No.

PROJECT STUDY
ON
CURRENT SITUATION OF ECONOMIC PARTNERSHIPS AND CHALLENGE TOWARD ECONOMIC COOPERATION
IN
SOUTH AMERICA

FINAL REPORT

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Project Study on Current Situation of Economic Partnerships and Challenge toward Economic Cooperation in South America: Final Report

LIST OF ERRATA

Page and line	Original text	Corrected text
p. ix, ll.23-29	3) Research cooperation There are many qualified researchers in the South American countries, so they frequently have exchanges with the administration or business world. It is extremely effective to support policies through collaboration with such researchers. The United Nations ECLAC (Economic Commission for Latin America and the Caribbean) which has its base in Santiago is especially noteworthy. "Creation of export dynamism" is a theme to be emphasized.	3) Cooperation for policy formulation There are many qualified researchers in the South American countries, so they frequently have exchanges with the administration or business world. Policy support can be made effectively through collaboration with such researchers. For example, "creation of export dynamism" is a theme to be emphasized.
p.5, l.25	experienced currency crises and major domestic economic disruption.	experienced currency crises and major domestic economic disruption, leading to recessions in the neighboring countries such as Paraguay and Uruguay.
p.44, ll.2-3	Concerning ODA too, experts of Japanese decent (for example, in the agricultural field) are playing	Concerning ODA too, experts of Japanese decent in such countries as Brazil, (for example, in the agricultural field) are playing
p.45, ll.6-8	A typical example of his was the rapid advancement by Japanese corporations into the Brazil-Manaus Free Zone that was established in 1970.	A typical example of this was the rapid advancement by Japanese corporations into the Brazil-Manaus Free Zone that was established in 1967.
p.46, Table 4-5 Note	Note: South America here refers to the 13 countries of Bolivia, Chile, Columbia, Ecuador, Falklands, Guyana, Paraguay, Peru, Surinam, Uruguay and Venezuela.	Note: South America here refers to the 13 countries of Argentina, Brazil, Bolivia, Chile, Colombia, Ecuador, the Falkland Islands, Guyana, Paraguay, Peru, Surinam, Uruguay and Venezuela.
p.57, ll.2-3	apart from high interest rates in excess of 15%,	apart from high interest rates in excess of 15% (as of June 2006),
p.58, ll.13-15	the Amazon region in the north has a lot of poverty and low education levels. As a result, the social structure is such that poor people from the north perform menial labor in the south;	the northern and north-eastern parts have a lot of poverty and low education levels. As a result, the social structure is such that poor people from the north and north-east perform menial labor in the south;
p.61, l.17	Corporations are unable to raise long-term funds	Corporations are difficult to raise long-term funds in the domestic market
p.67, ll.28-31	the Celades development costing US$1 billion that was implemented during Tanaka administration, however, even if the local people	the Celades development costing in total 68.4 billion Japanese Yen over a period of 22 years (of which JPY35.1 billion invested by Japan)

	know about Japan's cooperation, some government officials are unaware of it and, now that the JBIC bridge corporation has withdrawn from the region, there is no longer any evidence of Japanese involvement.	that was initiated in the wake of the visit by the then prime minister Kakuei Tanaka. However, even if the local people know about Japan's cooperation, some government officials are unaware of it.
p.68, ll.25-26	utilizing experts and volunteers of Japanese decent	utilizing experts of Japanese decent
p.109, Footnote 62 p.111, Footnote 65 p.114, Footnote 68	Thirteen South American countries: Argentina, Bolivia, Chile, Colombia, Ecuador, the Falkland Islands, Guiana, Paraguay, Peru, Surinam, Uruguay and Venezuela.	13 South American countries: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, the Falkland Islands, Guyana, Paraguay, Peru, Surinam, Uruguay and Venezuela.
p.109, Footnote 63 p.114, Footnote 69	The countries above excluding the Falkland Islands, Guiana and Surinam.	The countries above excluding the Falkland Islands, Guyana and Surinam.
p.175, ll.3-5	The dictatorship of General Stroessner was beaten in the presidential election of 1989, and the victorious President Rodriguez established a democratic constitution, making the beginning of democratic policies.	After the dictatorship of General Stroessner over 35 years was collapsed by a military coup in 1989, General Rodriguez was elected as President in the general election. The president established a democratic constitution, making the beginning of democratic policies.
p.178, ll.18-19	implemented by government agencies (with cooperation from CETAPAR, CAPECO and MAG-JICA too)	implemented by MAG-affiliated agencies (IAN and CRIA)
p.185, l.12	Small Vegetables Production Technology Improvement Project	Small Farmers Vegetables Production Technology Improvement Project
p.199, l.32	CONFIDES	COFIDE
p.221, ll.6-8	The basic characteristics of poverty are not absolute poverty as in some parts in Africa, but are relative poverty, in other words, a disparity problem.	The basic characteristics of poverty in South America are a disparity problem.
p.223, l.31	3) Research cooperation	3) Cooperation for policy formulation
p.223, ll.34-39	Consequently, it is extremely effective to support policies through collaboration with such researchers. The United Nations ECLAC (Economic Commission for Latin America and the Caribbean) which has its base in Santiago is especially noteworthy. Since the ECLAC has long-term experience and an independently critical mind (problem consciousness) as a research institution, they have a wide network across the Central and South America.	Consequently, policy support can be made effectively through collaboration with such researchers.
p.223, l.39 - p.224 l.1	"Creation of export dynamism" is a theme emphasized through research	One example of themes emphasized through the collaboration is

