POLITICAL FACTORS IN THE CREATION AND
IMPLEMENTATION OF THE ANDEAN
FOREIGN INVESTMENT CODE

THESIS

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The purpose of this investigation is to examine the political factors which came into the creation and implementation of the Andean Foreign Investment Code.

This study analyzes the political forces in the creation of the Code and examines the implementation of the Code in each of the Andean countries. This investigation concludes that although the Code has not been implemented uniformly in the Andean countries, it remains an important part of the Andean Common Market. In addition, the continual political consensus among the member countries is emphasized for the continuation of the Andean integration effort.
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CHAPTER I

THE ANDEAN FOREIGN INVESTMENT CODE

One of the most important integration movements in Latin America and in the Third World is the Andean Common Market. Established in May 1969 as a subregional group within the framework of the Latin American Free Trade Association, the Andean Group is an innovative and ambitious integration movement. Among one of its most important mechanisms for regional policy is the Andean Foreign Investment Code. The Code consists of a set of regulations for foreign investment in the area.

The purpose of this investigation is to examine the political factors which came into the creation and implementation of the Andean Foreign Investment Code. The two background factors were the concept of "dependencia" and the political consensus among the governments of the Andean countries.

The concept of "dependencia" is based on the assumption of the domination by the developed countries over the economic, political, and social systems of the developing nations. The governments of the Andean nations were in accord with this concept and they emphasized the need for greater independence from the industrialized nations. This
political consensus gave impetus to the approval and implementation of the Code.

The same political consensus prevailed from 1970 through the latter part of 1974. The political unity was disrupted by the military government of Chile, which no longer shared the same objectives as the other members of the Andean Group. The crisis lasted about a year during which time the members modified some of the provisions of the Code in an attempt to keep their unity. However, Chile withdrew from the Andean Common Market in October 1976. The other five members, Bolivia, Colombia, Ecuador, Peru, and Venezuela, have stated their support for the continuation of the Andean integration movement.

In examining the creation of the Andean Foreign Investment Code, the main sources have been books and articles in political science journals concerning the Andean Foreign Investment Code, the Andean Common Market, and the economic and political thought of Latin American economists and politicians. The Chapter concerned with the actual experience of the Andean countries with the Code relies on articles from law journals and on articles from economic and business periodicals. An important business periodical has been Business Latin America. Comercio Exterior de Mexico and The New York Times have been important sources in providing
important information about the progress of the Andean Common Market and the political changes in the Andean countries from 1970 through 1976.

This study indicates that the implementation of the Code has been far from uniform policy. Although the inclusion of regulations for foreign investment has meant a drop of foreign capital in the area, the Code has remained an important part of the Andean integration effort. In addition, the importance of the political leadership is emphasized. It is the political leadership of the Andean nations who play the major role in the integration effort. The success or failure of the whole Andean integration movement depends on the consensus among the present and future political leaders of the Andean countries.

The Scope of the Study

On December 30, 1970, the Andean countries approved the "Common Regime for the Treatment of Foreign Capital, Trademarks, Patents, Licenses, and Royalties." The common regime, known also as Decision 24 or the Andean Investment Code, consists of a set of regulations for foreign investment in the area. Such an unprecedented move by a group of Latin American countries involved in an economic integration effort was conceived as a necessary step within the Andean integration framework. "Economists state the necessity of setting up a common policy of incentives and
control for foreign and domestic investment to be a requisite for the successful integration among developing countries. The Andean Common Market countries do require increased financial and technological resources, and by setting up common regulations, their bargaining power for such resources would be strengthened. In addition, the competition among themselves in attracting foreign capital would be avoided.

However, within an economic integration group, political factors also become important. The political forces behind the creation, the approval and the implementation of the Andean Code from October 1970 until December 1976 will be the subject of this study.

Historical Background

For many decades the economic integration of Latin America has been thought to be the most viable solution to its underdevelopment problem. The United Nations Economic Commission for Latin America (ECLA) and the Organization of American States (OAS) looked to integration as a means of promoting economic development in Latin America. During the 1950's and 1960's, the Latin American countries began to approach seriously their developmental problems in a pragmatic way by accepting the integrationist idea. The idea

that a cooperative approach to common problems would benefit each of the participating countries became an important incentive for regional economic integration.

The first effort at integration was the Central American Common Market (CACM), formed in 1960. It included all the nations of Central America except Panama. That same year the Latin American Free Trade Association (LAFTA) was created. LAFTA represented 90 percent of the population of Latin America and 94 percent of its area.¹ A third group, the Caribbean Free Trade Association (CARIFTA), was established in 1968 by eleven British Commonwealth nations and territories. Economic integration to promote development became an accepted principle in Latin American thought.

The Central American Common Market has achieved limited success. Most of all the barriers to intra-Central American trade have been eliminated. A common external tariff for the region has been developed. Intra-regional trade has risen dramatically. New industries and expansion of existing industries have been stimulated through the Common Market.

By contrast, LAFTA has not had much success. Intra-regional trade has been extremely slow and has only increased modestly. The pace of the negotiations has been slow. In

addition, because each of the member countries has an unrestricted veto power in all major decisions, the effectiveness of the organization has been further reduced over the years. One important difference which posed additional problems has been the disparity in levels of economic development among the member countries. The countries in LAFTA can be divided into three groups, according to their level of economic development: "The Big Three": Argentina, Brazil, and Mexico; the intermediate group: Chile, Colombia, Peru, and Venezuela; and the countries of lesser development: Bolivia, Ecuador, Paraguay, and Uruguay.

In addition to dominating LAFTA, the "Big Three" gained most benefits from trade. They were also the most successful in attracting investments. The intermediate group generally suffered unfavorable trade balances in intra-LAFTA commerce and were the most critical of the free trade principles in economic integration. The less developed members were granted special nonextensive tariff concessions, but have taken little advantage of these.

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3 Ibid., p. 7.
4 Ibid., p. 7.
Formation of the Andean Common Market

The unsuccessful record of LAFTA prompted some of the participating countries to approach the integrationist movement in a more innovative and aggressive way. In 1966, Chile, Colombia, Ecuador, Peru, and Venezuela opened formal negotiations for the creation of a subregional group within LAFTA, with the Declaration of Bogota. The Declaration states:

"...the tariff reduction procedures provided for in the Treaty of Montevideo (treaty which brought LAFTA into being) are not sufficient to accelerate genuine Latin American integration within a reasonable time or to have a dynamic impact on the economic development of the continent...We have decided to launch a joint campaign with a view to the approval, within the Latin American Free Trade Association, of specific measures for putting into effect the proposals set forth in this Declaration and, in particular, the adoption of practical formulas which will guarantee treatment appropriate to the situation of our countries, which are among the countries at a relatively lower level of economic development or lacking adequate markets. All these measures are essential for achieving the harmonious and balanced development of the region in accordance with the spirit of Montevideo."5

The Declaration of Bogota proposed an action program through which their objectives would be met. The signatory countries would conclude closed complementary agreements, extend to each other tariff concessions, and co-ordinate

their national development policies, especially in relation to petrochemicals, basic metallurgy nonmetallic minerals, electronics, food processing, paper, foreign investments, and agrarian reform. Facilities for physical integration such as roads, telecommunications, networks, would be built. The conference at Bogota also established the Mixed Commission, composed of high governmental representatives to draft an agreement to propose measures for implementing the proposals of the Declaration.

The Andean Subregional Integration Agreement

The most important agreement drafted by the Mixed Commission was the Andean Subregional Integration Agreement, sometimes called the Cartagena Agreement. This is the basic agreement of the Andean Common Market. The agreement was signed on May, 1969 by Bolivia, Chile, Colombia, Ecuador, and Peru. Although Venezuela had participated in the preparatory negotiations, its private sector found some of the provisions of the completed text unacceptable. Important Venezuelan industrial sectors felt they would be at a competitive disadvantage, due to some of the provisions of the agreement. Nevertheless, Venezuela signed the Consensus of Lima on February 13, 1973, and became then a member of the Andean Common Market.

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6 Ibid., p. 99.
The subregional agreement of the Andean Common Market is far more ambitious and aggressive than the Treaty of Montevideo which conceived LAFTA. The emphasis is not only in the freeing of trade, but also in the development of new industries in the area. The principal objectives of the Andean Common Market are the "acceleration of the industrialization process in the region, the equitable participation of all the members in this process and the diminution of the political and economic dependence of the subregion from the industrial centers of the world."\(^7\) Other minor objectives are those of facilitating the participation of the Andean countries in LAFTA and the establishment of favorable conditions in LAFTA for its conversion into a common market.\(^8\)

In order to achieve their objectives, the Andean countries have established some mechanisms:

1. Harmonization of economic and social policies and coordination of national legislation,
2. Joint planning and execution of industrial projects,
3. Intensification of the subregional industrialization process and implementation of Sectoral Programs of Industrial Development,

\(^7\)Miguel S. Wionczek, "Hacia El Establecimiento de un Trato Comun para La Inversion Extranjera en el Mercado Comun Andio," El Trimestre Economico, Mexico, XXXVII, (April-June, 1971), p. 659. (Translated by the author.)

