions, or to modify the tariffs applicable against third countries.[12] The first of these alternatives would be undesirable, clearly; the second would not only be undesirable but would probably be quite impractical as well, since it would involve negotiations with the other countries. At the end of 12 years, therefore, the member countries would presumably have to be prepared to live under a regime of intra-area imbalance, another reason for doing so from the start.

Escape clauses

In spite of the limited nature of the commitments proposed to be undertaken--as outlined above--both the expert group's report and the Montevideo treaty contain fairly liberal escape clauses.

12/ That is, intra-area creditors could raise their tariffs against nonmembers and intra-area debtors could reduce theirs. Again this would put the real burden of adjustment on the creditors, whose terms of trade would tend to worsen as a result.

The former proposed that if the application of the common market "should give rise to any serious disturbances in any important sector of a country's economic activity, or cause considerable unemployment of labour which cannot be absorbed in other activities," such country may, unilaterally, suspend the application of concessions already granted as well as the extension of new concessions. If the suspension should be prolonged for more than a year, the other members, or any one of them, may request negotiations "with a view to re-establishing the reciprocal situation prevailing before, or finding new ways and means of ensuring equilibrium."

The Montevideo draft goes even further in adding the balance of payments situation as another reason for invoking the escape clauses; only prior notification to (not consultation with) the members is required. The text of this article (No. 26) is reproduced here. As will be seen, it is not only broad in scope, but somewhat ambiguous.

> "Article 26. After previous notification to the Committee, any Contracting Party may put into force as emergency measures, special measures appropriate to each case, to protect the national interests affected, whenever
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> a) they are justified by the conditions of its balance of payments;
>
> b) there arise, from unforeseen causes, serious disturbances in any important sector of the national economy, which affect the level of employment or the rate of economic progress.
>
> "So soon as the Committee receives such notification, it shall examine the causes which may have necessitated such measures, and it shall promote the adoption of those measures which it judges appropriate, within the field of collective action, to correct or eliminate those causes.
>
> "If the application of the special emergency measures should last for more than one year, the Committee shall propose, on its own initiative or at the request of any Contracting Party, the initiation of new negotiations with the aim of reestablishing the original situation of reciprocity, or of finding ways toward a new equilibrium."

In addition, article 23 permits a member, subject to prior authorization of the contracting parties, to impose quantitative restrictions of a transitory nature of two types:

1. On imports "destined to supplement basic internal production" of products subject to special programs of government encouragement or important to the national economy, provided that no reduction in the "normal consumption" of the importing country is involved.

2. On exports, when necessary to ensure the domestic supply of certain products.

There is also an article (25) providing for a vaguely worded and broad exception for "specified" agricultural products for the 12-year transition period. However, there seems to be no provision for any permanent exclusion of agricultural products from the terms of the agreement; given the extensive protection for such products in many Latin American countries, elimination of barriers will undoubtedly involve very difficult negotiations.

Escape clauses are probably a necessary part of any international trade agreement; whether they hinder the attainment of the basic objectives--in this case a free trade area--depends on how they are applied in practice. Obviously, there is a danger that the article 26 provisions might be abused; they can be unilaterally imposed and the other members are apparently restrained from taking countervailing action for a period of a year. Moreover, there is no restriction as to the causes of the "disturbances" that can justify the imposition of the restrictions. For instance, even if a balance of payments deficit were clearly the result of internal inflationary developments and not of outside influences, the country involved could still avail itself of the provisions of this article. The domestic reasons are limited to "serious" disturbances in "important" sectors, but the operating definitions of these adjectives are left to the countries concerned.

Since the imposition of restrictions under article 23 must have the prior approval of the other governments, perhaps a sufficient safeguard has been provided. An interesting aspect is that permission will be required to impose quantitative restrictions on exports. Perhaps some of the Latin American countries (e.g., Chile) may be persuaded to decrease their use of this basically uneconomic device, under which producers are in effect forced to subsidize domestic consumers to the detriment of the country's balance of payments. The possibility of conflict might arise if, for instance, a country got into balance of payments difficulties because it had restricted exports. Would its trading partners in such a case be requested to speed up liberalization in order to help the deficit country, or would the latter be permitted

to put controls on imports to redress a balance of payments deficit caused by quantitative restrictions on exports? In the event, such questions are not likely to arise, but we have here another example of the care taken in drafting the treaty not to disturb existing practices or relationships.

Other clauses

Before turning to the second major topic--the question of special payments arrangements--there follows a brief summary of the remaining major provisions of the Montevideo treaty, most of which were foreshadowed in the earlier ECLA papers and the reports of the expert group.

