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EXECUTIVE SECRETARIAT

ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI		X		
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9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/Pers				
14	D/OLL				
15	D/PAO				
16	SA/IA				
17	AO/DCI				
18	C/IPD/OIS				
19	NIO/ECON	X			
20	NIO/LA		X		
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SUSPENSE 13 Nov
Date

Remarks

To 19: Please prepare response for DCI signature and take appropriate follow-up action.

Executive Secretary

7 Nov 84

Date

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Approved For Release 2008/11/07 : CIA-RDP86M00886R001200330023-1 ent of State

United States Permanent Mission to the Organization of American States

Washington, D. C. 20520

October 16, 1984

Executive Registry
84 - 9579

Dear Bill:

The economies of most Latin American countries have been in a freefall. Despite some modest recent improvements in their exports, primarily to the U.S. and helped along by our Reagan-led recovery, as well as some indications of a very modest resumption of growth, full-recovery cannot be expected for some time. Their debts are potentially overpowering and the prospects for early repayment without major capital infusions are small. Furthermore, with these economies still being in the doldrums, and with the people becoming restless, this region, so strategically important to the United States, remains a potential breeding ground for leftist adventurism.

All need not be lost. Their desperate capital needs can be met -- not by more borrowing -- but rather by major infusions of foreign direct investments, by reviving their relatively dormant private sectors and by bringing into better balance the private sector-public sector ratios now highly tilted toward generally inefficient state enterprises. A fair number of the countries owing the largest amounts of the $350 billions have nearly 75% of their Industrial production owned by the government, with the energetic private sector being pushed aside. Excessive printing of money, capital flight and, in some cases, corruption have been the result. As Senator Manuel Ulloa of Peru has said, "Is it any wonder no one wants to invest in our countries where we don't want to ourselves?" Just after World War II, half of all U.S. investments overseas were in Latin America - now only 5% of new investments, often bringing with them needed technology and management skills, are going there. Much of this, however, will require basic structural changes in their economic approach, and as I travel in the region, I see a new willingness on the part of many countries to face up to these issues.

Frankly, what is needed is a healthy dose of Reaganomics - it works!

During the week of August 27-31, we had our Annual Meeting of the Inter-American Economic and Social Council of the OAS in Santiago, Chile. One of the matters we discussed was how to promote a structural change in Latin America to bring about a greater awareness of the political-economic benefits of a vital private sector and a free market approach to the region's economic problems. I strongly feel that a measure of success

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in promoting this structural change could be the greatest legacy leaders like you and those of us serving in positions which influence economic thought can leave to future generations. In our Hemisphere at the present time, we have a "window" of opportunity to stem the tide of socialist-statist philosophy and we must take every opportunity to speak out against statist "non-solutions" to the region's economic problems. These issues directly effect our own long term survival in this hemisphere. As Ben Franklin said, "We must all hang together or we will surely all hang separately."

In the enclosed speech to the Chilean-American Chamber of Commerce, I have directly confronted the sacred cows of the Calvo Doctrine, Andean Pact Decision 24, and certain development policies earlier inspired by Raul Prebisch, who himself has modified many of his views, as Keynes did later in his life. In this effort, the work of such researchers as Dr. Hernando de Soto of Peru has provided us not only with valuable intellectual ammunition, but also represents the spadework in preparing the ground for a philosophical re-orientation in development economics in Latin America.

President Reagan addressed this whole issue in this speech to the World Bank last month, calling for greater infusions of foreign direct investments into a more hospital investment climate south of the border.

I hope that you, as a friend of the OAS, will find these remarks of interest, and we here at this Mission would very much appreciate your input before we move to the next phase in this battle in mid-November at our OAS General Assembly in Brasilia. We need your help and counsel on this.

Sincerely,

Bill

J. William Middendorf, II
Ambassador
Permanent Representative

Enclosure: As stated

The Honorable
William Casey,
Director of CIA.

Bill
Still pushing the Reagonomics Theme For the Hemisphere So depressed and in need of capital.
Bill

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Current Policy No. 609

The Private Sector's Role in Latin American Development

August 30, 1984

United States Department of State
Bureau of Public Affairs
Washington, D.C.