\(^8\)Avery, op. cit., p. 201.
4. A more accelerated program of trade liberalization than the one adopted by LAFTA,

5. A Common External Tariff, to create a margin of preference for regional producers,

6. Program to speed the development of the agricultural sector,

7. Improvement of transportation and other physical communications within the region, and

8. Preferential treatment to the less developed members, Bolivia and Ecuador. ⁹

Institutional Framework

In order to administer and direct the movement towards integration, the Andean Common Market has established a governing structure. The institutions which form the governing framework consists of the Commission, the Junta or secretariat, the Consultative Committee, the Economic and Social Advisory Committee, and specialized advisory councils.

The Commission is the highest organ of the Andean Common Market. The Commission establishes basic policies and formulates measures necessary to adopt them. It meets three times a year in ordinary session in Lima, Peru and whenever necessary in extraordinary session. It is composed of one representative and an alternate from each member

country, each with an equal vote, and most decisions are reached by a majority vote. The Commission chooses the members of the Junta and governs their work.

The Junta is the secretariat of the Andean Group. It is composed of three persons who may be citizens of any Latin American country. They are selected for three-year terms and are to be true international civil servants; they may not receive instructions from any government. The Junta is the administrative organ of the Andean Group and it is responsible for administering the various agreements undertaken by the member countries. In addition, the Junta plays an important role in the decision-making process since they are responsible for research and the drafting of new agreements. It has a staff of about 35-40 and is headquartered in Lima, Peru.

In addition to these two bodies, the Andean Common Market created two auxiliary bodies: The Economic and Social Consultative Committee and the Consultative Committee. The Economic and Social Consultative Committee provides the forum for the private sector. It is composed of representatives of business and labor. The purpose of the Economic and Social Consultative Committee is to link the nonofficial economic sector to the organs of the Andean Group.
The Consultative Committee has the function of serving as liaison between the member governments and the secretariat. The purpose of the Consultative Committee is to enable official consultation and advice from the member governments in the preparation of its proposals before they are submitted to the Commission. It is composed of one representative from each member country and consultants and advisors from the public and private sectors.

The Andean Common Market has also established a number of advisory councils on such matters as fiscal policy, planning, foreign exchange, monetary, tourism, health, etc.

In addition to this administrative framework, the Andean Group created another institution, previous to the signing of the Cartagena Agreement. The Andean Development Corporation preceded the Cartagena Agreement by about a year. It is the financial institution of the group. Its objective is to stimulate subregional integration by promoting the forming and expansion of industries. 10 It also attempts to bring about the equitable distribution of enterprises in the region and gives priority to the promotion of enterprises that operate in more than one member country.

10 The Andean Pact: Definition..., Op. Cit., p. 6
Architects of the Andean Foreign Investment Code

The Common System for Treatment of Foreign Capital and on Trademarks, Patents, Licenses, and Royalties is the result of six months of studies and deliberations by a group of experts working with the Cartagena Agreement Council.\(^{11}\) The designers of the Andean Foreign Investment Code are mainly experienced attorneys who for many years had represented direct foreign investment in the area. In addition, a number of economists and administrators, many of whom were trained in the United States, formed part of the drafting of the Code. In addition to the experts from the Andean Group member countries, other experts from Argentina, Brazil, Mexico, the United States, Canada, and Japan were invited to aid in the task of creating the Code.\(^{12}\)

The creators of the Code believed that the process of development and integration requires the continuing transfers of developed-country capital and technology and the interest of the Andean Group in foreign capital and know-how is to get it to aid in filling the gap caused by the insufficient supply of local capital and technology. The problem in designing the Code was this: How to eliminate the negative

\(^{11}\)Ibid.

results of the past by the foreign investors in the area, and at the same time create the conditions by which foreign capital and technological know-how could help the economic and industrial growth of the subregion. The answer was the Andean Foreign Investment Code.

Below, the political forces which made the drafting and the implementation of the Andean Foreign Investment Code.

The International and Regional Forces Behind the Drafting of the Andean Investment Code

For many decades the Latin American countries have experienced economic underdevelopment and powerlessness in world affairs. In their quest to better their economic situation and their position in the international order, they have decided to unite their efforts through regional economic integration groups in order to obtain both their economic and political goals. The Latin American Free Trade Association and the Central American Common Market reflect this effort. The newest economic integration effort in Latin America is the Andean Common Market. A subregional group within the Latin American Free Trade Association, the Andean Common Market was established in 1969 by Colombia, Chile, Peru, Ecuador, and Bolivia. Venezuela agreed to join in February 1973, and became a full member in January 1974.

The Andean Group, dissatisfied with the slow progress of the Latin American Free Trade Association, decided to join their efforts in order to promote its own development, overcoming all forms of domination and dependency. The aims of the Andean countries include the reduction of intra-regional tariffs, industrial planning on the regional level, and the harmonization of their economic policies. Within the harmonization of their economic policies, one of the most important decisions reached was the approval of the Andean Foreign Investment Code. The political forces which brought about the drafting of the Andean investment Code will be examined below.

**International Aspects of the Concept of "Dependencia"**

The concept of "dependencia" views underdevelopment as caused by an international system of economic, social, political, and cultural domination. According to this view, the global underdevelopment which afflicts the greater part of the world; Asia, Africa, the Middle East, and Latin America, has resulted from the mercantilist and

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capitalist expansion of first the European nations and later of the United States. Theotonio Dos Santos, a Brazilian economist, suggests that the "dependencia" situation occurred within the historical experience of the world. He states:

"Dependence is a situation in which a certain group of countries have their economy conditioned by the development and expansion of another economy, to which the former is subject. The relation of interdependence between two or more economies, and between these and world trade, assumes the form of dependence when some countries (the dominant) can expand and give impulse to their own development, while the other countries (the dependent) can only develop as a reflection of this expansion. This can have a positive and/or negative effects on their immediate development. In all cases, the basic situation of dependence leads to a global backwardness and under the exploitation of the dominant countries. The dominant countries have a technological, commercial, capital resource, and socio-political predominance over the dependent countries (with predominance of some of these aspects in various historical moments). This permits them to impose conditions of exploitation and to extract part of the domestically produced surplus."  

Dos Santos further views the dependence situation as evolving through three historical stages. The first stage began with colonization by the European nations. The

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19 Cockcroft, Frank, and Johnson, op. cit., p. 71.
colonies became the suppliers of gold, silver, and tropical products. At this first stage the colonizers had complete monopoly over trade, land, minerals, and manpower. This stage Dos Santos called "colonial dependence." The second stage of dependence began at the end of the nineteenth century. The dominant countries, having a financial and industrial monopoly, began to invest abroad. This investment was mainly geared to the production of export goods: raw materials and agricultural products. The local economies of the dependent countries devoted their production activities to these primary export products. This stage is called the "financial-industrial dependence."

The most recent form of dependence began with the rise of the multinational corporations in the postwar era. These corporations began to invest in the manufacturing sector of the economy of the dependent country. Not only was foreign capital active in the export sector, but this latest form of investment implied their penetration into the internal market structure of the dependent economies. This stage is called the "technological-industrial dependence."

This economic dependence in turn affects the under-development of the social, political, and cultural structures

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20 Dos Santos, op. cit., p. 232.
21 Ibid.
in the dependent countries. Throughout history, the local oligarchs of the dependent countries have managed to gear their capital to activities which complemented those of foreign capital. This association with foreign interests greatly benefitted the local oligarchs. By perpetuating their economic wealth, they also increased their political, social, and cultural domination, contributing to the underdeveloped structure of their societies. Therefore, economic dependency on the industrialized nations is inextricably linked to the internal structure of the dependent societies.

The above have been the main points of the theory of dependency. The regional effects of the dependency theory in relation to Latin America will be examined below.

The Regional Experience with Dependency

On June 12, 1969, the then Foreign Minister of Chile, Gabriel Valdez, suggested to President Nixon of the United States a reason for the continuing underdevelopment of the Latin American countries:

"It is generally believed that our continent receives real financial aid. The data shows the opposite. We can affirm that Latin America is making a contribution to financing the development of the United States and other industrialized countries. Private investment has meant and does mean to Latin America that the sums taken out of our continent are several times higher

23 Cockcroft, Frank, and Johnson, op. cit., p. 23.
than those that are invested. Our potential capital declines. The benefits of invested capital grow and multiply themselves enormously, though not in our countries but abroad. The so-called aid, with all its well-known conditions, means markets and greater development for the developed countries, but it has not in fact managed to compensate for the money that leaves Latin America in payment of the external debt and, as a result, of the profits generated by private direct investment. In one word, we know that Latin America gives more than it receives. On these realities it is not possible to base any solidarity or even any stable or positive cooperation."

Gabriel Valdez was then a member of the cabinet of President Eduardo Frei. His words express the regional effect of the dependency theory.

According to the "dependencia" theorists, the original state of a society is undevelopment, not underdevelopment. The underdevelopment of the Latin American countries began with the conquest of the Spanish and Portuguese. The colonies became important sources of wealth through which the dominant countries, Spain and Portugal, increased their wealth and promoted their own development. In addition, the colonizers began acquiring great amounts of land and political power, beginning the traditional social, political, and economic structure of underdevelopment.

In the early 19th century the Latin American countries began to obtain their political independence, but it did not bring about their liberation from economic dependency.

