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THE ANDEAN PACT:  
A MODEL OF ECONOMIC INTEGRATION FOR  
DEVELOPING COUNTRIES

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THE ANDEAN PACT: A MODEL OF ECONOMIC INTEGRATION FOR  
DEVELOPING COUNTRIES\*

by Ricardo Ffrench-Davis

There is a noteworthy trend in the world today for countries to group together in an effort to expand their economic space. The phenomenon is occurring alike among rich and poor countries, in socialist and capitalist systems. While the European Economic Community takes in new members, on the same continent the Council for Mutual Economic Assistance (COMECON) joins various socialist nations. 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 in 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

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\* I am indebted to E. Tironi, A. Aninat and D. Schydrowsky for their useful comments.

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 of import substitution on a regional basis.

In 1970, the Cartagena Agreement joining six Andean countries in a program of subregional integration went into effect.<sup>1/</sup> 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, the Andean Pact has had an incipient but growing impact on the economic life of the countries, that surpasses that of the Latin American Free Trade Area (LAFTA) at the height of its influence. This internal effect has been manifested externally in incipient joint participation by the Andean Nations in various international forums, thereby lending greater force to their positions.

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

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<sup>1/</sup> So-called 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. A sixth member, Venezuela, was accorded entry by means of an additional agreement in February 1973, known as the Lima Consensus. Venezuela's actual incorporation into the Group started taking place during 1974.

implementation to the present (June 1976)<sup>1/</sup>. In order to provide a framework for the analysis, a brief account of the major objectives and benefits 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 to be afforded to foreign capital, and on the issue of coexistence within the integration process of regimes with divergent political approaches. Finally, section IV contains some remarks related to the stage reached by the process in 1976.

#### I. THE OBJECTIVES OF INTEGRATION

The increased trade that integration processes bring 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 role of economies of scale,

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<sup>1/</sup> Further background information can be found in the bibliography at the end of this paper.



at the present degree of industrialization of latinamerican countries.<sup>1/</sup> Indeed, the majority of the most dynamic industrial activities demand a scale of production that exceeds that of domestic markets. Although there undoubtedly are exceptions, it is difficult for developing countries to gain easy access to the markets in industrialized countries of many manufactured goods.<sup>2/</sup> Current international conditions have reenforced this situation by strenghtening obstacles and accentuating the instability of the foreign markets; furthermore, the increasing role of transnational corporations in international marketing makes even less realistic the crucial assumption of a unified competitive international market.<sup>3/</sup> The inevitable consequence of restricting industry to production for internal demand is the inefficiency (higher real costs) of smaller scale production and ultimately that available investment resources result in a lower level of satisfaction of the needs of

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<sup>1/</sup> See a theoretical analysis on the role of economies of scale on the welfare implications of custom unions in Corden (7). For a discussion of welfare effects in developing countries of trade creation and trade deviation see Mikesell in Robson (31) and Ffrench-Davis (13).

<sup>2/</sup> See Baldwin (3) and GATT (15) 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 (29).

<sup>3/</sup> Transnational corporations integrate some markets that otherwise would have had no connection. However the market becomes integrated from the point of view of the multinational parent and branch firms, thus becoming more difficult for domestic producers, from developing countries, to export to those "captive" markets.

the population.<sup>1/</sup> 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.<sup>2/</sup> In other words, integration is the most realistic option for small countries, given their need to export and the practical difficulties of obtaining ready access to world markets.

Moreover, joint action by a group of nations results in greater bargaining power than the sum of that wielded by the countries separately. 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, and in negotiations with developed countries to facilitate access of industrial exports to their markets.

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<sup>1/</sup> A low level of GNP is one of the factors limiting the intensity of 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.

<sup>2/</sup> The analysis of the numerous sources of benefits and costs of the integration process will be omitted here. We believe the factor mentioned above, the exploitation of economies of scale that the reciprocal opening of markets allows, is a determinant source of net benefits.

Finally, the acceleration of development and 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 1950's.<sup>1/</sup> The efforts culminated in 1960 with the signing by seven Latin American countries of the Treaty of Montevideo, which gave rise to the Latin American Free Trade Association, 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 barriers to trade among the countries. But progress was slowed after a brief period with the result that during the past ten years LAFTA's

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<sup>1/</sup> See ECLA, in Wionczek (38) and INTAL (16).



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 -by means of investment planning on a regional scale- the equitable distribution of the benefits of integration. Nor did the Treaty 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 a resolution calling for, among other things, a regional investment planning mechanism,<sup>1/</sup> the proposals were never carried out.