Following is an address by J. William Middendorf II, Ambassador to the Organization of American States (OAS), before the American Chamber of Commerce, Santiago, Chile, August 30, 1984.

It is a great pleasure for me to appear before you today and to have this opportunity to share with you my thoughts on increasing economic opportunities for the countries of our hemisphere.

Virtually all our countries have undergone severe economic retrenchment since 1980. I am pleased to be addressing this vital forum in Chile today and, while economic recovery in the United States has been proceeding somewhat longer than in Chile, I am also especially pleased to note that in the first quarter of 1984, Chilean gross domestic product grew by 4.5% on an annual basis.

We all know that debts have become a crushing burden and that unemployment has skyrocketed. Today I propose to present my thoughts on a tried and true formula for long-term economic success so that this hemisphere—so rich in assets of raw materials and of manpower—may reach the kind of potential enjoyed by so many other nations with far fewer assets.

Development and the Private and Public Sector Roles

The question of effective and efficient utilization of available resources, both internal and external, in the process of economic development and growth is the central issue of public policy in most countries in Latin America and the Caribbean. In most developing countries, a large portion of all resources is privately owned by a large number of businessmen and farmers who, while acting independently, contribute a flexibility and capacity for entrepreneurship in a nation's drive for economic development which is not typical of the public sector. In too many instances this private sector has been severely restricted.

In order for governments to stimulate and sustain economic growth and to diversify their economies in the quest for economic development, a viable private sector must be present. However, without a reasonably efficient public sector capable of providing—at reasonable and manageable economic costs—the necessary infrastructure and overall environment conducive to sound investment, the private sector is unlikely to make its full contribution to commerce, growth, and development. Economic development begins with a set of motivations and attitudes that are concretely expressed in the absence of civil conflict, a system of generally accepted and enforceable property rights, and the ability of individuals to enjoy the fruits of their labor without confiscatory systems of taxation or arbitrary seizure of property. If government pursues policies that significantly distort private sector decisionmaking, if it is inefficient and/or ineffective, then the overall prospects for economic development suffer and international commerce with it.

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We all recognize, for example, that planning at various levels and for varying time periods is an inherent part of economic activity in any economy. Individual entrepreneurs engage in planning so that scarce capital, skilled labor, land, and other resources should not be wasted. But to engage in sound planning for the future, one must know where one is in the present, and in this connection, I should like to mention the invention of double-entry bookkeeping as one of the pivotal intellectual achievements of Western civilization and, I would even go so far as to say that, without this achievement, the industrial revolution and commerce, industrial production on a global scale, and indeed the high standard of living to which one can aspire today would be almost inconceivable without well-developed accounting practices. Regrettably, a recent article in a major U.S. business magazine pointed out that a number of Latin countries rank at the bottom in terms of their accounting practices for financial reporting. It is no accident that those countries with the most developed economies and with the most efficient capital markets also have the most developed accounting systems, practices, and professions.

Planning at a highly centralized government level cannot determine how each economic unit should effectively behave under all circumstances. In order to effectively support and complement the decisions of entrepreneurs, planning must be flexible enough to be able to accommodate to changing circumstances, and we know that a centralized state planning apparatus is inherently incapable of such flexibility. In a governmentally planned economy, the dynamics of the bureaucracy rather than the competitive exigencies of supply and demand determine inputs and outputs. As we have seen, such an economic system results in waste, inefficiency and shortages—in other words, a low standard of living. More importantly, centralized planning concentrates too much economic power into the hands of those with political and military power, thus reducing liberty and opening the door to corruption.

A good example of how the private sector can triumph in spite of governmental restrictions is revealed in the recent study by Peruvian businessman and economist Hernando de Soto. Because it takes a person 6 months to get government approval to set up a simple business in Peru, an informal economic system has grown to rival the more traditional business. According to de Soto, an informal economy developed and grew, despite the tremendous handicap of being illegal.

De Soto's study estimates that the informal economy of Peru now accounts for 90% of Lima's garment industry, 25% of its furniture industry, 60% of housing construction, and even a good part of the automobile and truck industries. The informal Peruvian economy, says the study, has grown so fast that it now accounts for an estimated 60% of the Peruvian economy and almost none of this output is counted in the official $22 billion Peruvian gross domestic product. Perhaps most important is the private sector's ability to create jobs; in Peru an estimated two out of every three jobs are now in the informal sector.