24 Ibid.

The dominant country became England and later the United States. During this time the economies of the Latin American countries were geared to the production of export goods. This production was mainly in the hands of foreign investors. Foreign capital also began to build facilities which complements their export activities. The national governments and private businessmen had little control over the international markets for primary export goods. In addition, the prices of these primary products are unstable and many times result in unfavorable terms of trade in relation to imports.

The penetration of foreign capital strengthened the position of the national oligarchs. The oligarchs now began to invest in activities which complemented those of the foreign investor. The class structure existing from colonial times was further perpetuated by this association.

From the 1930's through the 1950's, the Latin American countries adopted an industrialization strategy. This strategy stimulated the growth of their economies and increased their manufacturing industry and their national entrepreneurial class. However, around the 1950's, they began to fix high tariffs on the import of goods that were

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26 Cockcroft, Frank, and Johnson, op. cit. p. 38.
27 Dos Santos, op. cit., p. 233.
28 Cockcroft, Frank, and Johnson, op. cit., p. 39.
produced locally. This protective move for their local products induced foreign investors to penetrate the manufacturing sector. The national governments had virtually no restrictions on foreign investment in that sector. Consequently, foreign investors began to expand rapidly in the manufacturing sector and thus to become an important part of the internal market structure of the Latin American countries.

By the late 1960's, the multinational corporations began their largest expansion. "They began to buy up local firms and setting up their own subsidiaries with the result that much of the benefits from industrialization has gone abroad in payment for capital equipment and in the transfer of profits, royalties, and other financial equipment." The effect of the expansion of foreign investment was the displacement of the national entrepreneur.

In the early part of the twentieth-century until the 1960's, the immigrants and local entrepreneurs provided most of the skilled personnel. The financing and capital came mainly from national and foreign public sources. Technology and know-how were acquired through the purchase of licenses and technical assistance. All these factors contributed to the formation and the strengthening of private enterprise

29 Danino, op. cit., p. 641.

and industry. But the penetration of foreign subsidiaries in the local economies in the 1960's discontinued this trend. The subsidiaries of foreign firms provide the entrepreneurship, management, design, technology, financing, and marketing.31

The negative economic effects of the latest stage of dependence have greater negative consequences in the socio-political areas of the Latin American countries. The penetration of foreign subsidiaries in all the economic aspects of the nations has transformed the nature of ownership in Latin America. The acquisition of medium and large firms by foreign subsidiaries has helped erode the national entrepreneurial class.32 This in turn affects the class structure by diminishing the role of the middle class. In addition, the mode of production, changing from labor-intensive to capital-intensive, further aggravates the job market. This change favors those who can adapt to the new technological production, therefore creating a privileged and underprivileged lower class.33

The regional acceptance of the dependency theory is part of the cause for the outbreak of nationalism in many Latin American countries. The inclusion of a common set of

31 Ibid.
32 Ibid.
33 Ibid.
rules for foreign investment by the Andean Group confirms this view. The Andean Group viewed foreign investment as restraining them from achieving their own potential. The solution was to break with the international trade system by controlling foreign investment in their countries and directing them in areas which they deem appropriate for their own development.

Political Consensus

The late 1960's found the Latin American governments disillusioned with their development effort. The development strategy of the last decade had not brought success, and the rising demands for socio-economic progress, coupled with the growing concern over their economic and political dependency on the industrialized nations, gave impetus to a nationalistic desire for economic development through internal reforms and economic integration.

The failure of the Latin American Free Trade Association (LAFTA) to accelerate development prompted President Lleras Restrepo of Colombia and President Eduardo Frei of Chile to call on Venezuela, Peru, and Ecuador for subregional economic integration within the framework of LAFTA. Their official statement, the Declaration of Bogota, included not only

34 Ibid., p. 517.
35 Armstrong, op. cit., p. 1599.
their intention to promote regional development planning and joint ventures among their nations, but also their intention to adopt a common regional policy for foreign investment. The Acuerdo of Cartagena, signed in May 1969, by Colombia, Chile, Peru, Ecuador, and Bolivia, provided for the adoption of a common set of rules for the treatment of foreign capital prior to December 31, 1970.

Since August 1966, when Presidents Lleras Restrepo and Frei called on Venezuela, Peru, and Ecuador to begin the formation of the Andean Subregional Integration Group until 1970, the Andean countries had experienced changes in their governments. In October 1968, President Belaunde Terry of Peru was overthrown in a coup d'etat by a military junta headed by General Velasco Alvarado. An election in Ecuador made Jose Maria Velasco Ibarra president in August 1968. Bolivia had gone through a series of changes of government and by October 1970 General Juan J. Torres became president. In Chile, Salvador Allende succeeded Eduardo Frei in an election on September 4, 1970.

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36 Ibid., p. 1600.
38 Fouts, op. cit., p. 538.
39 Ibid.
40 Ibid., p. 539.
In April 1970, Misael Pastrana became the successor of Carlos Lleras Restrepo after an election in Colombia.\textsuperscript{41} Despite all the changes of governments, the Andean countries were in complete accord that the adoption of a foreign investment code was necessary in diminishing the external dependency of their economies and for the success of their integration and for the achievement of their developmental goals.

The Peruvian military government, in power since October 1968, called itself the "Revolutionary Government." The social-minded military government, headed by General Juan Velasco Alvarado, aimed at reaching a "realignment of Peruvian society...to alter the structure of economic, political, and social power in Peru."\textsuperscript{42} Since its ascent to power, the military government began making reforms in Peru, such as the agrarian, banking and educational reforms. Their international policy was based on a nationalistic and independent approach. On July 1970, the Peruvian government announced the General Law of Industries.\textsuperscript{43} This law prohibited wholly-owned foreign firms in the industrial sector. These wholly-owned foreign firms would

\textsuperscript{41}Ibid., p. 539.

\textsuperscript{42}Danino, \textit{op. cit.}, p. 639.

have to enter into contract with the state and their foreign ownership would be reduced after a fixed period of time to one third or less; a "mixed enterprise" (maximum foreign capital of 75 percent) would have a contract with the state and foreign equity would be reduced to 49 percent or less. In addition, there would be special authorization for some mixed companies who have no more than one third ownership in foreign hands, who may continue with no fixed time limit. This "fade-out joint venture" provision was specially supported by the Peruvian government and was successful in having this provision written in the Andean Common Market Investment policy.

On September 4, 1970, Salvador Allende became the first Marxist to be democratically elected president in Chile. Shortly after his election, President Allende announced his intention of establishing a "new government that would be a multi-party system, a nationalist, popular, democratic, and revolutionary government that will move toward socialism."

In relation to foreign investments, President Allende stated, "we must recover our basic resources that are in the hands of foreign capital, essentially American copper,

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44 Ibid.
45 Ibid.
iron nitrates, which are in your hands, the hands of American monopolies. Then we must nationalize the monopolies that influence the social and economic development of the country." 47

On October 7, 1970, following a political crisis, Army General Juan J. Torres was sworn in as President of Bolivia. President Torres headed a leftist nationalist government. 48 His government stressed greater sovereignty in the economic and political areas of Bolivia and the nationalization of many of the foreign-owned installations.

In Ecuador, the nationalistic feelings had been growing strong. Growing concern over their country's external dependency and the intensification of their dispute with the United States over their offshore waters and economic rights, further deepened their nationalistic feelings. 49 President Velasco Ibarra was in favor of the adoption of a common set of rules for the regulation of foreign investment.

In 1966, President Carlos Lleras Restrepo together with President Frei of Chile, had been the principal initiators of a subregional integration group within LAFTA. On March 22, 1967, the government of Lleras Restrepo enacted Decree-Law 444. This law established rules for foreign investment

47 Ibid.
for the purpose of harmonizing them with the national interest.\textsuperscript{50} This law established a limit for the remittance of profits at 10 percent, and established legal control over foreign private investment in Colombia. This decree law also required the previous approval by the Departamento Administrativo de Planeacion for any private foreign investment of $100,000 (U.S.) or more.\textsuperscript{51} On April, 1970, Misael Pastrana became President of Colombia. President Pastrana continued the Lleras administration's emphasis on social objectives and economic development.

On October, 1970, in accordance with the Cartagena Agreement, the Andean countries released a proposed draft of the Andean Investment Code. In general, the draft was well received. However, the divestment provision became the object of controversy and heated discussion.\textsuperscript{52} The divestment provision required foreign firms to offer at least 51 percent of their shares for purchase by national investors within 10 to 15 years. Private businessmen were concerned that with this provision the state might assume a greater role.


\textsuperscript{51}Ibid., p. 87.

\textsuperscript{52}Armstrong, op. cit., p. 1603.
The discussion became so heated that at one point the whole integration effort was threatened. The proposed draft divided the Andean Group in two: Peru, Chile, and Bolivia supporting the draft and Colombia and Ecuador opposing some of the provisions.

The main opponents of the Andean Investment draft were private interests in Colombia and Ecuador. Colombian businessmen especially protested against the Code, stating that Colombia already had regulations for foreign investment (Decree-Law 444) and that that law was sufficient for the regulation of foreign capital. The private interests felt that such stricter regulations would discourage foreign investment and this in turn would affect the economic development of Colombia. Other businessmen voiced their fears that through the Code the State would be assuming a greater role and this will also be manifested in the whole integration effort.

