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THE LATIN AMERICAN FREE TRADE ASSOCIATION



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## Foreword

The Latin American Free Trade Association (LAFTA) came into being in 1961; nine countries--Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, and Uruguay--comprised the association. By the middle of 1962, the member countries had inaugurated programs designed to establish a free-trade area among themselves and to achieve a degree of integration of their respective economies. Although the initial membership consisted of the aforementioned countries and the initial goal was a free-trade area, the ultimate objective of LAFTA is to establish a common market embracing all countries of Latin America.

This digest is designed to provide an understanding of the major provisions of the Treaty Establishing the Latin American Free Trade Association. No attempt has been made to analyze the possible effects of the treaty on the economies of either the member countries or third countries, nor have the economic relationships between the member countries been discussed in detail.

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Nature of the treaty

A Treaty Establishing a Free Trade Area and Instituting the Latin American Free Trade Association (Montevideo Treaty) was signed at Montevideo, Uruguay, on February 18, 1960, and became initially effective on June 1, 1961. <sup>1/</sup> A free-trade area, as defined in article XXIV, section 8(b), of the General Agreement on Tariffs and Trade (GATT), is understood to mean "a group of two or more customs territories in which the duties and other restrictive regulations of commerce . . . are eliminated on substantially all the trade between the constituent territories in products originating in such territories" although the members retain their own customs administrations and tariff systems with respect to imports from outside their customs territories. The elimination of import duties, charges, and other restrictions on trade between the member states is to be achieved during a 12-year period (1962-73).

The contracting parties to the LAFTA treaty regard the actions to be taken thereunder as a multilateral effort

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<sup>1/</sup> English and Spanish texts of the Montevideo Treaty have been published by the Organization of American States in Washington, D.C.

towards the gradual and progressive achievement of a common market. 1/ The contracting parties agree to make every effort, in promoting the integration of their economies, to harmonize their import and export policies and practices, their industrial and agricultural policies, and the treatment they accord to capital, goods, and services from third countries.

### Objectives

The immediate objective of the signatories to the Montevideo Treaty is to bring about an expansion and diversification of trade among the contracting parties. This is to be accomplished through the gradual abolition of restrictions on trade among the participating states, the negotiation of so-called agreements on complementarity among interested parties (see p. 10), 2/ and the adoption of other measures leading to the progressive integration of the economies of the LAFTA countries.

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1/ A common market, as the term is usually understood, encompasses not only the abolition of trade restrictions among the member countries and the adoption of a common external tariff, but also the free movement of factors (labor and capital) among the contracting parties and, at times, some degree of integration of national policies and institutions.

2/ These agreements are preferential arrangements, negotiated either by the interested governments or by private concerns, providing for the apportionment of the output of various parts and components used in the same production process (i.e., vertical combination or integration). These agreements are discussed later in this report.

The participating members hope that the trade liberalization program of the Montevideo Treaty will encourage the establishment of new industries and bring about a more fruitful exploitation of available domestic resources. The development of wider markets among the LAFTA countries is expected to attract new enterprises and to reduce costs of existing enterprises through facilitating mass production and distribution, and specialization.

Parties to the treaty

A provisional draft of the LAFTA treaty was approved in September 1959 by delegations from seven South American countries: Argentina, Bolivia, Brazil, Chile, Paraguay, Peru, and Uruguay. The actual signatories to the Montevideo Treaty on February 18, 1960, were Argentina, Brazil, Chile, Mexico, Paraguay, Peru, and Uruguay. With the adherence of Colombia and Ecuador to the treaty in the latter part of 1961, the number of contracting parties was increased to nine. Bolivia, although expected to adhere to the treaty, had not done so by the end of June 1962.

The Montevideo Treaty remains open to accession by the other Latin American governments. <sup>1/</sup> Before obtaining the advantage of concessions already exchanged between the contracting parties, an acceding state must grant equivalent concessions.

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<sup>1/</sup> During the years 1958-60, certain of the Central American countries also agreed to establish a common market among themselves.

### Application of the treaty

For any member country, the Montevideo Treaty becomes effective 30 days after deposit of the instrument of ratification. For the first members--Argentina, Brazil, Chile, Mexico, Peru, and Uruguay--the treaty became effective June 1, 1961. For Paraguay it became effective on July 21, for Colombia on October 30, and for Ecuador on December 3, 1961.