The liberalization of trade among the member countries has been of modest scope, even though the original deadline set forth for the comple-

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<sup>1/</sup> Resolution 100, approved by the end of 1964.

tion of this process has expired.<sup>1/</sup> Indeed, the established commitments for the elimination of barriers to reciprocal trade were not fulfilled until the mid 1960's, and coincided with a significant increase in commerce. Subsequently, the deadlines fixed were repeatedly extended. In practice, wherever the measures reducing barriers on reciprocal trade came up against vested interests, the process was halted without touching them. Indeed, advances were made only when there were parties in one country interested in gaining markets in other countries and such initiatives were not met with opposition from sectors in the latter ones who felt they might be damaged.

Two observations are appropriate in regard to this approach. On the one hand, the liberalization of reciprocal trade implies not necessarily the disappearance of the firm of the higher-cost country, but rather-- if properly regulated-- a greater degree of specialization in product varieties and qualities within the respective enterprises of each country.<sup>2/</sup>

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<sup>1/</sup> 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. See INTAL (16) and (17).

<sup>2/</sup> Even though it might be that the returns to product-specialization are large, it is frequent that it is not clear in what products the comparative advantages of each enterprise are located. In such circumstances, a centralized decision on specialization patterns can lead to a more efficient, smoother, and politically more reasonable process as compared to that achieved through "market competition".

On the other hand, liberalization based on the requests of interested parties renders the process passive. Conversely, and 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 developing economic environment, where substantial differences were and continue to be the rule. Greater relative levels of development are present in the industrial poles of Argentina, Brazil and Mexico. Consequently, the acceleration of integration within a framework such as LAFTA would have meant the repetition on the scale of Latin America of a world economic pattern, wherein some countries are mostly limited to the production of raw materials, while other countries specialize in the production of manufactures more meaningful in promoting economic development, and appropriate an overwhelming share of the benefits of

integration.<sup>1/</sup>

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. But a process of integration requires much more than an agreement on lowering internal tariffs. For this reason, serious shortcomings began to become evident as the integration proposal 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 that foreign firms were able to move into without restrictions, and even had the encouragement of the governments of various host countries.<sup>2/</sup> Because of these defects, the acceleration of the integration process, within the prevailing framework, would tend to concentrate its benefits in the most developed members and would end up serving the interests of the multinational corporations more than

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<sup>1/</sup> See a discussion of the subject in Díaz-Alejandro (8). For data on the flows of trade and on the participation of each country on the "Complementarity Agreements", see INTAL (17). A discussion of various aspects of the issue can be found in Robson (31).

<sup>2/</sup> For an examination of the changes in attitude of many Latin American countries in the direction of the rationalization of policies vis a vis foreign investment, see Vaitzos (34). Unfortunately, the positive trend has suffered several up-and-downs.

those of the Latin American people.<sup>1/</sup>

In summary, the purpose expressed on repeated occasions to progress toward a common market was never implemented. None of the measures required to accomplish this goal was 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 were to undergo substantial improvements.

The progressive building of a more comprehensive scheme, outgrown from the past experience, along with the impossibility of amassing unanimous support from all members of LAFTA, led several countries to seek a path of their own. The Andean countries, who perceived the need for expanded markets more intensively than was the case with 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.

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<sup>1/</sup> The theoretical discussion of the effects of integration on the tribution of benefits among transnational corporations and member countries can be found in Tironi (33). Tironi discusses several alternative outcomes; many of them, that are based on rather realistic assumptions, lead to cases of "inmiserizing growth".

### III. MAIN FEATURES OF THE CARTAGENA AGREEMENT

The Andean Pact was signed in 1969. Since then it has shown significant progress, though it has not been free from the obstacles to be expected in an undertaking of such magnitude, and given the range covered by the political changes that have been taking place in the subregion.

The Andean countries' integration agreement 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 would participate in it as a single economic bargaining unit.<sup>1/</sup>

We shall see, then, whether it is plausible to expect the Andean nations in conjunction to wield economic weight comparable to the three largest members of LAFTA. To examine this, we must determine the rela-

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<sup>1/</sup> In the mean time, the Andean countries would operate as one economic unit in their relations with other LAFTA members in such matters as negotiations related to tariffs and industrial production agreements.

tive significance of the Andean countries. As can be seen in Table 1, despite the small size of each individual Andean nation, 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.<sup>1/</sup>

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<sup>1/</sup> This assumes, of course, that the group does not duplicate development patterns of the three largest countries, for this would impede future complementation of their economies. 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 to be adopted by the common tariff policy and the industrial planning program will exercise a key role in the productive structure created within the Andean market. In like manner, the promotion of certain specialization agreements between the Andean Group and the other countries of Latin America would mean a step forward in the road of integration of the region.