> 1. With the approval of the contracting parties, complementary agreements may be negotiated covering individual products or industries, beyond the concessions granted under the general provisions. These so-called "complementary agreements," which "shall be adapted to the peculiarities of each sector of production," (Articles 14 and 15), obviously involve the danger of creating special monopoly positions and presumably for this reason require the consent (by two-thirds vote) of all members, even though they may involve only two countries.
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> 2. Provision is made for a permanent Committee, with a secretariat, which would have broad powers for carrying out the agreement.
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> 3. Provision is made for the later adherence of other countries; generally speaking such countries would have to grant concessions equal to the cumulative concessions already granted by the original members.
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> 4. A time schedule for the annual negotiations is fixed; all changes to take effect on each January 1 must be communicated to the public by the preceding November 1.
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> 5. The agreement is open to proposed further amendments to January 15, 1960; a final meeting of the contracting parties is to be held in February "to conclude definitely the treaty."

PAYMENTS ARRANGEMENTS

From the very beginning, the position of the ECLA secretariat and the expert group has been that the Latin American common market should be accompanied by special payments arrangements, preferably a full-fledged payments union, with an automatic credit system, which would eliminate or greatly reduce the need to use convertible currencies, mainly U.S. dollars, to settle trade balances within the area. Under the bilateral agreements that until recently governed much of the trade in southern South America, balances in excess of swing credits were usually required to be settled in U.S. dollars. Rather than make such settlements, the debtor countries would frequently halt imports when the swing margins had been reached. Little or no provision was made for multilateral use of the clearing balances, even within the area. Clearly, the substitution of a payments union for such a bilateral system would be a major step toward liberalization.

In the meantime, however, five of the seven countries involved in the Montevideo draft, and practically all the other Latin American republics, have adopted currency systems that are either fully convertible, or practically so.13/ In spite of this fact, Dr. Prebisch and his aides still feel that a payments union is necessary. A discussion between Dr. Prebisch and the observer from the International Monetary Fund on this issue at the ECLA meeting in Panama in May 1959 involved the most heated exchange of the entire meeting, during the course of which it was made clear that the IMF was opposed to the ECLA proposals for a payments union in Latin America.

The principal arguments for the ECLA position on payments matters involve in one way or another the principle of reciprocity--or regional balance--which has already been discussed.

1. A basic premise of the position is that Latin American countries are in general unwilling to use dollars to settle trade balances among themselves. More realistically, what is probably meant is that they are unwilling to use dollars to pay for goods from each other which they could procure more cheaply in third countries. This was conceded by Dr. Prebisch in a speech to the Central Banks Working Group in Rio de Janeiro in November 1958. On speaking of the

13/ Many of them, especially in the Caribbean area, have had fully convertible currencies all along.

necessity for trade equilibrium within the area (see point 2 below), he said ". . . were a persistent disequilibrium to be registered, the debtor countries would be paying for part of their imports of industrial goods from the creditor countries with gold or dollars that they could have used to buy similar products at a lower cost in the world market."

2. Given the principle of "reciprocity" as an objective, it must be recognized that making the necessary balance of payments adjustments, via the method of accelerating or retarding the rate of granting concessions, would be a slow process. In the meantime, some countries would have deficits which, in the absence of a payments union with a credit system, would have to be settled in dollars. This possibility may discourage countries from joining the system, or from extending concessions as rapidly as they otherwise would.

3. The necessity of granting credits would put a greater pressure on the creditor countries to take measures to increase their imports from the area than they would be likely to do if they received immediate payment for their surpluses in the form of convertible currencies.

4. The sequence of events in Europe, from bilateralism through limited transferability of bilateral-account balances, to the European Payments Union, and, finally, to full nonresident convertibility, is also cited as favoring a similar course in Latin America.

It is the opinion of the writer that special payments arrangements are neither a necessary nor desirable adjunct to a common market, be the latter a free trade area or a full-fledged customs union. The following arguments are offered in support of this position,14/ not necessarily in the order of their importance:

14/ Needless to say, no credit for originality can be claimed for these points. They are the outcome of reading and discussion during the past couple of years. However, personal discussions with Mr. Romulo A. Ferrero, Lima, Peru, and a perusal of the series of articles on the subject which he wrote for the bulletin of the Lima Chamber of Commerce have been especially helpful.