Another factor Mr. de Soto's study points out is that South American economies often have two kinds of private sectors: one that is seriously burdened by excessive regulation and hampered by bureaucratic inefficiency but is officially sanctioned, and a second one which is far more in accord with free market principles, but whose existence is barely acknowledged. This difference is made clear by an experiment recently documented by a study group from Mr. de Soto's Institute for Liberty and Democracy in which it tried to set up a legal garment firm without easing the way with tips. According to a *Wall Street Journal* article:

> It took a lawyer and three others 301 days of full-time work, dealing with 11 government agencies, to complete the paperwork—which, when laid end to end, measured 102 feet. (One of the researchers then tried the same experiment in Tampa, Florida, and finished it in 3½ hours.)

In most countries, the public sector needs to be more circumspect about extending its activities into fields where it does not have practical experience; rather, it should encourage a climate where thousands of independent and interdependent economic units of the private sector can perform efficiently. As James B. Burnham, U.S. Executive Director of the World Bank, stated:

> The pay-off from the adoption of more sensible pricing and exchange rate policies and from reducing the role of government economic enterprises is extraordinarily high in many cases. The actual financial resources needed to implement these policy changes are relatively small, which is one reason why the fixation on equating economic development with the flow of concessional assistance is so misleading and threatens to divert attention from what is really needed in today's world, namely: more market-oriented economic and financial policies.

For the reasons I have just outlined, the Reagan Administration has espoused a fresh but also historically validated view of development—a view that encourages a vigorous private sector as the "principal engine of economic growth." The reason I say that the Reagan Administration's view of development is also a historically validated one is that this philosophical emphasis on the private sector is rooted in the notion of broad private ownership of the means of production. To illustrate, let me give you some selected quotes:

- "Men pay most attention to what is their own." (Aristotle)
- "The most meritorious degree of charity is to prevent poverty by putting the poor man in business so that he may earn an honest livelihood." (Moses Maimonides, 12th-century Talmudic scholar)
- "When incentive to acquire and obtain property is gone, people no longer make efforts to acquire any. This leads to destruction and ruin of civilization." (Muhammad Ibn Khaldun, 14th-century Arab jurist, historian, and statesman)
- "The church's teaching on ownership diverges radically from collectivism as proclaimed by Marxism and 'rigid' capitalism. The primacy of the person over things (can be restored through) joint ownership of the means of work." (Pope John Paul II, encyclical, *On Human Work*)
- "Developing countries need to be encouraged to experiment with the growing variety of arrangements for profit-sharing and expanded capital ownership that can bring economic betterment to their people." (Ronald Reagan, President of the United States of America)

The Finance-Commerce Link

Efforts to increase commerce between Chile—and indeed all of Latin America and the Caribbean—and the United States must focus on the two broad areas of trade and investment. Although these two areas are often treated separately for analytical purposes in the real world, they are complementary and mutually reinforcing and, therefore, poor public policy prescriptions designed for one area often have negative results in the other.

Finance is a key ingredient in the promotion of international trade, but nowadays, it is difficult to mention finance without mentioning the debt crisis. Assigning blame is an unproductive exercise—after all, *"errare humanum est"*—but one cannot escape

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noticing that there appears to be an unfortunate parallel between most of those countries of the hemisphere that owe most of this external debt, now totaling over $300 billion, and the fact that a large part of the industrial production of those particular countries is owned by their governments.

During the 1970s, Latin American countries annually increased exports by 23% and borrowings by 25%. But 1979 brought the second oil shock—in my opinion, one of the most devastating blows to the economies of the developing world in economic history. Although the 1979 OPEC [Organization of Petroleum Exporting Countries] oil price increase of 200% was much smaller than the increase of 1974 (400%), this increase was applied to a much higher base (about $13 a barrel versus $3 a barrel in 1974), thereby generating an effect that was nearly as great. The psychological effect was perhaps even more important, in that when the inflation-adjusted price of oil—which had not been expected to increase after after 1974—escalated in 1979, it destroyed confidence in the stability of relative prices.

