

EXECUTIVE REGISTRY

Directorate of Intelligence
Office of African and Latin American Analysis

86 5710X

5 December 1986

NOTE FOR:
D/DCI-DDCI Executive Staff

STAT

Jim,

Attached is my draft of the speech for Bob Gates' 11 December speaking engagement. If rumors that Dick Kerr has been tapped to fill in for the DDCI are true, please let me know and I will send copies up to the DDI's office.

Thanks,

STAT

DCI
EXEC
REG

B-802-15

Issues and Trends Affecting U.S. Business
in Latin America and the Caribbean

An Address to the Executive Committee and Trustees
of the International Center of Florida
by Robert M. Gates
Deputy Director of Central Intelligence

December 11, 1986

It is a pleasure to be here today. I am grateful to the International Center for this chance to share some thoughts with you on what those of us in the Intelligence Community see as some of the salient political, economic and security issues and trends affecting the business climate in Latin America and the Caribbean.

The picture I am about to sketch for you will have both positive and negative elements, for I see both enduring challenges as well as emerging opportunities for US firms operating or investing in the region. I'll begin by ticking off some of the factors that will continue to make doing business in Latin America difficult.

Let me say as an aside here that I fretted a little about how much time to spend talking about the negatives we see in the Latin and Caribbean scene. We spend a lot of time at the CIA worrying about threats to US interests abroad--and these include

business interests. Looking on the gloomy side of things is an occupational hazard of the intelligence profession. For reasons that I will come to later I didn't want to be guilty of saying things to discourage active US business involvement in the region. Objectivity is something we also cherish at CIA, however, and so I will be as candid in outlining the continuing difficulties that will confront US business in Latin America as I will be later in pointing out the opportunities. This said, I'll proceed on the challenges.

First, there will be a continuing threat to U.S. commercial interests in Latin America from terrorist groups, many of them supported and abetted by the Soviets, Cubans, Nicaraguans or Libyans. It will probably come as no surprise to many of you to learn that our statistics show more acts of violence--bombings, kidnapping and the like--against US business personnel and facilities in Latin America last year than in any other part of the world, the Middle East included. Colombia headed the list of dangerous places followed by Chile, Peru, and Bolivia. On the other hand, there were no such terrorist attacks in Argentina--the highest risk country for US business in the early 1970s--or in El Salvador, and a sharp fall off in incidents in Honduras. To be honest with you, while the threat in individual countries will vary over time, I believe that

terrorists will continue to target US businesses as a means of maintaining pressure on governments, obtaining operating funds, and gaining the publicity they crave. Aside from the human costs, the dollar value of protecting US personnel and commercial facilities will remain high.

Second, the security problems caused by the activities of insurgent groups or by political unrest will continue to hamper US business operations and discourage new initiatives. Peru, Colombia and El Salvador are examples of countries where attacks by large and well-armed revolutionaries on the rural infrastructure and their actual control of some territory cause major problems for U.S. companies involved in agricultural sector enterprises or engaged in the extraction of oil and mining of other mineral resources. The trend toward closer symbiotic cooperation between insurgent groups and narcotics traffickers in South America is viewed by the Intelligence Community as having particularly worrisome implications for the maintenance of security in outlying areas. Periodic episodes of turmoil in countries with chronic instability problems--Haiti is a case in point here--will also create labor problems for US businesses, and otherwise complicate their operations. Again, I have to confess that despite the progress that has been made in containing guerrilla activities in places like El Salvador and

Guatemala and the general decrease in the sort of popular unrest that marked the region in the past, the root causes of insurgency and the sporadic leftist-backed political violence that continues to occur in the Caribbean and in South America are deep seated and working to overcome them is a long-term proposition on the part of the affected governments.

Another set of difficulties for Americans doing business in Latin America flows from the sway that political nationalism continues to have over economic decision-making. At the most fundamental level, the statist approach to economic development in some countries has given bloated and inefficient government-owned enterprises a virtual monopoly of key sectors, foreclosing opportunities for US business. In Mexico, for example, the control state-owned companies have over sectors such as energy, food distribution and steel production limits opportunities for US or Mexican private firms to get involved in these activities. In other countries, domestic private investment will continue to be permitted, but foreign investment excluded, in sectors selected for special protection. Brazil, for example, under its so called Informatics Law, continues to limit foreign firms from manufacturing or selling products in the computer and data processing industries. In many countries, foreign investment will remain limited to 49 percent of company equity.

Beyond direct controls on investment, some Latin American countries are likely to continue to respond to domestic political pressure with tactics that discourage foreign business. Let me list several examples:

- Political pressure to inflate employment and raise wages, such as is found in the high-unemployment Caribbean region, means that US business will have to contend with laws that make it difficult for companies to lay-off or fire workers and can cause wage bills to skyrocket.
- Endemic overvalued exchange rates, often set in response to consumer pressure, will cause foreign exchange shortages and bottlenecks that hamper the ability of companies to conduct international financial transactions on a timely basis.
- Moreover, in many countries bribery and corruption will remain time-honored domestic business practices that can get in the way of legitimate new investors seeking to compete within the established business community.