Table 1

THE ANDEAN ECONOMIES IN 1972

(1974 dollars)

Countries	Population (millions)	Gross Domestic Product		Foreign Trade	
		Per capita (dollars)	Total (millions)	Exports of	Imports dollars)
	(1)	(2)	(3)	(4)	(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
<u>Andean Group</u>	<u>71.2</u>	<u>923</u>	<u>65,692</u>	<u>10,027</u>	<u>8,186</u>
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. We have multiplied the former by 1.90 and the latter by 1.42, in order to attain figures expressed in currency with 1974 purchasing power.

The most important features of the Cartagena Agreement are:

- a) An institutional set-up 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 establishment of a common barrier vis a 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 (sectoral plans 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 steps of 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. <sup>1/</sup> The presi-

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1/ 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.

dency is rotated each year from one country to another by 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.<sup>1/</sup>

#### 1. Toward the Establishment of a Common Market

The agreement calls for the selective elimination of barriers on

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<sup>1/</sup> Other entities, named for their founding agreements, are the Andrés 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 foundation and responsibilities of these and other Andean Pact organisms, see JUNAC (20). Furthermore, there is a growing number of organizations grouping professionals, entrepreneurs, labor leaders, and research institutes.

trade (let us call them internal tariffs) among the Andean Countries. From the outset, tariffs on commodities not being produced were abruptly suppressed, thus instantaneously providing an expanded market to any potential investment in those sectors. On the other hand, where there is production duplicated in various countries, the start of liberalization has been postponed until agreements on the rationalization of installed capacities and on the localization of output are reached. Lastly, the obstacles on the remaining goods are being gradually reduced since 1971.<sup>1/</sup> In accordance with this program, about 3,000 items or groups of commodities are subject to internal customs duties of 50% or less in 1976.<sup>2/</sup> These rates will continue to be reduced annually. The Cartagena Agreement established that internal tariffs would continue to be reduced 10% by year, thus disappearing by the end of 1980. This date would presumably be spreaded until 1982.<sup>3/</sup> Consequently, these goods could

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<sup>1/</sup> There is a more favorable treatment for Bolivia and Ecuador: they reduce internal tariffs slower, and the other four members do it faster 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 (1). It is useful to mention that the Andean tariff schedule contains about 5,000 items.

<sup>2/</sup> Internal customs 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%.

<sup>3/</sup> Decision 100, approved in March 1976 by the Commission, that modifies the text of the Acuerdo de Cartagena.

circulate within the Andean subregion starting January 1983.<sup>1/</sup>

The progressive removal of barriers is one crucial factor explaining the fast increase in reciprocal trade. The low levels of exchange, prevailing in 1969, rose to 8% 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 of raw materials, as shown in Table 2.

Tariff policy is the foreign trade instrument used by the Pact to systematically regulate the structure of imports.<sup>2/</sup> Among other advantages, this mechanism allows the government to know what level of protection is being provided for the various import substitutes. By contrast,

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<sup>1/</sup> The countries agreed to eliminate from January 1971 on 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 recall 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 be established.

<sup>2/</sup> Other foreign trade tools also influence the composition of imports, though in an indirect or in a less systematic way: i.e. exchange rate policy and some non-tariff devices that ought to subsist. Mechanisms belonging to other policy areas, such as industrial programming, also affect the composition of trade.

Table 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
<u>Agriculture</u>	<u>54.8</u>	<u>60.3</u>	<u>79.2</u>	<u>97.0</u>	<u>37.2</u>	<u>37.6</u>	<u>35.8</u>	<u>27.0</u>
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
<u>Mining</u>	<u>21.4</u>	<u>21.8</u>	<u>19.2</u>	<u>22.4</u>	<u>14.6</u>	<u>13.6</u>	<u>8.7</u>	<u>6.2</u>
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
<u>Manufactures</u>	<u>70.9</u>	<u>78.1</u>	<u>123.0</u>	<u>240.1</u>	<u>48.2</u>	<u>48.8</u>	<u>55.5</u>	<u>66.8</u>

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

experience in the past with the traditional systems of bureaucratic restrictions has shown --apparently without exceptions-- that governments have not known what protection was being granted to each import substitution activity. This situation is in basic contradiction with 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 included in the universe of tradable products. Each country should gradually equate its national tariffs to the CET on items imported from outside the subregion. A so-called minimum common external tariff has been applied between 1971 and 1976. According to this instrument, the countries could not charge lower duties than the agreed upon rates, but were allowed to maintain higher rates.