	cooperation.	"creation of export dynamism" which means pursuit of a scenario for diversified and value-added economy, not just for economic expansion caused by increase of export.
p.224, ll.5-8	Accordingly, recommendations should be made by each nation with respect to the incorporated promotion and creation of a new export industry, export infrastructure development and information exchange between the private and public sectors through joint research between South American and Asian research institutions.	Accordingly, recommendations should be made by each nation with respect to the incorporated promotion and creation of a new export industry, export infrastructure development and information exchange between the private and public sectors through joint research between South American and Asian research institutions. This kind of policy support initiatives shall preferably be conducted with such institutions that have a wide network of information and personal connection across Latin America, such as the United Nations ECLAC.

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Summary

Overview of the South American Economy

South America is blessed with abundant exports of agricultural and mineral resources, accounting for 10% of the developing world. By comparison, its population is relatively small at 360 million, which is only 7% of developing countries worldwide. The income level is therefore high at $3,600 on average (average for Central and South America: average income level for all developing nations is 1,460 dollars).

South America has experienced economic crises on two occasions, a debt crisis in the first half of the 1980s and a currency crisis from the latter half of 1990s to the early 2000s. However, recently the economic situation has remained stable mainly due to the settlement of macro economy and public finance policies under the collaboration of the International Monetary Fund (IMF) and the World Bank and high international prices for primary products and demand of agricultural and mineral products and economic growth have recovered. “From stabilization to growth” appears to have become the fundamental direction for the future.

However, domestic disparity is still prominent. When viewing the Gini Coefficient, seven of the top-ranking 20 countries are in South America. However, starvation hardly exists in South America. South American poverty is a disparity problem and a social problem. A handful of wealthy (large landowners) and influential families monopolize the majority, while small farmers and indigenous people and the poor in urban areas suffer from low income. Since the disparity between nations is also very large, the average income level of three (3) advanced nations in South America (Argentina, Brazil and Chile) is 1.7 times more than the average income level of the four (4) least developed nations (Bolivia, Ecuador, Paraguay and Peru).

In similar a manner as other donors, Japan has continuously provided development aid to South America and contributed to its socioeconomic development. At the same time, South American resources and markets are also important for Japan. In addition, approximately 1.5 million Japanese descendants reside in South America. So for more than 100 years a smooth relationship through economic diplomacy between South America and Japan has been nurtured largely through the efforts of Japanese descendants. However, the present trade and investment relationship between South America and Japan is one of withdrawal. This has resulted from a gradual build up of events such as Japan’s diversification in importing nations, the concentration of Japanese companies that have branched out into Asia, and economic inconsistencies in some South American states. In the 1990s, the ODA showed signs of withdrawal in the private sector. However, since the turn of the 21st century, ODA has also decreased due to budget constraints.

There is little likelihood that the current tone of withdrawal in economic relations between South America and Japan will continue. And it shouldn’t. In the future, trade liberalization in Asia and the Pacific region will accelerate. Further progress on free trade with Asia is also anticipated, not only with Japan, but also with ASEAN nations and Oceania, and eventually with China and India. Under such circumstances, if the Japanese economy recovers and the

South American economy continues to grow, there is a possibility that South America will become a target not only for Japanese trade, but also an important investment for all of America. Sustainable ODA is also an important message by Japan for South America.

According to interviews of 33 Japanese companies in South America (the total number of Japanese companies in South America is 336) many companies expressed the following expectations toward the Japanese government.