Aside from the problems attendant on economic nationalism, US businesses will be challenged by the economic hard times that

confront most of the region. These hard times both reflect and contribute to the region's continuing external debt crisis--which is rooted in the heavy borrowing of Latin governments during the 1970s and early 1980s. Although the record is very uneven, Latin governments generally have done well in coping with debt and related problems. Initially, they had no choice but to adjust their economies through stabilization programs involving the reduction of chronic budget deficits, the liberalization of prices, devaluations and wage freezes.

Through such efforts, debt default has been avoided but at a high cost. Almost without exception, the annual growth of the Latin American economies has stagnated. Consumer price inflation throughout the region rose from 85 percent in 1981 to 316 percent in 1985. Living standards have slipped and per capita income is still below the levels recorded in the late 1970s for nearly all countries in the region. Moreover, spending on education, healthcare, and new infrastructure has been cut back throughout the region which will impede efforts to expand productivity and support economic diversification and export promotion.

Nor have world economic conditions been propitious for Latin American recovery. Despite the salutary effects of declining world interest rates and the steady growth posted by the US

economy, slumping commodity prices--notably oil--the collapse of intraregional trade and the unwillingness of Europe and Japan to stimulate vigorous growth have held back the growth in Latin American exports. Debt servicing requirements remain high--interest payments alone claimed 35 percent of Latin export earnings in 1985--causing a heavy outflow of capital to meet their foreign obligations. On top of this, some \$6.5 billion in private Latin capital left the region last year to end up in US and Western banks and real estate--the so-called capital flight problem.

I could continue marching down the list of challenges faced by potential investors and by the Latin governments themselves but I want to get on with the good news. I hope in fact that my listing of some of the region's problems will impress you, as it has me, with the positive factors that have emerged.

I would begin the good news by asserting that the psychology of the region is changing and that the change shows signs of being dramatic. The old feelings of dependence and inferiority are receding, being overtaken by a can-do, must-do spirit.

Among the more visible indicators of a new mindset is the turn to democracy. Cycles of military repression and open politics have occurred before in the region, but the current move

into competitive electoral systems has many distinctive features. The scope is unprecedented. Latin America is more democratic today than at any point in history. Only five authoritarian regimes remain--Cuba, Nicaragua, Suriname, Chile, and Paraguay--representing a minuscule portion of the region's population. Long-lived regimes have given way to this democratic wave--a generation of military rule in Brazil has ended and after two generations of Duvaliers in Haiti, that impoverished nation may begin a new era. For the first time, normal, elected presidential successions have occurred in such countries as : Honduras, Ecuador, Peru, and Bolivia. Democracy may be "taking" this time.

Also notable are the quality and seriousness of the new leadership. One can hardly fail to be impressed by the boldness of President Sarney, thrust into office unexpectedly when the President-elect died before assuming it. We see growth and flexibility in Bolivia's Paz, who espoused statist policies during the Revolution but who now, in a new era, is moving toward free-market prescriptions. We can only admire the leadership of President Alfonsin, who remains highly popular despite Argentina's hard times. The region boasts leaders who retained their optimism in the worst of times, such as Guatemala's President Cerezo, who survived numerous assassination attempts

when he opposed military rule, or President Duarte of El Salvador, who bears the scars of torture. These are men of courage and vision, a truly new political generation. Most are centrists, interested in and receptive to better relations with the United States.

Their views of the United States are sophisticated; many of these leaders have spent enough time living in our country or studying it to know us well. They are not viewing us through throwback stereoscopes that show a colossus of the north. They are men of vision who want to advance their nations and are willing to do business to achieve their goals.

The citizenries of these countries have shown courage and resiliency as well. The route to democracy was hard; in many places, it was unspeakably brutal. I think we have reason to hope that once won, freedom will not be given up by these populations, who are also increasingly sophisticated and willing to work for their goals. We can see this in the relative discipline that labor has shown. Despite hard economic times, labor has been more willing than in the past to give scope to national leaders. And in many places, austerity plans governments have been forced to adopt have meant real tough times for the people. On other domestic fronts, we see creative new

ideas arising to deal with national problems-- many new twists on economic policy, ways civilians are handling sensitive issues such as retribution for past military crimes, Alfonsin's plan to break Argentine fixation on Buenos Aires by moving the capital south. We see high energy being channeled in positive directions.