NOT FOR PUBLICATION

1. If a country's currency is freely convertible into any other currency, at least for nonresidents, and if the other foreign currencies are convertible between themselves, no one currency has any greater value (or is more useful) than any other. If some of the currencies involved are those of the members of an economic union, they would still have the same value in settling international accounts as a third currency (say, the U.S. dollar). So the argument that Latin American countries would not want to use dollars to settle balances among themselves has no validity if the Latin American currencies are effectively convertible, which is presently the case for all Latin American currencies other than those of Brazil and Uruguay.15/

2. The foregoing is not meant to imply that a country would not prefer to settle its adverse trade balances in its own currency, to be used only for purchasing its exports, that is, to receive a credit from the other country. This aspect, considered a virtue of a payments union by the protagonists of the latter, may also be regarded as its principal defect--it all depends on one's point of view. As already indicated, to the extent that countries find themselves in deficit due to their own financial mismanagement, overvaluation of the exchange rate, etc., an automatic credit system enables them to postpone the implementation of measures to restore equilibrium. It enables them to exist, for a time at least, on resources provided by others. In effect, it rewards the bad performers and penalizes the good. But even the "reward" to the "bad" performer will not be in its own best interest in the long run.

3. A payments union with automatic credits, if it is to achieve the aims of its Latin American proponents, cannot be operated without exchange control. Measures would have to be taken to ensure that all transactions between members were reflected in the reciprocal balances

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15/ Even the currencies of Brazil and Uruguay are legally convertible--even to residents for capital purposes--at the free market rates of exchange; but the possibility of sudden and substantial declines in the value of such currencies obviously limits their acceptability to foreigners. At the time of writing, the Cuban peso also seems to be effectively an inconvertible currency; on the other hand, certain other Latin American currencies that are legally inconvertible are *de facto* convertible.

held in and by the respective central banks. If not, private traders would be free to conduct their business in any currency they wished, or to convert export proceeds into dollars and hold them abroad, or buy imports from outside the area, or make any other use of them they wished. Even if the central bank offered as good a rate (in terms of local currency) as could be obtained in the open market, there would be many reasons why an exporter might prefer to dispose of his foreign exchange receipts other than by selling them to the central bank. Thus without exchange control, the balances of trade, for purposes of calculating the reciprocal credits to be granted, would have to be derived from the customs declarations (universally considered to be unreliable) or some similar sort of registry.16/ Only those exporters receiving payment in a member currency considered to be weak (and which they could not immediately convert into some other currency) would be likely to surrender it to their own central bank in exchange for local currency.

Any step to impose exchange controls in those countries that have not had them, or reimpose them where they have been abandoned, must be regarded as a retrograde action, and would be completely out of harmony with the trend of the times. For several countries, it would constitute a violation of their stabilization agreements with the International Monetary Fund.

4. Since all of the Latin American countries are (relatively) underdeveloped, none of them should be expected--least of all forced--to extend credit to other countries, even to other underdeveloped ones. Moreover, there would be no assurance in a payments union that the creditors would always be the most advanced countries; the opposite has occurred often enough under the bilateral agreements previously in effect. The latter situation (say, Bolivia or Paraguay being creditors of Argentina in the clearings) would be even less defensible than the reverse.

16/ The difficulties of including invisible transactions in such a system would be even greater; yet failure to include them might be unjust to some countries which might offset a surplus on visible trade with a deficit on services account--or by private capital movements. In the latter case, it might even find itself in the position of financing its export surplus twice.

5. The European example cannot be convincingly cited in this instance either. Neither the European Economic Community (the common market) nor the Benelux economic union (the most closely integrated economic union now in operation) have any special payments arrangements. Balances arising from their reciprocal trade are cleared through the exchange markets in the same manner as all their foreign transactions. The step-by-step progress in Europe was not the result of the entrance into a common market; it was the slow way out of a system under which practically all the currencies were essentially inconvertible. Convertibility is what gives the economic integration plans their best prospect for success; not the reverse.

Probably because of the emphatic opposition to a payments union expressed at the Panama meeting by the U.S. and the International Monetary Fund,[17/] the Montevideo treaty leaves the payments question open. Article 39 states, briefly, "The Committee shall consider the common problems of the Contracting Parties, in their mutual payments relations, in accordance with the agreements which may be concluded." An annex to the treaty reads as follows: "Until such time as the agreements mentioned in Article 39 have been reached, referring to payments between the contracting parties, the Committee shall be empowered to judge on these and by unanimous decision take whatever provisional decisions they consider suitable." The Montevideo meeting also adopted a resolution calling for a meeting of central bank representatives in December 1959 (since postponed to January 1960), at which time the payments problem was to have been discussed further, and requesting the ECLA and the IMF "to carry out a special study on the problem of payments within the projected Free Trade Area and possible solutions." A similar resolution had been adopted at the ECLA session in Panama.