The implementation of this minimum tariff has also been gradual.<sup>1/</sup> Subsequently, the countries should modify their tariff schedules year by year, starting in December 1976, until reaching common rates among all

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<sup>1/</sup> A brief description and analysis is found in Aninat (1).



TABLE 3

TRADE OF MANUFACTURES IN 1974

(millions of dollars, and percentages)

Country	Total exports of manufactures	Share of manufactures in total	Reciprocal trade	
			Exports of Manufactures	Share in total exports of manufactures
	(1)	(2)	(3)	(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
Perú	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. Figures are provisional.

members by the end of 1980.<sup>1/</sup> Presumably, all dates related with the CET would be postponed by two years. Thus the approval ought to be made before December 1977, and its implementation started in 1978. At the same time, a revised minimum CET, to be approved in 1976, would be at work during the two following years.

When the Common External tariff becomes fully implemented, it may differ from one product to another, but for each of them is to have the same rate from one country to another. At the same time, as will be recalled, 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 reciprocal exports, within the widened market.

The setting of the level and structure of the tariff schedule should be determined according to objectives of the integration process, being shared by all participants, that can be achieved by tariff policy, such as the fostering of productive activities that absorb labor intensively

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<sup>1/</sup> 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.

or contribute better to technological development.<sup>1/</sup> The latter is not an end in itself, but rather provides the foundation for an industrial expansion in accordance with the particular characteristics of the member countries and with greater foreign independence. On the other hand, both from a social as well as 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 can contribute efficiently to the goal of creating higher employment levels through the use of incentives giving preferences to activities using more labor-intensive technology.

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, we should mention several other requirements, which, because of their specialized nature, will not be examined here in greater detail. These include: elimination of tariff loopholes (exemptions) which weaken the integration process whether their beneficiaries are sectors or regions, state or foreign enterprises; harmonization monetary, credit and foreign exchange policies; and rationalization

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<sup>1/</sup> See JUNAC (25), for a discussion of alternative objectives usually assigned to tariff policy. An analysis of the role of tariffs in a planned development of the economy is made in French-Davis (12).

of other foreign trade mechanisms 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 been 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 policy have been defined, and a proposal to create a Pool of Foreign reserves is finally drafted.<sup>1/</sup> 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 taking into account both the political viability of establishing uniform policies and the expected benefits this action might have toward the fulfillment of the objectives of the Pact.<sup>2/</sup>

## 2. Investment Planning

The basic objectives of the Andean strategy that are influenced by the allocation of resources are the target not only of tariff policy, but as much are those of the Sectoral Plans for Industrial Development

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1/ See JUNAC (21), (24) and (23), respectively.

2/ 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 degree of incidence of each policy in the foreign trade of each country.

(SPID), which constitute the main direct instrument for industrial planning<sup>1/</sup> and for an equitable distribution of the benefits of the integration process. The SPID mechanism was designed to correct the injustices and inefficiencies that would be provoked by the unregulated functioning of the economy when the merging of markets takes place among 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 is fundamentally realistic in its efforts to solve this problem. The listing of the goods in the tariff universe included almost 6,000 items. But this number does not give an adequate view of its real scope, for many items on the list encompass merchandise with different varieties and quality. Consequently, there are actually tens of thousands of different commodities involved, therefore, it is obviously 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--on the basis of the economic and technological importance and the economies of scale involved in the production of the items--for

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<sup>1/</sup> Other direct instruments are the programs for rationalization of existing industry and for agricultural development.

eventual inclusion in the SPID programs. Instead of submitting the production of these goods unrestrictedly to the dictates of the "invisible hand", the Andean countries have opted for regulation of the market to put it at the service of planning.

About a third of total tradable merchandise is subject to eventual inclusion in subregional investment planning.<sup>1/</sup> This is still an excessive number of products for centralized adoption of all production decisions, but that is not the purpose of the SPID. Rather, the program provides that a certain group 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 with the complexes making up each productive sector. The designated country is conferred the right to develop the production of the respective product-family and is guaranteed a market free of obstacles and tariff 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

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<sup>1/</sup> About one fifth of the tariff universe does not form part either of the SPID reserve or of the program of automatic liberalization of reciprocal trade. Those items belong mostly to 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 1985 unless the commission previously approves a rationalization program with respect to them. Such programs can be designed when two or more countries have included the same item in their lists of exceptions.

apply a duty equal to the CET against third countries, thus providing the production originating from the favored country with a margin of protection equal to the common tariff.