- Promotion of good relations between Japan and all South America nations from a long-term perspective
- Clearer statement of trade strategies and food strategies
- Dissemination of Japanese image
- Maintain trust of Japanese descendants
- Collaboration with the private and public sectors (vital to nations with unforeseeable markets)

Companies do not expect to make a profit through ODA. However, as a part of the above-mentioned expectations toward the government, many of them expect Japanese ODA. The following matters are especially noteworthy.

- To continue even a small amount and ensure a long-term mutual relationship
- To promote partnerships between aid activities and companies (effective utilization of information owned by business organizations)
- Backup for social contributions by companies in recipient countries

Footsteps and Current Status of Regional Economic Integration

Since many nations in South America have a small population in addition to remarkable disparity in incomes, each domestic market has been limited. The move toward regional economic integration has therefore existed since long ago. Currently, the major economic integration systems and ideas are as follows.

Community of Andean Nations (CAN)

The Community of Andean Nations (CAN) was inaugurated in 1969 as an economic partnership organization. Intra-regional tariffs were eliminated in 1993 and a common external tariffs (CET) system was introduced in 1995 and was officially inaugurated as CAN in 1996. The present member nations are Bolivia, Colombia, Ecuador and Peru. Venezuela withdrew in 2006 due to opposition toward FTA negotiations with the United States.

MERCOSUR (*Mercado Común del Sur*: Common Market of the South)

MERCOSUR was inaugurated in 1991. Intra-regional tariffs were eliminated and common external tariffs were introduced in 1994. Non-tariff barriers (NTB) were scheduled to be abolished but have hardly been realized. The present member nations are Argentina, Brazil, Paraguay, Uruguay and Venezuela (joined in 2006). The correspondent members are Bolivia,

Chile, Colombia, Ecuador and Peru.

Free Trade Area of the America (FTAA)

In order to establish the Free Trade Area of the Americas (FTAA) in 2005, major concerned nations reached a mutual agreement at the Summit of the Americas in 1994. The aim of this is multilateral negotiations by all nations in the Americas. However, there has been no subsequent progress. The United States has indicated the possibility of intensifying pressure toward economic reform since integration is regarded to be a lever; whereas, Brazil and other nations remain cautious.

In addition, the Integration of Regional Infrastructure in South America (IIRSA) was created by 12 South American governments and international organizations concerned and 31 priority projects have been partially prepared or being implemented.

Although economic integration has been improved as a mechanism in such a manner, actual trade depends greatly on extra-territorial trading. Extra-territorial trading accounts for 81% of exports and 81% and 72% of imports. The mutual flow among advanced nations in South America (Argentina, Brazil and Chile) is overwhelmingly great.

Associated with the gap between institution and reality, a confrontation of view points over the economic integration system has become obvious. Original economic integration refers to reinforcing group competitiveness by pushing ahead with deregulation in each nation and market opening. However, non-tariff barriers in regionally advanced nations are so great in fact that it cannot be realized. Despite imports and an increase in contraband trade (smuggling) in impoverished counties within the region, regional exports remain stagnant. In this sense, it is a natural matter of course that nations along the Pacific coast such as Chile, Colombia and Peru have a strong interest in a bilateral free trade agreement with the United States of America, and nations in Asia and Oceania.

On the other hand, nations with high level of dependency on resources, such as Venezuela and Bolivia, are intensifying their nationalism over natural resources during a backdrop of high international prices for resources. Nationalism over natural resources has become a way of denying free trade or the inflow of investment itself with opposition (resistance) to the United States regarded at its core. Compared with Asian and Pacific oriented nations along the Pacific coast, some nations are oriented toward regional integration along with the anti-US camp.

With regards to the background stance that economic integration tends to be split, it can be pointed out that the institution of economic integration and the policy reform through new liberalism track have both made progress at the same time. As a consequence, there is a tendency for economic integration to fix economic structures depending on some of the modern export sector and exports cannot connect to integration, diversification of national economies and the advancement of industrial structures. This is a result of a lack of export dynamism. For the same reasons, stable expansion in employment which is the largest element of poverty reduction has also not yet been realized. In the future, the connecting of trade with the modernization of national economies and poverty reduction appears to be a common task of

nations moving toward trade liberalization and nations moving toward nationalism over natural resources.