### Duration, renewal, and denunciation

The Montevideo Treaty is of unlimited duration. At the end of 12 years from the date of the treaty's entry into force, the contracting parties are to study the results achieved and make any changes deemed necessary in the treaty to fulfill its purposes more effectively, and to propose measures to achieve further economic integration.

To withdraw from the treaty, a contracting party must inform the other members of its intention at a regular session of the Conference of the Contracting Parties. It may then submit its instrument of denunciation at the following regular session. For the country withdrawing, thereupon participation in any new concessions exchanged ceases, but the reciprocal concessions already negotiated remain in force for another 5 years unless terminated by the consent of the Conference.

Free-trade area

The free-trade area contemplated in the Montevideo Treaty is to be achieved within 12 years from the effective date of the agreement (i.e., by June 1, 1973). In the interval, the participating states are to undertake the gradual elimination of the duties, charges, and other restrictions applicable to substantially all products of the area traded among them. The term "duties and charges" is defined in the treaty to mean customs duties and any other import charges of equivalent effect (whether fiscal, monetary, or exchange).

Each contracting party is to obtain equivalent concessions ("effective reciprocity") in the periodic negotiations of reductions in duties, charges, and other trade restrictions required by the treaty. These reductions are to be identified in schedules published by the individual countries and in a multilateral schedule. The National Schedule for each country consists of articles on which it makes annual reductions through negotiation with other members. The Common Schedule consists of articles on which all the member countries together agree to remove all import duties and other restrictions within the 12-year period.



Reductions in the National Schedules, unlike those in the Common Schedule, may be modified or withdrawn by negotiation.

National Schedules.--The National Schedules comprise the lists of commodities on which concessions are made in 12 annual negotiations. These schedules specify the reductions in duties, charges, and other restrictions which the contracting parties grant to one another. The National Schedules are to include the largest possible number of products traded among the LAFTA countries, and are to be expanded to include new products as these arise. Request lists are to be exchanged through a Standing Executive Committee of the association.

The first round of negotiated reductions, affecting the first seven ratifying countries, 1/ became effective on January 1, 1962. An extraordinary meeting of the Conference was held January 29-March 3, 1962, for the purpose of negotiating mutual concessions with Colombia. These concessions became reciprocally effective for the contracting parties on April 1, 1962. Ecuador, a less-developed member of LAFTA, is to negotiate for special

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1/ Argentina, Brazil, Chile, Mexico, Paraguay, Peru, and Uruguay.

benefits accorded by the Montevideo Treaty at the second session of the Conference of the Contracting Parties, which is scheduled to be held in August 1962.

The reductions in import duties and charges levied by each member of the association must average not less than 8 percent for each year, computed cumulatively. In the determination of such reduction, relaxation of import quotas and exchange controls is to be taken into account. To achieve the aggregate reductions required, negotiations by pairs or groups of countries are permitted. The Standing Executive Committee is to calculate the average levels of reductions negotiated by each contracting party to see that the minimum requirements of the treaty are met.

Concessions on products which appear in the National Schedules can be withdrawn (a) by negotiation among the contracting parties and on the basis of adequate compensation, or (b) under provisions of the escape clauses (see below).

The Common Schedule.--The Common Schedule is to consist of those products with respect to which all the IAPTA members agree to eliminate duties, charges, and other trade

restrictions with one another within the 12-year period. Negotiations on these items are to be held triennially, during the third, sixth, ninth, and twelfth years from the effective date of the Montevideo Treaty. The negotiations are to be completed and concessions promulgated by November 30 of each negotiating year.

The value of the products placed on the Common Schedule as a result of the first triennial negotiation is to constitute at least 25 percent of the average annual value of intra-area trade during the preceding 3-year period and is to represent another 25 percent in each of the successive negotiations until 1972-73, when substantially all of the trade will have been covered.

The inclusion of products in the Common Schedule is final and the concessions granted in respect thereof are irrevocable, except for temporary relief provided under the escape clauses (see below).

#### Most-favored-nation treatment

The treaty provides for the immediate application of unconditional most-favored-nation treatment to the goods and capital of each contracting party in the territory of the others. In addition, the products of each LAFTA

country are to receive national treatment (i.e., the same treatment as that accorded to domestic products) in the territories of the other members with respect to taxes and other internal duties and charges, and are to enjoy freedom of transit through the territories of the respective member states.