Nevertheless, the Colombian government was determined to continue with the integration effort. The same willingness to compromise and continue was demonstrated by the governments of Peru, Ecuador, Bolivia, and Chile. In

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53 Ibid., p. 1604.
54 Ibid., p. 1604.
55 Ibid., p. 1605.
56 Ibid.
December the Commission met and a compromise was reached. The basic compromise was an agreement to insert two new ideas into the divestment provision. The first insertion was to make a distinction between the new and the old foreign investment. The second change was that only the products of "national" firms (having 80 percent ownership by nationals) be allowed to enjoy the Andean regional market.

On December 30, 1970, the Andean countries, Bolivia, Chile, Colombia, Ecuador, and Peru, approved the "Common Regime for the Treatment of Foreign Capital, Trademarks, Patents, Licenses and Royalties." The text of the common regime or the Andean Foreign Investment Code states:

"The Ministers of Foreign Affairs of the Member Countries of the Acuerdo de Cartagena at their first meeting held in Lima, ratified the conviction stated at the Consensus of Vina del Mar that "economic growth and social progress are responsibilities of the people of Latin America on whose efforts depends the achievement of their national and regional objectives"; restated their decided support "to the full sovereign right of nations to freely dispose of their natural resources"; adopted as a common policy "that of giving priority to truly national enterprise and capital of the Member Countries in the economic development of the subregion "and recognized that foreign capital investment and the transfer of foreign technology constitute a contribution necessary for the development of the Member Countries and "must receive assurances of stability to the extent that they really constitute a positive contribution." 57

56 Ibid.
Below are listed the objectives and the main provisions of the Andean Investment Code

The Andean Investment Code

The main objectives of the Andean Foreign Investment Code are as follows:

1. The strengthening of national enterprises for the purpose of making them capable of active participation in the subregional market.

2. To foster joint enterprises, "associating domestic and third-country capital, local (subregional) and foreign resources, in order to achieve a multi-national scale development." 58

3. To strengthen the negotiating capacity of the member countries in relation to other states, who "supply the capital and technology and the international agencies involved in these matters." 59

The main points covered by the Andean Foreign Investment Code are as follows:

1. It classifies investment, both foreign and national;

2. It imposes restraints upon entry of new foreign investment;


59 "Common Treatment...," op. cit., p. 341.
3. It requires the divestment by existing foreign firms down to national levels or joint ventures in order to enjoy the advantages of the custom duty liberalization program of the common market;

4. Certain sectors of the economy that are adequately served by existing enterprises are closed to foreign investments;

5. The re-exportation of capital and the remittances of profits are regulated;

6. The importation and the use of technology, know-how, trademarks, and patents is restricted.

**Classification of Investments**

The Andean Foreign Investment Code classifies the ownership of an enterprise as follows: A national enterprise is defined as having more than 80 percent of the capital belonging to national investors; a mixed enterprise is 51 percent to 80 percent owned by national investors, and a foreign enterprise is one having less than 51 percent of its capital in the hands of nationals. The Andean Code requires that "crucial percentages be reflected, in the opinion of the national authorities, in the technical, financial, administrative, and commercial management of the enterprise." 60

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The term national investor includes the State, the national individual, national nonprofit organizations, a national enterprise as defined above and "aliens with more than a year of consecutive residence who renounce their rights to repatriate invested capital and to transfer earnings." 61

Restriction on the Entry of New Foreign Investment

"New investment" is defined by the Andean Foreign Investment Code as "any investment made after January 1, 1971, in new or existing enterprises." 62 The restrictions on new investment are as follows:

1. The investment must be made in development-related enterprises;
2. The new investment must be directed to an activity not adequately covered by existing enterprises;
3. The new investment cannot be made by the buying of shares, participation, or rights of national investors; and
4. The new investment cannot be made in a sector closed to foreign capital.

The new foreign investment may be made in "national" or "mixed" enterprises. New foreign investment is not permitted

61 "Common Treatment...," op. cit., p. 341.
62 Ibid., p. 342.
in the "public services, insurances, commercial banking, and other financial institutions; domestic transportation, advertising, radio-tv, newspapers, magazines, nor in enterprises dedicated to the domestic marketing of products of any type." 63

The Fade-Out or Divestment

The Andean Foreign Investment Code's provision for the transformation of "foreign" enterprises to "mix" or "national" enterprises are as follows.

1. In order to achieve full benefits of the common market free trade, the "foreign" enterprise has the option to be transformed to a "mixed" enterprise;

2. "Foreign" enterprises presently engaged in "commercial banking and other financial institutions, domestic transportation, advertising, commercial broadcasting, television stations, newspapers, magazines, and any enterprise engaged in the domestic marketing of products of any kind, will have to become 'national' investors." 64

Those "foreign" enterprises who have the option to be transformed into "mixed" enterprises have 15 years to achieve it in Chile, Peru, and Colombia. Those "foreign" enterprises in Bolivia and Ecuador have 20 years. The

63 Ibid., p. 352.
64 Ibid.
reduction of the foreign element must occur beginning the
date the Code becomes effective. Those foreign enterprises
who have to become national enterprises, will have to
offer at least 80 percent of their stock shares for sale
to national investors in a term not exceeding three years,
to run as of the date the present treatment comes into force.65

The transformation of "foreign" enterprises to "mixed"
or to "national" enterprises will be done through the "sales
of stock, shares, or rights to individuals, to the State,
or to state enterprises of the receiving country."66 These
sales will be controlled by a pertinent national authority.
The value of the stocks, shares, or rights shall be determined
at the time of the sale.

The "mixed" enterprise mentioned above in which the
national ownership own and control 51 to 80 percent of the
company may now be referred to be composed of private
individuals as opposed to the new "mixed" enterprises
governed by Decision 47 which are State-foreign investor
joint ventures. This new addition to the Andean Foreign
Investment Code states that a "mixed" enterprise may exist
even if national participation is as low as 30 percent
of the equity capital, provided that the percentage of

65Ibid.

66Oliver, op. cit., p. 778.
equity is held by the State, state entities or state companies, and the control of the company lies in the national authority of these bodies.

There are a couple of exceptions to the divestment provision. One, if the "foreign" firm (which is not engaged in any of those activities such as banking, finance, or in any of those activities which have to become "national" within three years) does not choose to take advantage of the enlarged market offered by the subregion, it does not have to divest. The other exception is, if the firm exports at least 80 percent of its production to third countries (outside the subregion) it does not have to transform, but the remaining 20 percent or less if sold in the subregion will not benefit from the trade liberalization measures of the Andean Common Market. 67

Capital Repatriations and Remittances of Profits

The provisions for the repatriation of capital and remittances "are not extreme, as foreign exchange systems go." 68 Profit remittances are limited to 14 percent annually of the total amount of the direct investment.

67 Oliver, op. cit., p. 779.
68 Ibid.
Direct foreign investment is defined as: "contributions coming from abroad owned by foreign individuals or firms to the capital of an enterprise in freely convertible currencies, industrial plants, machinery, or equipment with a right to re-export their value and to remit profits abroad.) In addition, direct foreign investments are those investments in local currency originating from resources which have a right to be remitted abroad." The foreign investor may re-export the amount of capital initially invested and registered, profits of the sale of the enterprise and the amount of reinvested earnings. Such reinvestments, however, are limited to 5 percent a year unless a greater amount is authorized.

Restrictions on the Importation and Use of Technology Know-How, Trademarks and Patents

The Andean Foreign Investment Code intends to stimulate the development of subregional technology. The Commission is to approve a "program directed toward promoting and protecting the production of subregional technology, as well as the adaption and assimilation of existing technologies." A competent national authority must approve and evaluate the price to be paid on all contracts for the importation of technology.

69"Common Treatment...", op. cit., p. 341.
70Oliver, op. cit., p. 780.
technology or the exploitation of patents and trademarks. The national authority will also evaluate the probable profitability to be derived and the overall impact regarding industrial development. Each contact must contain an explanation regarding how the transfer is to take place, the contractual value for each of the elements involved in the transfer of technology, and determine the period in which such contract will be in force.

Intangible technologies will have a right to payment of royalty authorized by the national agency. However, it may not be considered as a contribution to capital. If such technology is transferred from a parent company to some affiliate of the same firm, no payment of royalties shall be authorized nor will the foreign investor be allowed a tax deduction for this reason.71

Licensing agreements for the exploitation of foreign trademarks in the subregional area may not contain such restrictive clauses as "prohibition or limitation to export or sell products manufactured under the respective trademarks or similar products in some given countries...obligation to use raw materials, intermediate goods, and equipment supplies by the owner of the trademark or his affiliates..."72

71 Oliver, op. cit., p. 779.
72 "Common treatment...," op. cit., p. 346.
Restrictions on Borrowing

Regarding domestic credit, foreign enterprises shall only have access to short-term credit. The credit shall be given under the terms which the Commission may decide and upon the approval by the Board. The member governments are prohibited from guaranteeing any foreign indebtedness in any way, including those from international organizations, unless the state participates in the enterprise.
The approval of the Andean Foreign Investment Code on December 30, 1970, by the member countries of the Andean Common Market did not end private opposition from Colombian and Ecuadorean businessmen. Dissatisfied with the more moderate draft than the original, private interests in these two countries flatly rejected it. In both Ecuador and Colombia, private businessmen emphasized the detrimental effect of the Code on private enterprise and foreign investment in the area.¹

At a special session of the Andean Commission, the Colombian government supported by the Ecuadorean government was able to obtain a last-minute modification of the Code.² The modification, known as Decisions 37 and 37a, were: the elimination of the preferential state option clause, foreign investors were given normal access to short-term credit and the date dividing the old from the new foreign

¹Armstrong, op. cit., p. 1609.
²Ibid., p. 1611.
investments was moved from December 31, 1970, to June 30, 1971. By June 30, 1971, the modified Code was promulgated in each of the member countries.