Desperately, many developing countries borrowed even more after 1979 to maintain consumption levels, as well as to pay for the oil—such borrowings did not necessarily, therefore, flow into foreign-exchange-earning industries. This has been one of the contributing causes of today's dilemma. Suffice it to say that one can find enough fault to attach to all major economic actors—both in the developing countries as well as in the developed. Nor is it particularly productive to characterize the debt issue and its impact on trade and investment only in terms of problems. After all, international financial crises are not new—indeed, it has been said that with the invention of money, financial crises become almost inevitable.

That said, I believe that it is far better to characterize our present environment more positively in terms of the challenges facing us and how to meet them constructively. As one such positive step, last September the OAS external finance conference in Caracas, Venezuela, demonstrated that the nations of the hemisphere can come together and discuss major hemisphere economic problems constructively. The October 1983 meeting of the Inter-American Economic and Social Council (CIES) in Asuncion, Paraguay, unanimously confirmed the decisions taken in Caracas and established a special committee under the chairmanship of Senator Manuel Ulloa of Peru to examine external debt, trade, and financing. This initiative has received our close attention, and the report is to be presented to the Inter-American Economic and Social Council meeting here in Santiago this week.

The United States is deeply concerned with the external finance issue and has directed both bilateral and multilateral resources toward support of the international financial system response. The system has matured and changed during the past 2 years. More changes are to be expected as we look for the best responses to maintain international conditions for growth of economic opportunity in all our countries.

Here, I would like for a moment to discuss the impact of recent increases in U.S. dollar interest rates. We all understand the political impact of interest rate increases, but the political rhetoric overstates the real economic costs of higher interest rates because such rhetoric ignores the broader international economic environment, particularly the very positive development in Latin America's trade balance. If first-half of 1984 trends hold, Latin American exports this year to the United States could increase by as much as $8 billion, to approximately $50 billion. William R. Cline, a senior fellow of the Institute for International Economics, stated in his August 1 testimony before the Foreign Affairs Committee of the U.S. House of Representatives:

> [Non-OPEC] countries export $332 billion in goods and $116 billion in services. Most studies show that one percentage point additional OECD [Organization for Economic Cooperation and Development] growth causes exports of non-oil developing countries to rise by 1.7 to 3 percentage points, and to cause their terms of trade to rise perhaps 1½ percent in one year and more subsequently. Even using the conservative end of the range of estimates, in the first year, one percent extra OECD growth causes exports of goods and services to rise by about $12 billion (2.7 percent), or three times the direct impact of a one percentage point rise in interest rates. The dominance of the growth impact rises over time, if both the higher growth and higher interest rate are sustained, because the export base keeps growing faster while the interest rate shift causes a higher but then constant plateau of interest payments. Over four years, the trade-off between growth (benefit) and interest (cost) is as high as seven-to-one.

Latin America still needs vast amounts of capital for progress. If the decade of the 1960s can be considered the decade of official aid, the decade of the 1970s the decade of commercial bank lending, then the decade of the 1980s must be the decade of foreign direct investment. Why? Because in the 1980s, it would be prudent not to expect that official finance via the International Monetary Fund (IMF), the World Bank, and other multilateral lending institutions will be a replacement for private sector lending—and I stress the word replacement—for a number of reasons.

First, the sums needed are simply too large;

Second, virtually all industrialized country governments, including that of the United States, are grappling with the issue of control of their own government deficits; and

Third, it is unlikely that industrialized country central banks will be as accommodating toward these deficits as they were in the 1970s.

Further, there is a high probability that Latin America will not receive the same high level of borrowed capital to which it became accustomed during the 1970s. We should remember that borrowing is only one of the three types of international monetary transfers—the other two being direct aid, either government to government or multilateral, and foreign direct investment. We should also remember that foreign direct investment has the advantage over the other two of providing management know-how, technical skills, and technology transfers resulting in a high degree of export potential and, therefore, being a source for valuable foreign exchange.

In order to realize the tremendous growth potential of Latin America, the countries of the region will need large infusions of capital. In order to attract this scarce capital—in competition with others also aggressively seeking it, such as the Organization for Economic Cooperation and Development and Pacific Basin countries—the climate for investment must be conducive. The best test of this is found where local investors also find it attractive to reinvest their own funds and where there is no capital flight.