Trend in Assistance

The annual amount of assistance received by nations in South America from FY2000 to FY2004 is 2.4 billion dollars. Bolivia, Colombia and Peru are the three largest receiving nations. In terms of Japan ' s contribution, Peru, Brazil and Bolivia are the three largest receiving nations. Major donors include the United States, international organizations, Germany, Spain and Japan. All donors have been increasing their amount of aid since 2000. Only Japan has shown a significant reduction.

When viewing the transition in composition by sector for all assistance, the social infrastructure and social services sectors have increased sharply, which accounts for almost half at the present time. In recent years, economic development and cross-sectional issues have increased remarkably. On the other hand, the economic infrastructure and energy sectors have sharply decreased. In the economic development sector, agriculture, forestry and fisheries have increased remarkably. Assistant with respect to trade policies and regulations also have been rapidly increasing, which has exceeded assistance for the manufacturing industrial sector. If we look at Japan, similar to the overall trend, the social infrastructure and social services sectors have largely increased; whereas, the economic infrastructure and energy sectors have decreased considerably. However, the economic development sector has also tended to decrease. In terms of economic development, agriculture, forestry and fisheries have maintained a ratio of more than half; whereas, the energy sector has decreased substantially.

If we narrow down the contents of assistance for the four least developed nations in South America to the economic development sector, at first we see that Japan has thoroughly covered development tasks in accordance with a country-specific assistant plan.

Positive measures have been taken in the following fields, particularly through support for the non-traditional export sector and private sector which includes medium and small enterprises.

(1) Strengthening the competitiveness of medium and small enterprises
- Training for managerial and technical human resources
- Formation of production chain, in particular, support for processing and distribution industries in farming products
- Vocational training for non-skilled laborers

(2) Institution building necessary for industrial and export promotion
- Improvement in quality standards
- Export promotion
- Industrial finance
- Foreign investment enticement

(3) Strengthening economic activities at the local level

- Cultivation for planning capacity of municipal personnel

Other donors have also developed assistance activities in a similar manner as Japan. However, some of the measures are not observed very often in Japanese assistance. The following are some obvious trends.

(1) Technical cooperation integrated with trade policy

A typical model is support for strengthening the competitiveness of small and medium enterprises by the United States. For example, by introducing buyers from advanced nations, product development is being promoted at the place of production and quality improvements are being made based on the buyer ' s advice and needs. In this cooperation, there are no sector divisions, such as agriculture or the manufacturing industry; it is treated in an integrated manner as a production chain or regional economy.

(2) Support for decentralization coupled with supporting regional revitalization

The IDB, the EU, Germany and the United States are respectively supporting decentralization with the aim of regional economic development or the creation of production centers. Their aim is to formulate a plan through participation by the public and private sectors and by implementing local priority projects. Many projects have been narrowed down to specific necessitous (poor) areas.

(3) Support for micro enterprises incorporated with financial and technical assistance

In conformity with micro financing for micro enterprises, the United States, Germany, Spain and Belgium, etc. have provided technical cooperation for product development and provision of market information.

(4) Support for strengthening governance as part of investment climate development

The IDB, the United States and Spain, etc. hope to create an environment in which foreign capital (funds) can be advanced and utilized in business by improving the judicial system and labor laws, etc. At the same time, the United States is taking an active role in the networking of business leaders.

(5) Support for returnees from seasonal (migrant) workers

In Spain, there are many migrant workers from Central and South American nations, such as Ecuador. The government of Spain is implementing the agricultural cooperation program for returnees from farm households.

(6) Mining support

Since Canada is an advanced mining nation, assistance in the mining industry for Peru is a priority. Canada is intermediating in research cooperation between companies located in Peru

and universities overseas, as well as capacity building for the Ministry of Mining.

Direction of Assistance

For the above-mentioned footsteps and current status of the South American economy and regional economic integration and trend in assistance, the following directions appear to be implicated.

Measures for all of South America

In the development assistance issue “from the stability to growth and poverty reduction”, countries with high income areas (especially Brazil and Argentina) are expected to experience further economic development and expansion in employment by stimulating demand at home. For this, the correction of disparity (especially security of equal opportunity through education), poverty reduction and economic revitalization in rural areas are essential. Stimulating domestic demand in these countries will help to provide an opportunity for exports to surrounding nations and kick start the engine for all of South America.

On the other hand, the population in the least developed countries in South America is limited, and therefore improvement in the domestic market cannot be expected for the time being. Growth through exports should be emphasized. A special request is being made to integrate and to diversify the national economy by reducing the dependence on traditionally exported products which are susceptible to price fluctuations for exports.