It can be seen that the decision of where to invest is taken away from the market. The Cartagena Agreement Commission makes the decision, based on the proposal of the Junta, of which product-families are to be assigned to which countries. 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".<sup>1/</sup>

Programming, naturally, is not restricted to the selection of sectors and, then, to the geographical allocation of them. There is a series of aspects that achieve strategic importance after allocation, that it might be convenient to centralize, in order to achieve an efficient growth of

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1/ For specific analysis for the Andean case, see Ffrench-Davis (12). There is abundant theoretical literature by Anglo-Saxon authors on various aspects of this topic. For an interesting empirical analysis on economic reforms in the Eastern European countries, see Béla Kádár, "Dirección y regulación del comercio exterior en Hungría," CEPLAN; Estudios de Planificación N° 20, 1972; and Istvan Friss (ed.), Reform of the Economic Mechanism in Hungary, Budapest, 1969.



some manufacturing sectors. For instance, because of the externalities presumably involved for each firm, marketing and technological development could be centralized at each sector. 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 the sub-regional investment program and because of the economic importance of the products involved, which include an important segment of the metallurgical-mechanical sector.<sup>1/</sup> The Program encompasses approximately 200 items, chiefly machine-tools, machinery, electrical equipment, and instruments. It is estimated that by the end of the decade, the annual output in the items assigned in this Program will be on the order of US\$500 million of 1974, will require a total investment in the neighborhood of US\$450 million and will provide 40.000 direct jobs.<sup>2/</sup>

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

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<sup>1/</sup> For analysis of the provisions of this program, contained in Decision 57, see Avila (2). 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 Metalmeccánica," Lima, October 1974.

<sup>2/</sup> Avila (2), tables 3 and 5. Figures exclude Venezuela, that was not yet a member of the Pact. Negotiations are currently under way for the incorporation of that country into a metallurgical-mechanical Program.

an expansion of exports within the subregion. Thus we are dealing with a process that is radically different from historical patterns in that import substitution at the subregional level is complementary with 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. The margins of protection enjoyed by the products embraced by the plan range from 35 to 80%, and probably they could 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 as well as it allows the development of know-how whose use can be spreaded throughout the rest of the economy. For both reasons, the sector merits a protection larger than the average granted to industrial activities.<sup>1/</sup> In summary, it could be asserted that this SPID-- because of the characteristics of the sector and the economies of scale it allows, whose magnitudes are consistent with the size of the Andean Market-- generally guarantees the efficient development of the metallurgical-mechanical sector while allowing the participation of all the member countries.

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<sup>1/</sup> The high capacity to absorb employment represents a contribution to GNP that is not captured by the firm. 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.

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 controversial, are the petrochemical and automotive sectors.<sup>1/</sup> 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 US\$2 billion, while output will reach an estimated US\$1.2 billion by 1985. In contrast to these bulky figures, direct employed would amount to only 8,000 jobs, mainly technicians and highly qualified professionals. It becomes clear that this Program has features that differ substantially from those of the metal-mechanics Program. In fact, petrochemicals are notoriously capital-intensive (200 thousand to 300 thousand dollars per worker), they use non-spreadable technological knowledge, they are intensive in foreign investment and in captive technology, and have large economies of scale. These facts explain the substantially lower protection --nominal rates between 20 and 35%-- granted to petrochemicals as opposed to metal-mechanics. Furthermore, economies of scale would be insufficiently exploited because of the excessive influence of the desire of the negotiations to have a petrochemical industry at each country, thus being less specia-

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<sup>1/</sup> Several other Programs were sent to the Commission in 1975. The remainder are currently in their final stages of preparation and are scheduled for presentation to the Commission during 1976.

lized than it would be desirable. Nonwithstanding its shortcomings, the Program would allow a more efficient development of the sector than would occur by an independent effort of each country.

It seems possible, once all the SPID have been approved, to foster an exchange of allocations among countries in order to achieve a larger sectoral specialization by each participant.<sup>1/</sup> Two factors would probably contribute to this outcome. On the one hand, countries will face difficulties in implementing simultaneously all allocations they have been assigned, being forced to choose among them to start with. On the other hand, it is foreseeable that project evaluations will 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.

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<sup>1/</sup> Attempts to achieve an equitable distribution of costs and benefits in each specific program, 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 assigning 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 the greater specialization of one or two countries in the petrochemical sector against the tradeoff of the specialization of the remaining countries 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.