Henry C. Wallich, member of the Board of Governors of the U.S. Federal Reserve System, in a recent incisive paper entitled, "Why is Net International Investment So Small?," made the following comments:

> By comparing the growth in a country's debt with its current account, one can derive the capital flow that must have taken place in order to balance the accounts. If a country's gross liabilities, including equity investment, increase by more than its current account deficit, there must have been some countervailing capital outflow. For the [world's] eight largest borrowers over the years 1974–82, this calculation shows an increase in debt (equity and direct investment included) of $317 billion, while the current account deficit,

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adjusted for changes in official reserves, amounts to only $207 billion. Thus, there seems to have been a capital outflow of $110 billion. The degree to which borrowing financed this capital outflow differs among countries. For Brazil, only 12 percent of the inflow was compensated by outflows; for Mexico, 45 percent; for Venezuela, almost the entire inflow was absorbed into outflows. These data are more likely to understate rather than overstate, since under-invoicing of exports and over-invoicing of imports, a frequent practice in countries with exchange controls or export taxes, would have caused the current account deficit to be overstated.

Governor Wallich goes on to say:

> . . . There seems little doubt that substantial capital exports have taken place from the countries that were borrowing. Unfortunately, one must assume that in large part this represents capital flight. The assets, thus acquired, probably do not produce income and taxes for the capital-exporting country, and probably are not available to strengthen its foreign exchange position and its economy generally. In other words, given economic and political conditions of the capital-exporting countries, these foreign assets are not likely to play the same constructive role for the home countries that capital exports from developed countries have ordinarily played. To be sure, changes in the politics and economic policies of the respective countries, giving adequate protection to the owners of capital and a positive real return on domestic assets, may change that situation. They may convert what today is flight capital into an important resource for the country.

Maintaining an Open Multilateral Trading System

The challenge and opportunities which we face in the financial arena, however, must be seen in the broader context of global economic adjustment which obviously affects both Chile and the United States. Simply put, this adjustment involves converging the levels of consumption and production, and in the United States is reflected in the great success of the Reagan Administration in reducing domestic inflation and increasing U.S. gross national product (GNP)—for example, U.S. gross national product grew at an inflation-adjusted 7.6% annual rate in the second quarter, while prices as reflected in a GNP-based measure, or deflator, rose 3.2%. This process of global economic adjustment is not cost-free, but it is inevitable and has as its ultimate goal the restoration of sustainable noninflationary global economic growth.

Critical in this adjustment process is the maintenance of an open multilateral trading system. At the Williamsburg summit, President Reagan committed the United States to resisting protectionism, and he was joined in this commitment by the other leaders of the major democratic industrial countries. This commitment was reaffirmed at the London summit.

The maintenance of an open international trading order is essential for positioning countries, such as Chile, for servicing their external debt and for enabling the export and import sectors of both our economies to make their contributions to domestic economic recovery and growth. I also want to make three further points:

One, protectionism poses a serious threat to the prospects for a medium-term recovery in the world economy. Why? Because virtually all economic projections are predicated on open trade. If the assumption about the maintenance of open-trading policies is removed, the medium-term outlook for the world economy becomes bleak.

Two, protectionism poses a fundamental threat to the strategy that has fostered development since 1945. International trade is a powerful engine of growth. The experience of the 1960s and 1970s demonstrated that countries with "outward-looking" development strategies—characterized by liberal import regimes, adequate incentives for producers, and the maintenance of realistic exchange rates and prices as well as positive real interest rates—have performed better than countries with "inward-looking" development strategies. Protectionism would threaten the viability of the "outward-looking" strategies with far-reaching consequences for economic efficiency and world trade.

The strategy of industrializing through import substitution has been disappointing. It has fostered dual economies, crippled development in the agricultural sector, resulted in frequent balance-of-payments crises, and contributed to rapid urban growth and political instability. Studies by the OECD and the World Bank both recognize that a substantial relaxation of import restrictions, coupled with moves toward appropriate exchange rates, are necessary to expand exports and overcome the shortage of foreign exchange that most developing countries (except for some of the oil exporters) seem to face.