The experiences with the Code in the Andean countries (from 1970 to 1976) has been far from uniform implementation. Some of the member countries have delayed implementation; others have implemented the Code only partially. The most faithful and consistent country in implementing the Code has been Peru. After serious disagreement with the other member countries, Chile withdrew from most of its obligations under the Andean Common Market on November, 1976. In addition, the Code has been modified, keeping the original spirit but becoming a more flexible set of regulations for foreign investment. All these occurrences will be examined below.

Implementation of the Code in Each of the Andean Countries 1971-1975

Bolivia

Of all the member countries of the Andean Common Market, Bolivia has been the one which has resisted the implementation of the Andean Foreign Investment Code.3 The reason is fear the Code will make it difficult to

3Fouts, op. cit., p. 540.
attract the new foreign investment that they will need in order to continue their economic growth and participate meaningfully in the integration process.

Bolivia enacted the Andean Foreign Investment Code through Decree 9798 issued on June 30, 1971. However, a preface to that decree notes that foreign firms who wish to market their products for Bolivian market will not have to divest. The preface also notes that some of the Code's restrictions are in conflict with Bolivia's priorities for foreign investment and that adjustment to some of the Code's provisions would have to be made. In April, 1974, a decree was issued exempting both the banking and financial institutions from the provisions of the Code.

The basic regulation currently in practice in Bolivia is Decree Law 10045 of December 1971. This legislation gives incentives to both foreign and domestic investors. Divestment is required of only those investments in "basic and strategic" industries (metallurgy, iron, steel, and petroleum). These industries are reserved for a partnership with the state. The state would own 80 percent of the

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4Danino, op. cit., p. 642.
5Fouts, op. cit., p. 541.
6Ibid.
enterprise and the foreign investor must have minority ownership within twenty-five years.

The majority of new investments in Bolivia has been in the extractive industry since 1971. This industry falls under a special sector in the Andean Foreign Investment Code and qualifies under a different treatment as an enterprise which exports 80 percent or more of its production outside the Andean countries. However, two major new investments outside the extractive industry have been attracted by the more lenient practice of the Code.

One of these is to be made by Dresser Industries, a United States firm. The Dresser Investment will go into partnership with a Bolivian company and the Andean Development Corporation. This investment is for the production of three cone-type drill bits for the petroleum industry. The production of these drill bits will be allowed duty free entrance to the other Andean countries. In addition, the Andean countries have agreed to discourage similar production in their countries and to close production and foreign investment in that product until 1987. The Dresser Industries will have initial ownership of 60 percent of the firm and tentative plans for a fading to a minority position within ten years are being established.  

7 Ibid., p. 542.
8 Ibid.
9 Ibid.
A Swedish firm, Atlas Copco, has agreed to make an investment of $10.7 million (U.S.).\footnote{Ibid.} Atlas Copco will go into partnership with Bolivian investors and the Andean Development Corporation in the manufacture of air compressors and pneumatic hand-held rock drills. Atlas Copco will begin production with 90 percent ownership of the firm and intends to take the full term allowed to divest to minority ownership.\footnote{Ibid., p. 543.}

**Ecuador**

The Ecuadorean government enacted the Andean Foreign Investment Code as national law by Decree 974 on June 30, 1971.\footnote{Danino, op. cit., p. 642.} This decree was followed by Decree 1029 on July, 1971, stating that Ecuador will apply Article 44 of the Code which gives the option to the receiving country in applying different rules under special circumstances. The application of this provision led to a more lenient attitude towards foreign investment.

However, in April 1975, Ecuador adopted a stricter stand towards foreign investment. By Resolutions 01 to 05 of the Consejo Superior de Comercio Exterior, previously exempted sectors were now reinterpreted.\footnote{Business Latin America, April 23, 1975, p. 136.}
important innovations included in Resolutions 01 to 05 were as follows.

1. Construction firms for urban residential and office building were added to the list of industries that must become 80 percent locally owned. (This industry was not included in the Andean Foreign Investment Code.)

2. Foreign-owned branch operations can only be established on a temporary basis in order to fulfill a specific project, and

3. Marketing firms will become subject to the regulations as stated in the Code.

4. Capital increases in new investments in other companies in Ecuador were to be made out of the 14 percent remittance rights under the Code. In addition, new foreign investment in the banking and finance sectors were prohibited.14

In March, 1976, the Ecuadorian government reinterpreted the provisions of the Andean Foreign Investment Code.15 The government reversed Resolution 05, which stated that any capital increase would have to be made out of the 14 percent remittance-rights. Now, the Ecuadorian government will permit foreign investors to increase the capital of their Ecuadorian firms either by capitalizing

14Ibid.

reserves or by using undistributed dividends. Resolution 1012 states that foreign investors cannot under any circumstances participate in the capital of banks, insurance companies, or other financial institutions. The participation of foreign investors in this sector is now prohibited.\textsuperscript{16}

However, most of the new investments in Ecuador since 1971 has been in the extractive industries. There have been some major new investments in industries covered by the Andean Foreign Investment Code. A Swiss firm, the Societe Horlogere Andean-Suisse, in partnership with the Ecuadorean state finance corporation, the Andean Development Corporation, and private Venezuelan and Peruvian investors, will start manufacturing watches.\textsuperscript{17} The Swiss firm will have 51 percent ownership in the $4 million (U.S.) watch industry.

Direct foreign investment in 1975 was about $50 million (U.S.)\textsuperscript{18} This amount included an investment by a Swedish company in a joint venture for the production of reflectors and soldering lamps and Finnish participation in a mining venture. Most of the new investments are on a small-scale basis and are directed mainly towards the local or regional Andean market.

\begin{itemize}
\item \textsuperscript{16}Ibid.
\item \textsuperscript{17}Fouts, op. cit., p. 543.
\item \textsuperscript{18}Business Latin America, April 21, 1976, p. 124
\end{itemize}
Colombia

Of all the Andean governments, Colombia is the one which encountered the most difficulty in enacting the Andean Foreign Investment Code as national law. The situation in Colombia became so difficult that even the validity of the adoption of the Andean Pact came to be questioned. After a long period of litigation, President Pastrana of Colombia passed Law 8 in which Colombia officially restated its adherence to the Andean Common Market.\(^{19}\) This law also gave President Pastrana extraordinary authority to issue Decree 1900 on September 15, 1973. Decree 1900 enacted the Andean Foreign Investment Code as national law in Colombia.

The Colombian government adopted the Andean Code according to its own national priorities. On December 23, 1973, Decree 2719 was issued which exempted banks, commercial financial institutions, and companies engaged in domestic marketing from the Andean Code.\(^{20}\) On December 31, 1973, Decree 2788 exempted the extractive industries. On March 7, 1974, new regulations for foreign banking operations were adopted instead of those in the Code.

\(^{19}\) Danino, op. cit., p. 642.

\(^{20}\) Fouts, op. cit., p. 545.
The Colombian National Planning Department issued the results of a study on foreign investments in Colombia in September 1974. This study states that in 1972 total foreign investment dropped almost 50 percent from the 1971 figure. In 1973 reinvestments and new investments totaled $62 million (U.S.), an increase over the 1972 figure. In the first seven months of 1974, the investment figure was $72 million (U.S.) of which 33 percent was new investment. The low figure for 1972 and 1973 was a reflection of the uncertainty over Colombian's position on the Andean Investment Code.

Overall, manufacturing companies in the area have been willing to accommodate their operations to the Code in Colombia. As an example, Plymer International, which manufactures a variety of plastic packaging and synthetic textile products, has begun selling part of its equity to three private Colombian nationals and is planning to divest to a minority position according to the deadline of the Code.

In March 1975, Colombia adopted a stricter stand towards foreign investment. Previously exempted sectors, such as financial institutions and domestic marketing companies, now fell under new regulations. In late 1973,

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21 Ibid.
President Misael Pastrana had exempted the banking and financial sectors and the domestic marketing companies from regulations, as well as the natural resources development sector. The Lopez administration will now permit foreign-owned financial institutions to become "mixed," that is, 51 percent ownership in the hands of Colombians.23 The Andean Code is much stricter, requiring ownership of 80 percent in the hands of nationals.

In relation to marketing companies, Decree 169 provided that all new marketing companies selling Colombian products must have at least 80 per cent of the ownership in national hands.24 This rule places limits on new foreign investment going into existing firms that market local products.