### 3. Foreign Investment Policy

When liberalization of reciprocal trade within an integration process is not accompanied by coordinated industrial development policies and uniform treatment of foreign investment, integration can tend to weaken the position of the developing country vis a vis the giant multinational corporations. Indeed, the gamut of options open to foreign enterprises is expanded with integration, for now by investing in any one country the enterprise has access to the markets of all the member countries. Thus, the corporation is in the position of picking the country offering the greatest privileges.<sup>1/</sup> Consequently, the farther the integration of markets advances, the higher the priority that should be assigned to the adoption of a common regime for dealing with investments from outside the subregion. A selective and definite policy should be developed in order to replace competition between member countries with a united front vis a vis foreign investors.

The growing power and wealth of the transnational firms, which contrasts with the meagre contribution many of them make to the achievement of self-sustaining growth of the host countries, has caused concern

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<sup>1/</sup> 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 wishes so.

in broad professional and technical, academic and government circles.

Various research projects conducted during the 1960's 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 contribution of foreign markets.<sup>1/</sup>

On the other hand, 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. On the other hand, stability--even when it involves strict norms--is a good inducement to investments with more positive effects.

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 in this way foreign investors would be attracted who would be willing to operate mixed enterprises--with participation of the State or private Andean investors--which would make effective contributions to administrative and technological develop-

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<sup>1/</sup> A detailed discussion of relevant issues is made in Vaitos (35).  
A brief analysis can also be found in French-Davis (11).

ment, 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 which are the minimum restrictions to be applied by each government to foreign capital, but which allow the governments to legislate stricter norms if they so desire.<sup>1/</sup> In the awareness 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 with respect to other activities each country has the option of making use of clauses of exception.

Some of the fundamental aspects of Decision 24 are:

First, it is a stable norm due to its multinational character, whereby it can be modified only through the concurrence of several countries; second, the policy adopted is selective, in that each new foreign investment requires the express authorization of a national organism

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<sup>1/</sup> Decision 24 is currently in effect in all of the member countries. Its status is that of international commitment, that is, it prevails in case of conflict with internal legislation. See Acta Final, Decimo-sexto Período de Sesiones Ordinarias, Comisión del Acuerdo de Cartagena, Lima, November 1974.



responsible for the negotiation, admission and regulation of the investment;<sup>1/</sup> third, the agreement regulates the use 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;<sup>2/</sup> fourth, automatic reinvestment of profits and purchase of shares in domestic enterprises is restricted: both are required to pass through the same selective channels as initial investment, and the latter is regulated also in order to impede foreigners from buying stock at artificially low prices during the frequent downswings those markets suffer;<sup>3/</sup> fifth, the Decision recommends that these investments be prohibited in strategic sectors such as financial activities, advertising and communications media, but for governments not yet prepared for such a

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- <sup>1/</sup> 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 French-Davis (11).
- <sup>2/</sup> 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% of the licenses valid at the end of the past decade stipulated limitations on exports of the licensed enterprises. See E. Moyano, "Notas sobre el pago de licencias industriales en Chile", in Oscar Muñoz (ed), Proceso a la Industrialización Chilena, CEPLAN, Santiago, 1972.
- <sup>3/</sup> The simple-minded proposal of neo-classical 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, it tends to transfer capital gains from native to foreign owners.

step, recourse to the exception clauses mentioned above is available.<sup>1/</sup>

Lastly, the agreement establishes norms for gradually transferring ownership of the foreign firms, both new and existing, into domestic hands. Three categories of firms are defined according to the composition of their capital: national, mixed and foreign. National are those with more than 80% domestic capital; mixed, are those with a domestic capital share between 51 and 80%;<sup>2/</sup> and foreign enterprises are the remainder. Decision 24 stipulates that foreign enterprises should be transformed gradually into mixed enterprises within a period set as a general norm at 15 years. The foreign firms that do not sign a timeable 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 import duties in effect

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<sup>1/</sup> In addition, yearly remittance of profits is limited to 14% of the capital. Within the rationale of Decision 24, this rate obviously refers to profits expressed in money of equal purchasing power as the capital that generated them. Nevertheless, this should be made explicit in the respective by-laws. 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.

<sup>2/</sup> Enterprises with less than 51% 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% 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.

for goods being purchased from the rest of the world. The infractor country thus loses what is probably the principal incentive for new investments in the industrial sector: access to the expanded market made up of the six Andean countries.