For these reasons, the United States is urging developing countries to use great caution in applying import substitution measures and encouraging those countries to focus more actively on the possibilities which exports offer their economies, while striving to keep our markets open to those exports. Since the 1970s many of the more successful developing countries have been pursuing precisely such a strategy. The economic success stories, such as Taiwan, South Korea, and Singapore, have all adopted policies which emphasize exports as a means of promoting rapid industrialization.

In recent years, these and other countries have shifted toward more liberal trade and payment regimes. Often these moves have not been as rapid or as encompassing as we might want. But overall, particularly in Latin America, East and Southeast Asia, there has been a clear tendency of the more economically progressive and successful countries to move in the direction of liberalizing trade barriers and adopting policies aimed at stimulating exports.

Three, protectionism is, by definition, "anti-adjustment." It is an administrative way of delaying adjustment and changes in competitive positions stemming from changes in technology and productivity. We must jointly and severally rise to the challenge of structural adjustment rather than run away from it. Renewed growth and the reinvigoration of both our economies demand it.

The United States, by and large, is demonstrating its maintenance of an open economy. I should point out that the U.S. trade deficit for 1984 is projected to pass $100 billion. This is creating substantial trade surpluses for a number of our Latin American trading partners. But maintaining an open economy is not a unilateral task and, in this connection, I would like to mention the highly professional and vigorously competent presentations made by Chilean experts to U.S. Government agencies on the question of copper exports to the United States. In addressing the challenge of resisting protectionism in both of our countries, I find the words of Benjamin Franklin, although stated in a different context, most appropriate: "We must all hang together, or we will surely all hang separately."

The Role of Foreign Direct Investment

I have mentioned the complementarity of trade and investment and how key the element of foreign direct investment is to a strong private sector and thus to a healthy economy. Unfortunately, foreign direct investment has been subject to restrictions which have hindered growth of the private sector and, consequently, economic development.

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The attitudes from which these restrictions spring and their consequences have been aptly summarized by Brazilian Senator and former Planning and Finance Minister, Roberto Campos, in a speech he gave in the Brazilian Senate in June 1983, entitled "The New Demonology." He said:

> In my days as a youth . . . the demons were the petroleum trusts, the foreign-owned electric company, repatriation of dividends, and the spoilage of international commerce by rich countries. But the petroleum trusts were replaced by the sheiks. The electric company became a highly inefficient state company. The repatriation of profits related to risk capital—an average of 5 percent per year of invested capital—proved to be much less expensive than the payment of interest on debt capital that mysteriously is our preference. And those responsible for the great spoilage of international commerce—the two oil shocks—were not the industrial countries but our "good friends" of the Third World.
>
> The fashionable demons today are the multinational enterprises . . . little does it matter that the state most "spoiled" by the multinationals is also the richest and least dependent—Sao Paulo. And that Piaui, untouched by them, is poor and dependent. The contrast between the two states reminds me of what Professor Joan Robinson of Cambridge said, with the notorious frankness of the Marxists—"there is only one thing worse than being exploited and that is not to be exploited."
>
> Curiously, the North American unions perceive otherwise: they accuse their multinationals of benefiting other countries by exporting capital and jobs. If, suddenly, the multinational deserted us—which is not an impossibility if inflation, the exchange crisis, and the constant changing of the rules of the game become our style of life—we would not cure old sadnesses but would rather create new anxieties. Only our ideologies possess the imagination to create new scapegoats in such a case.
>
> . . . Developing countries are no longer—if they ever were—the paradise of the multinationals. The United States has become the magnet for European and Japanese investors, precisely because they have two things that we lack—a strong currency and stable rules of the game. The North Americans learned that, instead of fighting with the efficiency of Japanese competitors, let them produce in California, creating new jobs and bringing new management techniques. In commercial competition, as in the politics of Mato Grosso, the saying of a political chief of a distant outpost is appropriate—"a hand that can't be cut must be kissed."
>
> To fear this paper tiger, the multinationals, is the true "banana republic" syndrome. The government controls all the basic inputs—petroleum, electricity, telecommunications, railroad transport, credit and imports. Three technocrats—one controlling prices, another controlling credit at the central bank, and a third controlling CACEX [Brazil's international trade regulation agency]—could bring any of the great multinationals to a state of agony in a few weeks.