Venezuela

Although Venezuela was a signatory of the Declaration of Bogota which initiated the negotiations for the establishment of the Andean Common Market, she did not sign the Cartagena Agreement in May, 1969. The Venezuelan government was in favor of joining in a subregional group, but opposition came from private interests represented by the FEDECAMARAS (Federacion Venezelana de Camara y Asociaciones de Comercie y Produccion).25 The Venezuelan private sector opposed

23 Ibid.
24 Ibid.
the tariff cutting and industrial allocation programs in addition to the restrictions of the Andean Code.

However, in February 1973, Venezuela joined the Andean Common Market and the Andean Foreign Investment Code was implemented through Resolution 62 and 63 in April 29, 1974. In an unexpected move, Venezuela took a stricter stand than expected. Most analysts were expecting a more liberal attitude by the Venezuelan government towards foreign investment in the area.26

Venezuela chose to interpret the Code regulations as the minimum standards rather than maximum standards for foreign investment.27 In March 1975, in Presidential Decree 746, Venezuela established additional restrictions regarding clauses that must be dropped from contracts in relation to existing and new technology, patents, and trademarks.28 Going beyond the Andean Foreign Investment Code's restrictions, the forbidden clauses are as follows:

Those which

1. prohibit production and sale, once the contract has expired, of products that were under the technology agreement;

26 Armstrong, op. cit., p. 1613.
28 Business Latin America, March 19, 1975, p. 95.
2. forbid the continued use of the technology once the contract ends;
3. require use of specific quality controls as a proviso for using the technology;
4. prevent the use of trademarks similar to those of the licensor after the contract terminates;
5. call for royalty payments even when the technology goes to the user through a sales contract;
6. stipulate that the user must pay the local tax on the licensor's royalties and fees; and
7. require the user to give irrevocable authorization to the supplier to sell the products.

Companies had until December 31, 1975, to update their contracts with the new regulations.29

Peru

Of all the member countries of the Andean Common Market, Peru has been since the beginning the most consistent applier of the Andean Foreign Investment Code.30 The Peruvian government enacted the Code as national law through Decree-Law 189000 on June 30, 1971. This decree contained an indication of stricter national regulations than those of the Code in relation to the extractive industries, banking, and communication sectors.31

29 Ibid.
30 Armstrong, op. cit., p. 1622.
31 Fouts, op. cit., p. 551.
The Peruvian government continued to issue decrees in relation to the implementation of the Code. On October 19, 1971, Decree-Law 18999 established a competent national body for the implementation of the regulations of the Code. This decree also required the divestment of Foreign ownership to minority position even if they do not wish to enjoy the tariff benefits of the Andean regional market. Decree-Law 1962, on January 6, 1972, required the divestment of foreign ownership to not more than 49 percent equity. Decree-Law 19043, issued on November 25, 1971, prohibited new foreign investment in the banking sector and required the divestment of foreign ownership in this sector to no more than 20 percent equity. The transfer of foreign ownership to nationals was to be done within sixty days of the issuance of the decree, not within three years of the effective date of the Andean Foreign Investment Code as specified in it. Decree-Law 19470 sets limits on credit available to foreign investors.

Most of the new foreign investment in Peru has been in the extractive industries. The terms under which the foreign investor has invested in Peru has been that of Decision 47. This decision is not part of the Andean...
Foreign Investment Code but is a decision of the Andean Commission. Under this decision, a foreign entrepreneur might invest in an extractive industry and have 70 percent equity if he is a partner with the state. This division of ownership is permitted only if the state has decision-making authority over the action of the firm.

In the manufacturing sector, foreign firms have been reluctant to invest in Peru. However, in spite of the restrictive regulations, Peru has been able to attract some foreign companies willing to enter into joint ventures in order to produce goods for the Andean regional market. The most notable new investments have been made by Bayer (acrylic fibers), Massey Ferguson (tractors), Perkins/Volvo (diesel engines), Motokov (motorcycles), Metal Oriente (steel tubing), Uzinexportimport (machine tools), and Smith Tool (drill bits).³⁵

The West German Bayer investment was the first, and remains the largest new investment in Peru since the formation of the Andean Common Market and the ascent to power of the current military government of Peru.³⁶

³⁵Armstrong, op. cit., p. 1624.

When the contract was written the Andean Foreign Investment Code had not yet been established. With the creation of the Code, the Bayer Company agreed to change the previous structure of ownership. Bayer Industrial S. A. was accorded a strategic classification. In conformity to the new laws, therefore, Bayer now owns 60 percent of the firm, 30.14 percent is owned by the state, and 9.8 percent is owned by private Peruvian investors. The new contract gave the state the basic decision-making authority, in compliance again with the new regulations.

Massey Ferguson Ltd. of Canada is in partnership with InduPeru (the Peruvian government industrial entity) for the production of small tractor models. Massey Ferguson Ltd. owns 49 percent of the equity and Induperu owns 51 percent. The state has basic decision-making authority.

The Perkins (British)/Volvo (Swedish) joint venture with Induperu is for the production of diesel engines for tractors, trucks, and buses. The mixed enterprise is to be 52 percent owned by Induperu and 24 percent each by Perkins and Volvo respectively. The Peruvian government also has the same basic decision-making authority in the firm.

37 Ibid., p. 12.
38 Ibid., p. 18.
The Metal Oriente, S.A., investment is primarily for the production of steel tubing for the oil pipeline to run from the jungle area of Peru to the coast. This is one of the most important among some of the investments made by Japanese investors in Peru. The equity distribution is similar to the one Massey Ferguson and Perkins/Volvo had made with the Peruvian government. The state also has the basic authority in the decision-making process.

Uzinexportimport (machine tools), a joint venture of Rumanian investors with the Peruvian government, follows the equity distribution of the Massey Ferguson Perkins/Volvo and Metal Oriente investment. In addition, Uzinexportimport, as well as those investments mentioned above, will have domestic monopoly rights within Peru and possibly within the Andean regional market if Peru receives the automotive sectoral plan production.

The Motokov (motorcycles) investment is a joint venture of Czechoslovakian investors and a private Peruvian company. The Smith Tool (drill bits) is a direct investment by a United States Company with a private Peruvian citizen. These two joint ventures are in accordance with the regulations of the Code.

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40 Armstrong, op. cit., p. 1624.
41 Armstrong, op. cit., p. 1624.
Although in general foreign investment in Peru has declined since the implementation of the Code, some foreign investors have still been willing to show an innovative and flexible attitude to the new investment climate. One of the key incentives for foreign investors in Peru has been the monopoly rights within the domestic market and the possibility of penetrating the Andean regional market.\footnote{Council of The Americas, op. cit., p. 37.}

**Chile**

Chile withdrew from most of its obligations to the Andean Common Market. The withdrawal of Chile was official in November 1976, and will be examined in the next section of this chapter. In order to understand the action by Chile it is necessary to examine Chile's experience with the Andean Code.

Chile enacted the Code by Decree Law 482, issued on June 30, 1971. The Chilean Controller issued a ruling that, since the enactment of the Andean Foreign Investment Code meant a change in the national law, it required its submission to Congress. However, the Chilean Constitution gives the President the right to issue a law over the objection of the Controller if the President has the unanimous backing of his cabinet. This is the way President Allende enacted Decree Law 482. However, implementing
regulations were never issued, possibly because Allende's nationalization program was much stricter than those regulations of the Code.\textsuperscript{43}

The level of direct foreign investment in Chile dropped radically in the period 1971-1974. The main reason for this drop was the economic situation and Allende's stand in relation to foreign investment rather than the regulations of the Code.\textsuperscript{44} In spite of the situation in Chile, however, some foreign investors were interested in negotiating with the Chilean government.

The three most significant investments were those of the French firms Citroën and Peugeot and the Spanish firm Pegaso.\textsuperscript{45} The Citroën investment was to be in a joint venture with CORFO (the Chilean development agency) signed in August 1972. The enterprise was to be owned 51 percent by CORFO and 49 percent by Citroën. The investment was for the production of one of the small Citroën models, and Citroën was obligated to import into France Chilean-made motors, crankshafts, gear boxes, auto electrical components and insulated copper wire. The profit guarantee was expected to vary between a minimum of 5 percent to a maximum of 10 percent.

The Peugeot-CORFO contract established 60 percent of its ownership to CORFO and 40 percent to Peugeot.\textsuperscript{46} The

\textsuperscript{43} Ibid.

\textsuperscript{44} Fouts, op. cit., p. 547.

\textsuperscript{45} Council of The Americas, op. cit., p. 29.

\textsuperscript{46} Fouts, op. cit., p. 547.
firm was to produce medium sized Peugeot cars and automotive parts. Peugeot was committed to export to France Chilean-made motors, gear boxes, differentials, and auto electrical equipment for a total of about $42 million. Peugeot was also committed to export about $20 million in automotive parts to non-Andean nations. A 6.5 percent profit which could be remittable was guaranteed.

The Spanish firm Pegaso also entered into a joint venture with CORFO. This enterprise was for the manufacture of trucks and diesel motors for trucks and buses. The preliminary contract was signed in October, 1972. CORFO was to own 51 percent of the equity and Pegaso 49 percent. Pegaso was to receive 6.5 percent guaranteed remittable profit.

In spite of the strict investment climate in Chile, these three proposed investments show willingness on the part of some foreign investors to enter into agreements. The main incentive seems to have been the possibility of the growing market in Chile.