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 whereby the countries freely commit themselves to establish a policy on foreign investment that is stable, selective and demanding, and whose fundamental outlines have already been defined. This decision was reaffirmed on the occasion of Venezuela's entry into the Pact in 1973. Undoubtedly problems will arise on its way toward full implementation, and the interpretation of some of its provisions will surely cause disputes. Greater understanding of the rationale of this instrument and of its advantages for the permanent interests of each nation will be the best guarantee of the success of the implementation of the common policy. 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, should work toward the deepening of this process of conscious-

ness 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 firms 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, the rationalization process should bring the possibility of more advantageous handling of the new conditions created in world markets through the advent of the transnational corporations with diverse national origins, behaviors and motives. The new conjuncture of conditions 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 of their counterpart, and on the power with which they become equipped 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. The outcome, nevertheless, depends on the awareness achieved by each country that their development rests on their own efforts and not on those of others, thereby rejecting those 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.<sup>1/</sup> Its original provisions, backed up by accumulated experience recommending the design of strict but stable norms, create what can in essence become an appropriate mechanism to attract and regulate the sort of foreign investment that effectively serves to support internal development efforts.

#### 4. Coexistence of governments with opposing political leanings

As a group of countries moves toward the integration of their markets, progressively builds a common framework within which each member must place its policies; the framework inexorably becomes tighter as the process approaches full integration. Harmonization of policies is not sought for its own sake, but to the degree that it contributes to the better use of potential benefits and to ameliorate the cost that integration can bring about.

The large variety of public policies, tools, and institutions that can be the object of integration offers a broad field within which to choose what, to what degree, when, and with what speed to harmonize. The design of the specific program of harmonization, in order to become

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<sup>1/</sup> This does not, of course, mean that each and every one of the provisions of the Decision is flawless and free of ambiguity. The elaboration of the by-laws takes on even greater urgency for this reason.

effective, requires consistency between technical aspects and the sensitivity of each national authority with respect to having its autonomy of decision limited in certain policy areas. A crucial aspect, that has not been discussed in the previous sections, relates to the question of coexistence within a process of economic integration of different political regimes. It is frequently asserted, without further analysis, that political homogeneity is a prerequisite. However, there are many areas of policy that can be harmonized, reciprocal trade fostered, and some planning in common made, despite political heterogeneity.<sup>1/</sup> That is true during a large part of the long way toward full economic integration. And that is where, along the way, Andean countries will actually be operating for many years.

The Cartagena Agreement establishes a series of norms progressively conditioning the choice of economic policies in each country. Nevertheless, as long as the countries do not constitute an economic and political unity the member countries 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 them-

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<sup>1/</sup> Naturally, our assertion is only valid within some limits. The nature of the Andean Pact is inconsistent both with fully centralized and barter-economies, and with laissez-faire. 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 non-member countries.

selves, provided the mechanisms used to achieve their objectives conform to some guidelines.

As regards the dimension of the State, in particular State enterprises, the terms of the Pact are compatible with sectors of whatever size. In principle, a country with a small State area could coexist without problems with another whose State sector is overwhelmingly predominant. A sufficient condition for this coexistence is that the State sector must operate in such an economic framework that it effectively becomes subject to all the common provisions of the Pact which affect the level and composition of import and export trade.<sup>1/</sup> For the same reason, of course, the customs privileges enjoyed by many industries and regions of various countries must also be eliminated,<sup>2/</sup> and tax exemptions must be harmonized.

Similar observations hold for the case of consumption structure. It is commonly thought that progress towards a common market implies the imposition of certain patterns of consumption in all member countries, a situation that would impede the changes in consumption and

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<sup>1/</sup> The objective of this is to assure that the same margins of preference apply to all types of national enterprises, whatever is its ownership or mode of management. Care must be taken, nonetheless, with the interpretation and implementation of this assertion.

<sup>2/</sup> In the case of regions especially, kinds of incentives can be used that do not directly distort trade flows. It should be pointed out, moreover, that tariff exemptions frequently show little effectiveness in attaining the objectives for which they were established.

production structure that might be necessary for the implementation by one country member of 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. Limitations are directed only to the type of instruments that may be used, being consistent with the use of tools that restrict (or promote) as much the consumption of given goods, whether they are imported or domestically produced. 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 permitting 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.