In 1950, U.S. direct investment in Latin America accounted for nearly 50% of the total U.S. investment overseas. In 1970, the stock of the U.S. direct investment abroad amounted to $75.48 billion, of which 68.7% was in developed countries; only 17.2% in Latin America; and 3.0% in Asia and Pacific. At the end of 1982, the stock of U.S. direct investment abroad stood at $221.342 billion, of which 73.7% was in developed countries; 14.9% in Latin America; and 5.6% in Asia and the Pacific. While the absolute size of U.S. investment has risen, it is also clear that in the competition among developing countries for this scarce capital, Latin America is beginning to lose its lead over Asian-Pacific countries. Investment-flow data confirm this in that these flows declined for Latin America toward the end of the 1970s, except for Chile and Colombia. The stock of U.S. direct investment in Chile, as of 1982, amounts to approximately $854 million. Too often we forget that foreign direct investment also serves to transfer new technology and management skills in order to increase exports and reduce the burden on the existing export sector in achieving the dual goal of renewed domestic growth and servicing existing debt.

One of the difficult impediments to foreign investment in Latin America has been the Calvo doctrine. Many countries in the hemisphere incorporate the doctrine and other restrictions in their constitutions, in other laws, or in multilateral agreements, such as the Andean Pact decision 24.

For those of you who may not be familiar with the Calvo doctrine, it represents the views of a 19th-century Argentine jurist who maintained that a foreign investor or businessman, by choosing to do business in a given country, subjects himself exclusively to the law and courts of that country. In countries that subscribe to the doctrine there have been a large number of expropriations without fully satisfactory compensation. The investor has no right of recourse to his home government under international law unless he is denied fair access to national courts and tribunals. This was a reaction to perceived abuses of protection by the United States and European powers on behalf of their investors and traders in the last century. The contemporary result is often the invalidity under national law of any choice of law or forum outside the national jurisdiction.

One negative consequence of such a policy is that potential U.S. investors are constrained from obtaining OPIC [Overseas Private Investment Corporation] insurance coverage because of requirements limiting possible litigation to local courts. I note that Chile was able to sign an OPIC agreement with the United States last September. I predict Chile will reap the benefits of this enlightened and forward-looking policy.

The United States has long favored an open international investment system. A major U.S. goal in the 1980s is to reverse the trend toward government-induced distortions in the investment process through international understandings and voluntary guidelines leading to a more open and less interventionist investment climate.

The Administration has advanced the cause of private enterprise on two fronts in Latin America: the Caribbean Basin Initiative (CBI) and bilateral investment treaties. Both provide important incentives for the private sector and should stimulate additional foreign investment in their areas.

As you know the key elements of the bilateral investment treaties are:

- New and existing investment to be granted national treatment or most-favored-nation (MFN) treatment, whichever is more favorable, but both sides are allowed to list exceptions to national treatment in specified sectors of economic activitiy;
- Unrestricted transfer of capital, returns, compensation, and other payments into and out of the host country; and
- Dispute settlement procedures both for disputes between the host country and a national or company of the other country, and disputes arising between the governments.

While these treaties are reciprocal in their treatment and protection provisions, the major inducement for the developing country is the assurances such a treaty offers a foreign investor.

Several countries have seen the wisdom of negotiating such agreements. In this hemisphere, we signed treaties with Panama in 1982 and with Haiti in December 1983. We are also very close to agreement with Costa Rica, and we have had negotiations with Honduras, El Salvador, the Dominican Republic, and Jamaica.

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- There appears to be a growing perception by many countries in the hemisphere that increasing foreign direct investment will be vital to their prosperity in the decade, particularly as aid and debt prospects appear less promising.

Conclusion

If these programs and reforms are undertaken, and if the principles I have mentioned concerning the importance of the private sector, foreign direct investment, and market-oriented economic policies are followed, I am confident that the economic status of Latin America and the Caribbean will improve dramatically. In fact, this may be the long-term solution to economic malaise. Additionally, the commerce between and among Chile, the United States, and other countries of the hemisphere will surely increase. Give the private sector a clear runway, and it will take off—and with it the economies of our hemisphere. ■

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