Comparison with Western Europe

There can be little doubt that the movements toward economic integration in Western Europe have been a major stimulus to a similar movement in Latin America, although in Latin America more stress is laid on the effects of economic integration on industrial growth, through the creation of new industries or the expansion of existing ones, whereas the major emphasis in Europe seems to be on increases in productivity rather than simply the expansion of total industrial capacity. Of course,

17/ Similar opposition was expressed at Montevideo by the delegates of Peru, Paraguay, and Bolivia.

the Latin American argument is that the larger market will make it possible to establish industries which depend on large scale production to be efficient, but, as we have seen, there does not seem to be a major concern with increasing the productivity of those industries already established--except through such productivity increases that may occur as a result of a higher rate of output.

However, the European experience, both in the matter of reciprocal trade and in the development of payments arrangements, is frequently cited in the ECLA literature in support of the idea of a common market in Latin America. For this reason it seems useful to point up some of the many differences between the two situations.18/

1. About 50 percent of the international trade of Western Europe19/ consists of intra-area trade. The corresponding figure for Latin American trade is around 9 percent (1956 data); if petroleum were excluded the figure would be about 7 percent. Reciprocal trade of the seven countries which negotiated the Montevideo treaty ranged from 10 to 12 percent of their total trade during the years 1955-58. It would seem that the high level of existing trade in Western Europe and its greater diversity commodity-wise would make it relatively easier to establish a common market there than in Latin America.

2. Since 1949, almost no country in Western Europe has maintained an exchange rate seriously out of line with the internal value of its currency, or used multiple exchange rate practices; and the exceptions have usually been rather temporary. Admittedly, severe quantitative restrictions on imports were maintained for a time, but trade was conducted using exchange rates which permitted realistic international comparisons of values. And, by the time the European integration arrangements began to come into effect, all the member countries of the OEEC had established full external convertibility and were well along in the process of eliminating their quantitative import restrictions. Needless to say, the above characteristics have not, at least until recently, applied to many of the Latin American countries, although now only Brazil and Uruguay still have complex exchange systems involving a substantial degree of overvaluation.

18/ Again, in this section, I am especially indebted to the ideas expressed by Romulo Ferrero.

19/ The term includes members of the OEEC. The corresponding figure for the six members of the Common Market is 30 percent (1958 data).

3. An important and closely related fact is that, again with few exceptions, inflation in Europe has either not been a serious problem in recent years or has been kept in check by stringent monetary and fiscal policies.[20] An important feature of the European Economic Community is a commitment to coordinate financial policies in order to prevent the emergence of a serious balance of payments disequilibrium in any member. (There is no suggestion that it is expected that such a disequilibrium might result from the operations of the common market itself.) But the significant thing is that a substantial degree of economic stability was achieved before the common market arrangements went into effect. Very clearly this is not the case in many Latin American countries; for instance, the cost of living rose in the seven countries of the Montevideo treaty by the following amounts in the year ended October 1959:

	Percent increase
Argentina	118
Bolivia	27[a]
Brazil	43
Chile	44
Paraguay	10
Peru	18
Uruguay	44[b]

a/ Year ended September 1959.
b/ Year ended July 1959.

4. The sheer facts of geography and demography make the Latin American problem more difficult than that of Europe. The countries of Europe are close together, densely populated, and connected with an efficient transport system by water and land. By contrast, the population density of Latin America is one-twentieth that of the Six, and great distances and

20/ Under De Gaulle, France seems to have ceased being an exception to this statement.

formidable physical barriers separate the major population centers of the area. An ECLA study showed that ocean freight rates are frequently lower for shipments between Latin America and the U.S. or Europe than between points in Latin America.

5. The most obvious and perhaps in the end the most significant difference is in the grade of industrialization already achieved in the two areas. In Europe, already highly industrialized, the common market is not expected to lead to any revolutionary structural changes. One of its principal benefits is expected to be the increased productivity of industry as a result of wider markets and increased competition. In Latin America, the principal argument in favor of the common market as developed by ECLA[21/] is that it can contribute to industrialization by permitting the establishment of industries which it is believed could not function efficiently within the confines of the narrower national markets. As we have seen, the basic goal is an increase in the volume of output; the objective of increasing output per unit of input (i.e., reducing costs) seems to have a secondary role. A full implementation of the common market principle would require much more serious structural adjustments in Latin America than in Europe, and for that reason will undoubtedly prove much more difficult to accomplish.