##### 5. Economic Relations with Non-member 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. There are two questions that are crucial. On the one hand, whether the process of integration tends to be autarchic or relatively open. On the other, whether its scope is limited to the integration of domestic markets or it envisages a more ambitious framework. The answer to both questions is clear, although, because of the sort 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 more open to trade than in the past. Definitely, the rejection of absolute protection and its replacement by relative effective protection shows that import substitution, now at the subregional level, will be more selective than in the past. Furthermore the development of non-traditional exports to the Andean market could contribute to support, subsequently, the sale of manufactured goods to third countries. This factor, that seems to be important in promoting "infant exports", would be enhanced if trade policies rather than discriminating between import substitution and exports tend to discriminate according to the nature of each economic activity; i.e., labor intensity, infancy, and technological spreadability. In this case, protection to import substitution at the subregional level (reciprocal exports) is provided by the CET, consequently, being paid by the users at the importing country; on the other hand, protection to exports to third countries must be paid directly by the exporting nation.<sup>1/</sup>

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<sup>1/</sup> If there is a financial restriction, derived from difficulties of the government to obtain funds, the average subsidy to exports to third countries must be lower than that received by import substitution. Nonetheless, the average tariff would be lower and, for a given balance of trade, the exchange rate would tend to be higher and the subsidy to exports to third countries (that have been low at the Andean countries) larger than in the past.

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

It has been shown, in a previous section, that the Andean countries, as long as they work together, have an economic size that could allow them to deal as equals with any of the larger Latin American nations. This fact could make easier, sometime in the future, integration schemes among the Andean countries and other nations in the region. In the short-run, it is within the realm of the possible, though not easy, to promote modes of partial integration with other Latin American countries. These could consist in their participation in SPID, a scheme to be particularly welcome for the sectors whose economies of scale are larger than those covered by the markets of the Andean countries. In other words, 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 more probably could 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 that have been taking place, in practice are limited first to non-reciprocal preferences of developed countries to the developing world and, second, to liberalization of markets of industrialized areas that are of interest to countries and transnational corporations located in that same area.

Prevailing restrictions to trade among developing countries are released 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 reach an agreement to produce some inputs or capital goods used in their production. The agreement could include programming investment location, and the elimination of tariff restrictions to reciprocal trade on commodities produced by participating countries that are 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 favoured clause, when dealing with production agreements among developing countries. These agreements with other developing nations could be more easily promoted by the Andean countries as one unit instead of being done by each one in isolation. Thus, they can 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 a more active role of developing countries in international negotiations dealing with trade restrictions. This is also true for the members of the Andean Pact. Their systematic organization could contribute to improve, somewhat, the access of new exports to foreign markets.

In summary, a successful development of the Andean Pact would bring about an increase in the level and share of reciprocal trade. Nonetheless, this outcome could take place simultaneously with an increase in the international economic relations of the subregion, with other Latin American countries, developing nations in other continents and industrialized areas. Of course, whether this type of insertion in world markets is to prevail, would be determined by the design of export policies, by the role to be assigned to negotiations geared to improve the access to foreign markets, and by the actual use the Andean countries make of their improved bargaining power vis a vis third nations and international corporations.

#### IV. FINAL REMARKS

Various attempts have been made by developing countries to bring about integration, most often with meagre success. In general, the efforts have ended up after a few years with very limited forms of integration or in outright failure. The Andean integration, despite the difficulties experienced since 1975, 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, which 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 own profile. Balanced progress in this 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 such projects as the definition of products earmarked for industrial planning, the minimum common external tariff, 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 of 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 the half-decade of existence up to date.

The originality and success achieved up to the present by the Andean Pact is put in jeopardy to the extent that some governments relegate it to a secondary plane due to cyclical problems in their

countries. Likewise, the dangerous theoretical bias that there exists free competition in international markets to which large volumes of manufactures might be easily exported, on a permanent basis, leads to underrate the importance of the subregional market. An extension of that bias is the trend prevailing today at some political circles against an active role of the state in economic matters, in favor of free-trading, and open arms to foreign investment. These laissez-faire biases are as opposed to economic integration as autarquic approaches might have been in the past. Finally, some countries, for one reason or another, could concentrate excessively their search for markets for non-traditional exports 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 economic development as would be possible by means of a common market of the six countries, 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 the existing industries which have been temporarily excluded from integration, and the development of harmonized foreign exchange, tax and various foreign trade policies. 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 six countries. The design and final approval of many of these decisive steps is to be carried out during the coming months. Overcoming the obstacles presented by these impending decisions and their subsequent implementation, is an endeavor that depends on the simultaneous fulfillment of two conditions. On the one hand, the Junta must continue to carry on its work with the same dynamism and imagination that 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 a successful process would mean on the part of the members of the Pact. This should be evidenced in the countries' looking forward, with realism and imagination, to the future rather than to the present and the 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 consider 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 member countries-- would undoubtedly lead the process to a failure.

The return to the essence of the Cartagena Agreement, that

constitutes what lends it its seal of originality, would allow surpassing the present difficulties. 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 with 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.



## B I B L I O G R A P H Y

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