In September 1973 a military government took over the presidency. The military government rejected the economic policies of former President Allende regarding the policy of state-ownership and began serious efforts to

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47 Council of The Americas, op. cit., p. 30,
48 Ibid., p. 37,
attract foreign investment. Although the military government pledged to keep all of Chile's international commitments, they saw the Andean Foreign Investment Code's regulations as a hindrance to their economic goals. Accordingly, the new government issued its own investment law, Decree Law 600 of July 13, 1974. This decree, in effect, contradicted all the regulations of the Code in all its aspects. The decree provided for all new foreign investors to negotiate a contract with the Committee on Foreign Investments. Foreign investors were guaranteed treatment no worse than those accorded to national investors. Decree Law 600 made no provision for the gradual transformation of foreign companies into national or mixed enterprises. In addition, no profit remittance limits were made. In essence Chile was not implementing the Andean Foreign Investment Code.

Chile's action was followed immediately by a strong reaction from the other five members. Declaring Decree Law 600 to be incompatible with the "Common Regime for the Treatment of Foreign Capital and on Trademarks, Patents, Licenses, and Royalties," and in violation of the provisions of the Cartagena Agreement Article 27, the representatives

49 Fouts, op. cit., p. 547.
50 Armstrong, op. cit., p. 1612.
of Bolivia, Colombia, Ecuador, Peru, and Venezuela invited Chile to adjust its internal legislation in compliance to the Andean Code. 51

In response, the Chilean representative defended Decree-Law 600, claiming that it did not contradict the spirit or the letter of the Andean Foreign Investment Code. The other member countries were not persuaded of Chile's position, however. In November 1974 Chile officially recognized the Andean Foreign Investment Code as being in force through Decision 746. 52 However, its government was to show an increasing desire to change some of the provisions of the Code. This was just the beginning of Chile's discontent and this dissatisfaction eventually culminated in her withdrawal from most of the obligations of the Andean Group.

Crisis: Disunity and Withdrawal of Chile

In December 1975 the first major crisis among the members of the Andean Group occurred. 53 The confrontation divided the Group in two regarding the postponement of the deadline of trade liberalization in the area. Chile and

51 Fouts, op. cit., p. 548.
52 Fouts, op. cit., p. 549.
Colombia, on one side, argued that the original deadline for trade liberalization be fulfilled. Venezuela, Ecuador, Bolivia, and Peru maintained that, due to the delay in joint industrial programming, it became necessary to postpone the original deadline for the freeing of trade so the basic mechanisms of the integration movement could work in harmony. 54

The reason for the divergence of opinion seemed to have been the fact that Chile and Colombia had better developed industrial structures than their partners. In addition to the discrepancy over the deadline of the freeing of trade, Chile and Colombia insisted on a low common outer tariff policy. Peru and Venezuela wanted a high common tariff in order to protect the existing local industry and jobs.

Chile continued to press for new demands. This time she wanted to be excepted from a provision of the Code, in order to sell to foreign investors those companies taken over by the administration of Salvador Allende. The Code expressly prohibited the acquisition of local firms by foreigners. However, in an effort to bring reconciliation, the Andean Commission authorized Chile to sell foreign investors the companies purchased by the Chilean Development Corporation, CORFO. 55

54 Ibid.
55 Business Latin America, April 28, 1976, p. 130.
Through a series of negotiations, the member countries were able to reconcile their points of view in relation to the deadline of the freeing of trade and in an agreement concerning the common external tariff. Furthermore, in an unprecedented move, the Andean Commission granted Chile a special modification of the terms of the Andean Foreign Investment Code. All these actions demonstrated a willingness to compromise and to be flexible, in order to pursue their integrative goals.

However, Chile continued demanding further revisions of the Code, including revision of the following terms: (1) the restriction on profit remittances; (2) the restriction on the sale of state-owned companies to foreign interests; and (3) the requirement for transformation of foreign-owned companies into national or joint enterprises.  

Now, Bolivia and Ecuador supported Chile's position, being the two least industrialized members of the Andean Common Market, they had been in favor since the beginning of less strict regulations for foreign investment. Furthermore, Bolivia and Ecuador had been the two countries which had had the most flexible implementation of the Code.


57 Business Latin America, June 2, 1976, p. 171.
Their position was that the necessary modifications would not undermine the basic spirit of the Code.

Colombia had not taken any initiative in the relaxation of the regulations of the Code. Now, however, the country's industrialists having become aware of their government's disenchantment over the Code, began to unite in order to pressure for changes. President Lopez Michelsen defended Colombian participation in the Andean Group but expressed the belief that the economic situation faced by each of the members of the Andean Common Market made it necessary to revise the investment rules. 58

The two strongest defenders of the Code in the past, Venezuela and Peru, apparently felt now that the basic principles—majority local ownership and close controls of foreign investments—were already so established that the Andean region could afford a more lenient attitude towards foreign investments. 59 Both countries defended the basic philosophy of the Code and at the same time accepted some flexibility in its application.

While the other members were willing to compromise and make some changes in the investment rules, Chile began

58 Ibid., p. 171.
59 Ibid., p. 172.
to demand the virtual abolition of the Code. 60 The other members refused to abolish the investment rules. They all agreed that some modifications were in order, but the basic philosophy of the Code was to remain.

Chile's intransigence regarding the Code became so acute that other mechanisms of integration became affected. In a July, 1976 meeting held in Lima, the agenda was to negotiate a proposed amendment to the Cartagena Agreement.61 The amendment, Decision 100, dealt with the postponement of the group's free trade deadline from 1980 to 1982. Chile refused to take any action regarding this amendment until the question of the Andean Foreign Investment Code was settled.

In order to break the deadlock posed by Chile, the other members proposed an amendment to Decision 100. The amendment stated that Decision 100 would go into effect as soon as it was ratified by each of the member governments. If Decision 100 were not ratified by all the members within 60 days, the countries that had signed would then negotiate the rights and obligations of the Andean Common Market with the nonsigners. The amendment was approved by five of the six members with Chile abstaining. In effect, Chile had

60 Business Latin America, August 18, 1976, p. 257.
61 Ibid.
sixty days in which to decide whether to stay in the Andean Group or to withdraw from it. 62

In those sixty days, the other five members made all efforts to avoid Chile's withdrawal.63 The five members agreed to make important modifications in the Code and adopted a more lenient position on the common external tariff. The principal changes involving the Code were as follows.

1. The profit remittance limit was changed from 14 percent to 20 percent, with member countries having the option to make it higher if they wish;

2. Foreign companies may increase profit reinvestment in the countries in which they operate from 5 to 7 percent;

3. Capital flows from member countries will be treated as national investment throughout the region;

4. Investments by the international finance organizations to which member countries belong, as well as others specialized in promotion and development, will be considered 'neutral capital' and not subject to restrictive laws." 64

Chile did not accept the compromise and modifications of the Code arrived at by the five other members. Chile's

62Business Latin America, August 18, 1976, p. 257.


64Comercio Exterior de Mexico, op. cit., p. 402.
objective was the virtual elimination of the Code and a lower common outer tariff. Chilean sources stated that a low common external tariff was necessary to achieve their economic objective of reducing domestic inflation by opening the economy to imports of cheaper raw materials. 65

The other members of the Andean Common Market insisted that Decision 100 already contained the concept of a minimum and maximum level of tariff protection that allows the individual country some latitude. 66 Within Decision 100, Chile would be free to set the lowest permissible level while the other members desiring more protection could choose the maximum allowable external tariff. Chile now changed its demand from previous 20 percent to a low 12 percent for a common external tariff. This change of position demonstrated an unwillingness to seek meaningful changes. 67

Regarding the Code, Chile actually wanted a radical change in the terms. The Chileans saw the Code as contrary to their national objective of economic recovery. The government thought that once the Code was abolished, foreign investment would increase in Chile. Chile's refusal to accept the conciliatory move by the other five members signalled that her withdrawal was imminent.

66 Ibid.
67 Ibid.
On October 30, 1976, Chile officially withdrew from the Andean Group. All its rights and duties deriving from the Cartagena Agreement terminated. The only ties existing between Chile and the Andean Group concerned Decision 40, 46, 56, and 94 relating to the formation of multinational Andean enterprises, use of the subregional road network for heavy transportation and the right to come under Group regulations regarding double taxation.

In this way, the crisis which had brought about disunity and threatened the integration movement of the Andean Common Market was finally ended. The five members had attempted for months to accommodate Chile's demands. These demands had stopped the negotiations of other important agreements and the integration movement was not only stopped but was threatened.

The five members now expressed their determination to continue with their integrative efforts with renewed energy and adopted a series of decisions in order to end the crisis that had been unsettling the Group since December 1975. Decision 103, which modified the Andean Foreign Investment Code, was adopted. It raised the ceiling of profits that can be remitted annually from 14 to 20 percent and the automatic reinvestment level from 5 to 7 percent, among the other modifications expressed previously.

68 Ibid.
A well known Chilean economist, Orlando Saenz, expressed his disapproval of Chile's decision to withdraw. He stated that Chile's withdrawal from the Andean Group would cause the country serious economic, political, and international injury. Saenz called Chile's official decision an example of extreme short-sightedness. He states:

"...in economic terms, Chile will lose the only privileged market open to certain industrial sectors which, on the basis of it, were beginning to escape from the disaster produced by contraction of the domestic market and the tariff collapse caused by our economic policy...Perhaps the most amazing thing about this step is that it was so unnecessary; the good will of the other members reached such extremes that our country would have obtained all the flexibility it wanted on points considered basic."  