The energy of democratization is also producing a new cooperative urge among the countries. The new leaders have much in common and because of the struggle each has been through, they tend to respect each other. This provides a new basis for bilateral and multilateral effort. It shows up in various spheres: economic collaboration, including talk of a common market among Brazil, Argentina and Uruguay; nuclear and other scientific interchanges between Argentina and Brazil; some movement toward unified anti-narcotics programs; and increasing cultural exchange. The nations in the region are more and more willing to learn from each other and to pool resources against stubborn problems.

Another positive trend in Latin America is the change in attitudes toward capitalism and the free market system. This change is part of the broad shift in the world intellectual climate which is moving away from viewing statism as the panacea

for economic and social ills. Latin American intellectuals are not in the forefront of this sea change but they have not missed the fact that state-owned firms are being privatized from Bangladesh to Malaysia, from Turkey to Tanzania. Nor have they missed the fact that public leaders who once pretended that their countries were more socialist than was actually the case now pretend that their countries are more capitalist. India, the largest country in the Third World, and China, the world's largest communist country, are both seen as increasingly enthusiastic converts to the market system, and even in Eastern Europe some communists are speaking up for "market solution" in developed and developing nations alike.

As I said, Latin America is not in the forefront of this intellectual sea change and statism remains well entrenched in the region, but polling data--though limited--indicates that privatization is generally popular with the people and that the private sector is being seen with increasing respect. The leadership in many countries is behind the intellectual curve but developments such as President Alfonsin's request last May for a mission of US businessmen to increase the entrepreneurial attitude and performance of Argentine businessmen indicates that the decisionmakers are catching on.

Why did this come about? There are many reasons, but I would like to emphasize two which I believe are both very important and largely unrecognized. First, there is the influence of hard times. It is significant that the turn towards capitalism came just as much of the world was suffering recession. In most Latin American and other Third World countries there is a basic stratum of free enterprise "penny capitalism" that is submerged in times of prosperity and comes to the forefront in times of hardship. This stratum--which includes what economists call the underground economy--constitutes the family background of almost all Third World urbanites, except the highest political and commercial elites. Small merchants, market women, shoeshine boys, cab drivers, free-lance artisans, self-taught carpenters and plumbers, these are the people who keep on working when factories are closing and bureaucrats are losing their jobs. These people, from their own experience, have an intuitive understanding of the interconnections between hard work, saving, and getting along. When times are good, they are quite willing to take whatever "magical" benefits the freespending state has to give. When times are bad, however, they are realistic enough to know why.

Second, there is what I call the shadow of the twenty-first century. The twentieth century--ushered in by revolutions in Russia, China, Mexico, Turkey, Persia, and elsewhere--was the age

of social revolution. Even though these revolutions were not always successful, no one doubted their importance. Today, revolution is becoming intellectually old hat, as far from present day reality as the theological disputes of the Middle Ages. What does Lenin have to do with microchips? Or Mao's Red Book with the rise of Japan? The feeling is that the twenty-first century is almost here--and whatever it turns out to be, it will not be another Soviet-style revolution!

Sometimes I think we have the Russians themselves to thank for the declining popularity of statism. They have brought hundreds of thousands of Latin Americans and others to the Soviet Union for visits or for study. These Third World citizens are not dumb. Of course, some are brainwashed or coopted, but others look around and they don't like what they see. They see a society that, for all its military power, is grinding to a halt. They see a rigid class structure in which the elite live very well indeed while the masses go to the end of the line. They see racism and shoddy goods and crime and corruption and cynicism. They see a society where consumers spend twenty billion man-hours annually just standing in line! Speaking of the hard-currency stores that exist everywhere in the Soviet Union, one Latin American commented, "What kind of world power is it that won't even accept its own currency in its own stores?"

At another level US business should be encouraged by the cooperative and positive approach Latin America's new democratic leaders have taken in their struggle to resolve economic problems. While recognizing that their administrations have to deliver economic improvements to consolidate fragile civilian rule, they have generally eschewed resorting to radical policies, such as debt moratoriums, or a return to Peronist-style populist economic excesses. Instead, these leaders have opted for more pragmatic and practical solutions aimed at restoring growth. President Alfonsin in Argentina in 1985 and President Sarney in Brazil this year, for example, have launched bold economic programs to arrest hyperinflation that was causing economic chaos and political discontent. In both cases, inflation was arrested and the return of price stability has led to strong economic growth in Brazil--at a projected eight percent, the strongest performance in the world--and in Argentina which grew by 3 percent during the first half.

In Bolivia, Paz Estensorro, the former populist who introduced state-led development in the 1950s, is now relying on the magic of the market to reform the economy. He has broken the back of runaway inflation, which topped out at 22,000 percent in 1985, by implementing thorough-going public sector reform and restoring free-market oriented policies. Symbolic of his shift,

he recently closed down the country's largest tin mine to stem losses among inefficient state enterprises and in hopes of beginning new efforts to diversify the economy.