Exceptions to the application of most-favored-nation treatment are made (a) for less-developed countries, as discussed below, and (b) with respect to special benefits applied by any contracting party in its border trade, whether or not with a LAFTA country. 1/

Protocol No. 1 (art. 17) provides that the Contracting parties are to give consideration in their negotiations to cases in which differences among the countries in the protection afforded certain products give rise to inequitable competition. In such cases, steps--including the equalization of tariff duties and charges--are to be taken to equalize costs among the member countries.

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1/ LAFTA resolution 10(I) of Sept. 1, 1961, defined border trade as trade which meets the following standards: (a) It is between contiguous frontier towns, or between towns at least one of which, because of its geographic location, has difficulty in being regularly supplied from its own territory; (b) it is in goods destined exclusively for use in the aforementioned towns; and (c) it is, in volume, no greater than required for local needs.

Complementary arrangements

With a view to achieving vertically integrated or specialized manufacturing operations and thereby raising productivity and reducing costs, the contracting parties are authorized to sponsor bilateral or multilateral agreements among representatives of particular economic sectors; to negotiate at the governmental level mutual agreements by industrial sectors; and to promote progressively closer coordination of their national industrialization policies (see p. 2).

The working group on the Latin American regional market, meeting in Mexico City February 16-27, 1959, recommended that any preferential benefits under the complementary arrangements should continue in effect only as long as required by the infant industries they were designed to support. In the opinion of the working group, the customs duties abolished or reduced in a complementary arrangement should not be counted in computing the average level of concessions provided for in the treaty (i.e., such concessions should be additional to those granted generally and should in no way affect other obligations undertaken in the treaty). 1/

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1/ "Recommendations concerning the structure and basic principles of the Latin American common market, Report of the second session of the Working Group," in United Nations, Department of Economic and Social Affairs, The Latin American Common Market (Sales No.: 59.II.G.4), p. 49.

The complementary arrangements are to be embodied in protocols to the Montevideo Treaty and are to become effective after the contracting parties have determined that they are not in conflict with the treaty.

The LAFTA treaty contains special provisions relating to agriculture. The contracting parties are to coordinate their agricultural development and agricultural trade policies in order to achieve the most efficient utilization of their natural resources, to raise the standard of living of their rural populations, and to guarantee adequate supplies to consumers. In this connection, when the domestic output of any contracting party is inadequate to meet its requirements, other LAFTA members are to be given priority in furnishing the necessary supplies, with due consideration to competitive conditions and to traditional trade patterns in the area. Agreements relating to agricultural products are subject to the requirement only of notice to the other contracting parties before becoming effective. Special treatment for agriculture is also provided in the escape clauses of the treaty.

Special treatment for less-developed countries

Article 32 of the Montevideo Treaty provides for the temporary extension of special benefits to less-developed countries in the association. This special treatment has a

twofold objective: to attract the smaller Latin American countries to LAFTA, and to help them accelerate their economic growth so that the aims of the treaty can be more effectively accomplished. Protocol No. 5 to the treaty provides for such treatment to Bolivia (at such time as it may adhere to the treaty) and Paraguay. During its first session in July 1961, the Conference of the Contracting Parties to the Montevideo Treaty approved the extension of special treatment to Ecuador as a less-developed country (resolution 3(I) of July 31, 1961). 1/

Through negotiations with the contracting parties, a less-developed LAFTA country can obtain--

- a. Preferential concessions from the other member countries, for the purpose of encouraging the introduction or expansion of specific productive activities. 2/
- b. Permission to reduce its import duties, charges, and other trade restrictions less rapidly than the other parties.

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1/ A list of factors to be considered in appraising the degree of economic development of any country applying for these special benefits is contained in an annex to LAFTA resolution 18(I) of Oct. 11, 1961. (LS No. 30862, T-95/R-XX, in Spanish).