On October 31, 1976, the day after Chile withdrew from the Andean Group, President Carlos Andres Perez of Venezuela sent the following message to the Chiefs of State of Bolivia, Ecuador, Colombia, and Peru:

"With confirmation of Chile's withdrawal from the Cartagena Agreement, the Andean Group resolved an arduous prolonged crisis in which it had been involved for more than a year. This event, though deplorable because it means the departure of a country whose people have made a significant contribution to the cause of progress and Latin American fraternity, cannot be regarded as a negative

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70 Comercio Exterior de Mexico, "Chile's Withdrawal is Consummated," 22(December, 1976), p. 475.

71 Ibid.
factor if analyzed in the light of its necessary temperality and the no less important fact that five countries—Bolivia, Colombia, Ecuador, Peru, and Venezuela—have decided to move ahead toward integration after having exhausted all efforts to prevent the withdrawal of one member, and to remain united without weakening the basic objectives of Andean integration. Venezuela unreservedly approves the decision adopted yesterday at Cartagena Agreement headquarters and trusts that the vigorous effort which from the first has characterized the Andean process, now renovated with the agreement reached, will continue to unite forces for consolidation in the near future of harmonious, balanced development to ensure the greatest well-being for our peoples and provide the necessary stimulus to reinforce the LAFTA for the essential aim of achieving the supreme target of Latin American integration." 72

In Colombia, Jorge Valencia Jaramillo, considered to be one of the founding fathers of the Cartagena Agreement, expressed his regret at Chile's withdrawal. However, Jaramillo felt that the decision of Chile will strengthen the Andean integration movement. The Minister of Integration of Ecuador, Carle Montano, commented that the departure of Chile resolved the crisis that had affected the Andean Group for more than a year. "We are happy to go ahead without further problems." 73

72 Ibid., p. 476.
73 Ibid.
CHAPTER III

CONCLUSION

The Andean Common Market and the Andean Foreign Investment Code

In 1960, the United Nations Economic Commission for Latin America (ECLA), made a study of the economic situation of the Latin American region. The conclusion:

"Latin America, however great the external assistance it receives, however high the rate at which its exports expand, and they cannot do so very rapidly--will be unable to regain the rate of growth it achieved in the ten post-war years, unless it makes a sustained effort to establish within its own territory, the capital goods industries of which it is in such urgent need today, and which it will require on an enlarged scale during the next quarter of a century....In order to produce these capital goods and develop all the intermediate goods industries required in order to launch these highly complex industries....Latin America needs a common market."¹

In 1960, two integration groups were formed: the Central America Common Market (CACM) and the Latin American Free Trade Association (LAFTA). The Central American Common Market includes all the nations of Central America except Panama. The Latin American Free Trade Association includes all the major Latin American countries.

LAFTA failed to provide the dynamic stimulus among the nations. Overall, negotiations stagnated and the "Big Three," Argentina, Brazil, and Mexico clearly dominated the association. The domination of the "Big Three," and the stagnation of LAFTA, led Presidents Eduardo Frei of Chile and Carlos Lleras Restrepo of Colombia to propose to the west coast nations of South America the formation of a bloc within the LAFTA framework. In May 1969, Bolivia, Chile, Colombia, Ecuador, and Peru signed the Cartagena Agreement and established the Andean Common Market.

A more ambitious integration scheme than LAFTA, the Andean Common Market's purpose is the promotion of industrial growth which will not only raise the standard of living within their countries but will also enable them to deal in more equal terms with the "Big Three" of LAFTA. Among the important mechanisms to achieve this industrial growth is the controversial Andean Foreign Investment Code.

The inclusion of a set of regulations for the control of foreign investment in the Andean region was considered necessary in their industrial programming. The Andean countries agreed to harmonize their economic and social policies. Within the harmonization of their economic policies, they established the co-ordination of their industrial programming and sectoral plans. These two
important mechanisms would have been impossible to implement without foreign investment control.

In addition, studies made by experts in Latin American economics questioned the value of foreign capital's contribution to the development of the area. Therefore, the Andean countries, aware of both the negative and positive effects of foreign capital, wanted foreign capital, but in a direction which they felt would contribute toward their developmental goals.

The concept of "dependencia," both in the international and regional experience, further supported the necessity of the inclusion of regulations for foreign capital in the area. The Andean countries in the early 1970's were governed by leaders who shared the same political philosophy towards foreign investors. The countries were ruled by left-wing and moderate governments who insisted on greater independence from foreign capital. They shared the views that the penetration of foreign capital in their area was not only controlling a great sector of their economy but it also meant its intrusion in the social, political, and cultural areas of their countries.
Six Years of the Andean Foreign Investment Code

Since the approval of the Andean Foreign Investment Code in December 1970, its implementation has been far from being a regional policy. Implementation of the Code has been inconsistent in most of the countries except Peru and Venezuela.

Bolivia and Ecuador, the two less developed members of the Andean Group, have not implemented the Code in its entirety. Their actions reflect their fears of losing foreign investment needed for economic development. The Colombian government had legal problems in adopting the Code as national legislation. It was two years after the approval of the Code that Colombia was able to enact the regulations for foreign investment as national law. When the Code became part of the Colombian law, the Colombian government implemented it according to their national priorities.

In Chile, the Code was not implemented during the Allende administration. The Chilean regulations for foreign investment at that time were much stricter than those of the Code. The overthrow of Allende by a conservative military government was the beginning of Chile's dissatisfaction with the Code and other mechanisms of the Andean integration.
The amount of foreign investment in the area did drop. However, the experience of the Code in Peru demonstrates that there are some foreign investors willing to negotiate despite the strict regulations. The main incentives to those foreign investors has been the attraction of the large market and the exclusivity for production which they will have under the industrial co-ordination and sectoral planning of the Andean Group.

The two important modifications of the Code are (1) the change from 14 percent to 20 percent for the remittance level for foreign investors, and (2) the increase of capital reinvestment from 5 percent to 7 percent. These most likely will make foreign investors more attracted to the Andean region.

Politics and Integration

The integrative experience of the Andean countries in the past six years reinforce the conclusion arrived at by Ernst B. Haas in his article, "The Uniting of Europe and the Uniting of Latin America." In this article, Haas states that pragmatic consideration in an integration effort

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such as expectations of economic gains is "ephemeral" since it is not reinforced with deep ideological or philosophical commitment."

The Andean experience demonstrated that economic expectations were not enough to keep Chile within the Andean Group. The most important reason for Chile's withdrawal was the fact that the new military government of Chile no longer shared the same political objectives as those of the members of the Andean Group. It is the difference in the political philosophy which was the cause of Chile's withdrawal.

In addition, Haas states that in order for the integration movement to continue smoothly, it is necessary for both the political leaders and the major elites to share in the political commitment of the integration effort. This is one of the most important points that the political leaders of the Andean Group countries must take into consideration as they proceed with their integration. The experience with the Andean Foreign Investment Code in the past six years demonstrated some opposition from the major interest groups in Ecuador, Colombia, and Venezuela. In order to proceed smoothly, the Andean governments must be able to placate the fears of some of these private groups and perhaps offer some rewards at the national level in order to continue with their integration effort.
In comparing the integration experience of Western Europe and Latin America in the 1960's, Haas concludes that the Latin American integration effort differs from the European experience. The main difference is that in Latin America, politics plays a predominant role. The reason for the predominance of politics in Latin American's integration is due to the lack of homogeneity in the socio-economic structures of the countries, the nationalistic consciousness that prevails and the importance of ideology. All these three factors emphasize that integration in Latin America must depend on the political commitment of the countries involved.

The Andean Groups' experience clearly demonstrates that the decision to form a sub-integration group originated from the governmental leaders of the Andean countries. The political leaders shared the same political philosophy at the time of the signing of the Cartagena Agreement. They all agreed on greater independence from the industrial nations, and the governments were leftist and moderate. The political consensus continued as the member countries began to adopt economic measures for their integration. Despite some opposition from the private sector in adopting the Andean Foreign Investment Code, the governmental leaders of the Andean countries were able to enact the Code as national law.
The political consensus continued and the Andean Group progressed toward their integrative goal. This consensus was interrupted with the change of government in Chile. The new right-wing military government of Chile no longer shared the same political views as those of the more moderate governments of the Andean Group. The military government of Chile had requested the expert opinion of Professor Milton Friedman, whose more liberal stand in relation to foreign investment clashed with the economic and political objectives of the other members of the Andean Code.⁴ Therefore, Chile could no longer form a part of the group and its withdrawal was imminent.

The future of the Andean integration movement depends on the continuous political commitment of the government leaders of Bolivia, Colombia, Ecuador, Peru, and Venezuela. As long as the present and future governmental leaders of the Andean countries share the same political philosophy which originated the Andean integration group, the Andean Common Market will continue to progress towards its goal. In addition, in order to proceed smoothly, the governmental leaders of the Andean countries must arouse integrationist support both from the major private interest groups and from the population, and convince them that integration will eventually benefit all.

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