A number of other countries have also made clear their intention to seek foreign participation in future economic reconstruction. Although it is true that such initiatives are in their infancy in the region, the change in emphasis is heartening. Let me lay out a few examples.

- Venezuela has already eased some onerous restrictions on foreign direct investment and other countries like Brazil have liberalization plans in the works;
- Colombia has joined forces with the World Bank in making structural adjustment;
- Chile's successful debt to equity conversion program may lop off \$1 billion in external debt this year and has attracted intense interest in Mexico and elsewhere.

Other Latin American countries have taken more direct steps to open their economies to US investment.

- Grenada has lowered the duties on imports by 25 percent, relaxed foreign exchange controls, revised the investment code to open all sectors to private investment, and offers

lengthy tax holidays to investors in tourism and light industry.

-- Haiti has liberalized the investment code, improved tax incentive for foreign investment in agriculture and industry, opened up to competition sectors of the economy that were monopolized by Duvalier's family and associates, and is making progress in the reduction of corruption.

-- The Dominican Republic has set up numerous free trade zones and streamlined red tape, while Costa Rica has devalued its currency, reformed the credit system, passed a new export incentives law, and improved e banking and currency laws.

-- In a significant policy shift, Mexico recently agreed to permit IBM 100 percent foreign ownership in a computer firm to be located there.

An appropriate question to ask here is what can U.S. business do to capitalize on these positive trends and I'll take the liberty of going on to suggest some answers. My short answer is that US business can do a lot to help in Latin America and make a profit while doing so. One of the keys, in my view, is the application of technology as well as capital. A detailed look needs to be taken at the whole range of technology available

in the United States and the West in general and an attempt made to match these technologies with unutilized resources in Latin America. The range of technologies and applications truly is enormous.

I'll use Ecuador to illustrate what I mean. Despite being one of the poorer nations in Latin America, Ecuador has a wealth of under-utilized resources that could be developed with US technology and financing. Let's take, for example, wind power. The country's geography and prevailing winds are ideal for wind-power generation of electricity. This technology has the potential to produce some ten percent of Ecuador's needs, thereby freeing an additional 200,000 barrels of oil a year for export. And the United States is the world leader in wind technology.

Or take integrated marine shrimp production. Only about one-fourth of Ecuador's 160,000 acres of ponds used for growing shrimp are stocked with shrimp larvae. If a commercial hatchery capable of producing 8-12 million larvae per month were set up to offset the shortfall in naturally produced larvae, Ecuador could once again become a major shrimp exporter. Moreover, such a project would largely free the country from the spasmodic havoc caused by the El Nino weather pattern. The benefits to economic--and even political--stability could be very important.

Another example would be the production and packaging of high-value processed vegetables. Of Ecuador's cultivatable land, only forty percent is currently being used. Much of this land would be ideal for production of asparagus, artichokes, broccoli, mushrooms, palm hearts, and tomatoes. With US technology--blast freezers and the like--and managerial and marketing assistance, this produce could be frozen or processed into paste, pulp, or concentrates for export.

I could go on citing examples. Natural gas--Ecuador has perhaps one of the largest deposits in Latin America--or tourism--Ecuador's Galapagos Islands are truly unique as a tourist destination--come to mind. And there is animal feed production, dairy farming, tissue culture, gold mining, agrichemicals, hydroelectric power, forestry products, processed tropical spices, cut flowers, beef cattle, polymetallic ores. The list is extensive.

Although not all Latin American countries have as hospitable an investment climate as does Ecuador under the Febres-Cordero government, most do have wide ranges of underexploited resources and, as I indicated earlier, increasingly pro-capitalist attitudes. It would be easy to duplicate Ecaudor's list of resources and matching technologies in nations such as Costa

Rica, Colombia, Uruguay, and Jamaica. Among the big three of Latin America--Brazil, Mexico, and Argentina--it is not so much a question of locating underutilized resources as of stimulating efficient, privately-owned heavy industry.

These examples of where US business can make a difference serve to underscore the basic point I want to leave with you. There are many aspects of the Latin environment that make it a difficult place for US firms to operate and this will remain the case. But I hope you will agree with me that there are a number of encouraging trends in the region. From a policy standpoint, nurturing effective, popularly supported political systems in Latin America capable of dealing with local social, economic and security problems and amenable to cooperating with the US regionally and globally is a cherished goal. This goal is perhaps more achievable today than in the past. But the new civilian governments as well as the established ones need all the help they can get in grappling with the host of problems that confront them. Renewed US investment in the region coupled with the application of technology and the infusion of entrepreneurial and management know-how is vital. Active US business involvement can lead to a self-reinforcing cycle of economic improvement and political and social stability--all feeding back again to economic advancement and a fertile business climate.