2/ For example, the Conference of the Contracting Parties authorized (resolution 12(I)) the members to grant to Paraguay, for 9 years beginning Jan. 1, 1962, a total exemption from duties and restrictions on its primary and industrial goods. This exemption was to be confined to the products upon which it might be granted by a country without excessive damage to that country's producers.

c. Permission to adopt corrective measures for a disequilibrium in the balance of payments, subject to fewer limitations and controls than are provided for under the more general escape-clause provision of the treaty (art. 24).

d. Permission to apply temporarily and in a nondiscriminatory manner, measures designed to protect the domestic production of items vital to its economic development. Such measures could include quantitative restrictions on imports, changes in import duties, and the establishment of price-fixing systems.

e. Collective assistance from the other LAFTA members in obtaining financial or technical assistance, both inside and outside the area, for expanding existing productive activities or encouraging new ones--particularly those which would utilize domestic raw materials in their production process.

f. Special technical assistance programs, promoted or supported by the contracting parties, for the purpose of raising productivity levels in specific production sectors. 1/

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1/ Although the provisions of the Montevideo Treaty are vague as to the distinction between some of the benefits available to less-developed countries and those available to any LAFTA member, some clarification is provided in LAFTA resolution 17(I) of Oct. 11, 1961, emanating from the first session of the Conference of the Contracting Parties. This additional information, to the extent deemed necessary, has been included in this report.



Escape-clause provisions

Any LAFTA country whose productive activities, volume of trade, or balance of payments are adversely affected by the concessions resulting from the application of the Montevideo Treaty can seek relief under various escape-clause provisions of this treaty. If a participating country suffers significant and persistent disadvantages because of concessions granted to other members of the association, the injured party can request its LAFTA trading partners to consider the adoption of suitable nonrestrictive measures to remedy the situation (art. 11).

If the injury results from causes other than concessions, it can be remedied, if necessary, by more drastic measures (art. 12).

If imports of commodities in the National Schedules or the Common Schedule have, or are likely to have, serious repercussions on productive activities of vital importance to a member's economy, the affected party can receive authorization from the contracting parties to impose temporary nondiscriminatory restrictions on such imports. However, these restrictions can not be such as to reduce consumption of the commodities in the importing country below customary levels (art. 23). In addition, any association member which adopts measures to correct an overall unfavorable balance of payments can receive permission to extend these measures, provisionally and without

discrimination, to the products included in the liberalization program (art. 24). If the immediate application of escape-clause remedies is necessary, the affected party can apply them before receiving formal permission to do so.

The measures permitted under the escape clauses of the treaty generally are not to extend beyond 1 year. If they continue in effect beyond that period, the contracting parties are to enter into negotiations leading to the elimination of these measures. 1/

For the purpose of protecting supplies and maintaining prices, a member country can restrict its imports of agricultural products included in the trade liberalization program to those amounts necessary to supplement domestic production and may apply nondiscriminatory measures to equalize the prices of the domestic and imported products (art. 28). The imposition of such restrictions, however, is not to reduce customary consumption or give rise to uneconomic production. Should these limitations be transgressed, a member country considering itself injured can request the association to study the situation with a view to applying remedial measures.

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1/ Withdrawal of concessions in the National Schedules by negotiation and on the basis of adequate compensation are not affected by this limitation.

Organization and administration

The Latin American Free Trade Association is a legal entity, with authority to contract, acquire and dispose of property, institute legal proceedings, and hold and transfer funds in any currency. The organs of the association are (a) the Conference of the Contracting Parties, and (b) the Standing Executive Committee.

The Conference of the Contracting Parties.--The Conference is the policy-making organ of the association. It is responsible for promoting the periodic negotiations and implementing the other provisions of the Montevideo Treaty, approving the budget of the Standing Executive Committee, and adopting its own rules of procedure and approving those of the Standing Executive Committee.

The Conference is composed of the accredited representatives of the member states. Each national delegation has one vote, and the presence of at least two-thirds of the contracting parties is required for a decision. During the first 2 years that the treaty is in force (i.e., June 1, 1961-May 31, 1963), adoption of decisions by the Conference requires the affirmative votes of at least two-thirds of the contracting parties, with no negative vote cast. Except for certain

administrative matters, on which a two-thirds majority will still be required, the contracting parties must determine the voting system to be adopted after this 2-year period.

Meetings of the Conference are to be held annually, but special sessions may be convened by the Standing Executive Committee. The place and date of the subsequent regular session are decided at each regular session of the Conference. At each of its regular sessions, the Conference elects a Chairman and two Vice-Chairmen.

The Standing Executive Committee.--The Committee, with headquarters at Montevideo, Uruguay, is the continuing organ of the association and is responsible for supervising the implementation of the Montevideo Treaty. The Committee is composed of a standing representative from each contracting party, each of which has one vote. Each representative has an alternate.