6. Finally, the European common market has major political overtones; it is seen by many as a step toward eventual political integration, however distant that goal may be. The commitment to coordinate economic and financial policies, if adhered to, is bound to lead to closer political ties. Whether this factor is favorable or unfavorable to the common market as an economic venture may be disputable; but, so far at least, it is a factor that differentiates the European and Latin American situations.

PROSPECTS FOR SUCCESS

There is reason to believe that a true common market, either a free trade area or a customs union, organized on the principle of free

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21/ See especially "The Influence of the Common Market on the Economic Development of Latin America," E/CN.12/C.1/13, April 28, 1959.

competition within the area, and free entry into any industry in any member country, would materially assist in the economic development of Latin America. There are many industries where the size of the market is important, although this argument has been overemphasized in the ECLA literature. Freedom of competition and free entry would serve to stimulate productivity increases in existing industries. And assuming no increase in tariffs against third areas (perhaps an unrealistic assumption), a reasonable degree of competition from that source seems to be assured.

But this emphasis on competition, at least within the area, is all-important. For this reason the provision of the Montevideo draft which apparently permits the continuation of present tariffs on products which are produced in one or more of the member countries but in which no trade among the members has yet occurred is pernicious and should be eliminated. For it is precisely among such products that the greatest opportunity for increasing the degree of specialization exists. As long as the countries are not compelled by the agreement to include such products in the preference lists, there will be substantial pressures from the producers not to include them; it will always be uncertain whether or not they will be included, and producers will not be able to make plans intelligently. Whereas if it were known for certain that at the end of 12 years any product (or at least any product not on a list of specific exceptions) produced within the area could move freely within the area, this would be a tremendous stimulus to rational investment.

A free trade area organized along these "complete" lines would also tend to attract more foreign investment than the more limited system envisaged in the Montevideo draft. The adoption of the Ottawa system of tariff preferences within the British Commonwealth served to attract significant amounts of U.S. capital to the U.K. and Canada, even at the bottom of the depression. In order to provide the widest possible scope for manufacturers of any product to set up factories within the area, free access to the markets of the whole area should be granted. To exclude certain products from the system would be tantamount to saying to the foreign manufacturers of those products, "We really do not want you to set up a factory in our territory; we are afraid of the competition you will offer to our domestic producers who are already established."

Any form of economic integration can be fully successful only if each of the partners maintains a unitary rate of exchange for its currency at a realistic level. Only with a unitary system can proper cost comparisons be made, and only if exchange rates are realistic can balance of payments disequilibria be avoided. If one country, for instance, tries to maintain an exchange rate that seriously overvalues its currency, it is certain to develop a balance of payments deficit, and thus become a burden on its partners (or, if no credit is

available to finance the deficit, to renege on its agreement to liberalize trade). If there is some doubt about the ability of any member to control its internal financial affairs so as to maintain the value of its currency, the members will be wise to continue more or less indefinitely the flexible exchange rate systems that have been adopted by several of them, notably by Argentina and Peru.

With unitary and realistic exchange rates, the principal reason for exchange controls and quantitative import restrictions will have disappeared, and complete convertibility can be achieved and maintained. There will be no need for a payments union, since one foreign currency will be just as useful as any other. This is not to deny the prospective benefits of a credit system to enable countries to tide over seasonal or other short-run balance of payments difficulties. Actually the resources of the International Monetary Fund (and, where these exist, a country's own reserves) are available for this purpose, as well as other sources of credit--including private sources. If the free trade area wishes to have its own credit pool, there could be no objection. But to be fully effective, such credit should not be available on an automatic basis--for reasons indicated above (pp. 20-21)--but should be extended only on condition that steps have been taken which would eliminate the deficit that provoked the need for the credit in the first place.22/

But the common market must not be regarded as the sole, or even a major, solution to the problem of economic development in Latin America. For to do so would be to say that all that is needed is the availability of a large market and economic advancement is secured. If this were so, India would have long since been developed. A large (protected) market may be of help, but it is not a sufficient, nor even a necessary, condition for economic development. And it would be unfortunate if an exaggerated belief in the efficacy of the common market to promote economic development should divert resources of energy and intelligence that should be devoted to the solution of more relevant problems.

22/ The author does not accept the view so frequently found in the ECLA literature that surplus countries are as much--or even more--responsible for balance of payments disequilibria as--or than--the deficit countries. The only possible exception would be a case when the surplus country had undergone a serious deflation. Certainly failure to inflate as rapidly as one's trading partners should be considered a virtue, not a sin.