The prescribed powers of the Committee include convening the Conference, preparing annual work programs and budgets for the approval of the Conference, negotiating contracts and other instruments of public and private law, and representing the association in dealings with third countries and international organizations and entities. In addition, the Committee undertakes

studies and formulates recommendations to the Conference with respect to the effective implementation of the Montevideo Treaty; and it submits to the Conference an annual report of its activities and of the results of applying the treaty.

The Committee may seek technical assistance and collaboration for itself and for the Conference of the association from individuals and national and international organizations, especially from the secretariats of the United Nations Economic Commission for Latin America (ECLA) and the Inter-American Economic and Social Council (IA-ECOSOC) of the Organization of American States. Protocol No. 3 to the Montevideo Treaty provides that representatives of these two secretariats are to attend meetings of the Standing Executive Committee when the business to be discussed, in the Committee's opinion, is of a technical nature. The aforementioned representatives must be approved by the Committee. For the study of specific problems, the Committee may create advisory commissions, staffed by technical experts from each of the contracting parties.

The Committee also makes decisions on matters delegated to it by the Conference, and undertakes tasks assigned to it by the Conference. One of these tasks, stipulated in protocol No. 1 to the

treaty, is that of acting as a clearing house for the exchange of statistical and legislative information among the contracting parties. The subject matter of such exchanges includes trade data; customs legislation and regulations; exchange, monetary, fiscal, and administrative legislation, regulations, and practices affecting exports and imports; international trade treaties and agreements whose provisions relate to the Montevideo Treaty; information on production or export subsidies, including minimum-price systems; and information regarding the existence and activities of state-trading systems.

The Committee is assisted in its work by a secretariat. The secretariat is comprised of an executive secretary and technical and administrative personnel, all of whom are international civil servants, forbidden to seek or receive instructions from any government or other national or international entity.

The executive secretary is elected by the Conference for a 3-year term but is eligible for reelection for similar periods. He not only attends the plenary meetings of the Committee (without the right to vote), but also serves as the secretary general of the Conference. His duties consist of organizing the work of the Conference and of the Committee, preparing the Committee's annual budget estimates, and recruiting and hiring staff in accordance with the Committee's rules of procedure.

Arbitration procedures

Unlike the Central American common market treaties, the LAFTA treaty does not contain specific provisions respecting the settlement of disputes arising from differences in the interpretation or application of its provisions. 1/

Treaty relationships with third countries

Although the Montevideo Treaty states that its provisions should not affect the contracting parties' rights and obligations that derive from prior treaties signed, it nevertheless requires that the provisions of such prior treaties be reconciled with those of the LAFTA treaty. 2/ As of April 1, 1962, Argentina and Paraguay still had bilateral trade agreements in force with the United States. Both agreements provided for unconditional and unrestricted most-favored-nation treatment of the products of each of the signatory parties. 3/ The United States has no trade agreements in force with Colombia, Ecuador, and Mexico. The four remaining LAFTA members--Brazil,

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1/ However, LAFTA resolution 14(I) of Oct. 11, 1961, provides, in part, that in the case of dumping or other unfair trade practices engaged in by any LAFTA country adversely affecting another, if a remedy cannot be effected by direct negotiation between the interested parties, the matter is to be referred to the Standing Executive Committee for its study and recommendations.

2/ Except, under protocol No. 4, for commitments to purchase or sell petroleum and petroleum derivatives resulting from treaties signed prior to the Montevideo Treaty.

3/ Both the Argentine and the Paraguayan agreement except customs union arrangements to which the respective countries may be parties from this most-favored-nation provision.

Chile, Peru, and Uruguay--are members of the General Agreement on Tariffs and Trade (GATT). The LAFTA treaty is designed to conform generally with GATT provisions (art. XXIV) regarding the establishment of customs unions. The LAFTA arrangement has been discussed with the Contracting Parties to GATT; at the 16th Session of GATT (May-June 1960), a working party was established to consider the Montevideo Treaty in the light of the GATT provisions. The working party completed its examination at the 17th Session (October-November 1960). As a number of questions raised by various GATT members could only be answered after the LAFTA agreement had gone into effect, the Contracting Parties agreed that the Latin American countries might proceed to ratify and apply the Montevideo Treaty without prejudice to the legal and practical issues involved.