Why is assistance necessary for the least developed countries in South America?

In order to achieve economic growth and integration in South America, assistance for nations where development is relatively poor (LDC: least developed countries in South America) is essential for the following reasons.

(1) Instability in least developed countries in South America becomes an obstacle to economic integration and can easily create friction between neighboring countries.
(2) Cooperation for advanced nations (Argentina, Brazil and Chile) has accumulated sufficiently over the past 20 to 30 years and with good results. It is natural to shift support to the least developed countries in South America.
(3) Poverty and resources in the LDCs in South America exist side by side, so neglecting poverty will easily become an obstacle to development and exporting of resources.

Development Issues and Assistance in Least Developed Countries in South America

Items commonly listed in the current development policies of least developed countries in South America are outlined as follows. Since each of the policies reflects information and the opinions of aid organizations, including the World Bank and the IDB (Inter-America Development Bank), the items may be regarded to be common assistance subjects of LDCs in South America.

(1) Since economic level greatly depends on specific primary products and specific foreign markets, it is susceptible to external shock and it is difficult to achieve sustainable economic growth. In addition, an expansion in exports does not always lead to an increase in employment and poverty reduction domestically. To avoid such a situation, firstly a production chain should be developed; secondly products and markets should become diversified and then advanced.

(2) Therefore, productivity should be improved in the non-traditional export sector; market competitiveness should be reinforced and the market should be diversified. The private sector will be supported, particularly through the reinforcement of competitiveness of medium and small enterprises (managerial human resources, technology and market access), better efficiency and by stabilizing the supply of ingredients of farming products, etc.

(3) Support for the private sector:

- Fairness, transparency and effectiveness of administration should be promoted.
- Infrastructure including roads should be substantiated.
- Human resources should be effectively utilized to the maximum through education, vocational training and labor market reforms.

(4) As prerequisite conditions, macroeconomic policies, social services, governance, environmental and resources conservation will be continuously reinforced.

Five Directions – The Future of Japanese Assistance

Since the turn of the 21st century, Japanese assistance toward South America has continuously decreased, while other donors have increased their amount of assistance. Naturally, an increase in the number of countries with graduates from ODA recipient status is desirable. However, if it remains as is, it will be difficult to prevent the expectation for assistance in South Asia from shifting from Japan to other donors. In order to maintain the trust of recipient countries and Japan's national interest, securing a certain amount of assistance in keeping with the international trend would appear to be a prerequisite.

In light of the meaning of assistance, development issues and current assistance status with respect to least developed countries in South America, since ongoing Japanese assistance in recent years conforms to major development needs, the basic Japanese direction is considered to continue and substantiate this. In any case, assuming an increasing assistance scale, it is difficult to do so. If so, existing projects should be developed by effectively utilizing them to the maximum in order to correspond to recent needs. Accordingly, the future direction is summarized as follows.

(1) Economic development in the assistance for South America

Economic development is vital to poverty reduction. Even in the JICA country-specific aid program tree, in principle it is positioned in such a manner. However, both are provided as parallel programs in some cases. In such the case, it is pointed out projects for poverty countermeasures tend to be treated preferentially over projects for economic development. However, both are not in a substitutive relationship, so the understanding that “economic development pushes forward for the great goal of poverty reduction” is accepted internationally. Consequently, poverty reduction is not an urgent task; it is an issue of medium and long-term economic development. In this sense, the common understanding that the “highest priority theme for poverty reduction in South America is economic development” is indispensable.

(2) Importance of policy support

Many donors tend to directly provide assistance to the private sector for reasons of unstable politics, insufficient continuous administration and lack of trust between the public and private sectors. However, the continuity of politics and administration is a prerequisite of development. Although direct support for the private sector until it is realized is in itself effective, continuous support for capacity building in the governmental sector is also important. Japan has abundant experience in this field and is also greatly expected.

(3) Partnership between trade and development

We cannot discuss economic development in South American nations without promoting exports. In recent years “the promotion of production centers in response to the market” and “connecting trade with poverty reduction” has attracted public interest from a policy viewpoint. In the case of Japanese assistance, ability development in manufacturing was major goal. At the same time of ability development in manufacturing in South America, assistance in due consideration of marketing point of view is also desirable in the future. To be specific, the participation of specific buyers should be obtained. Further enthusiastic negotiations by the FTA and EPA are anticipated in the future. And negotiations by the FTA and EPA might also move ahead more briskly. As part of this, integrated support for reinforcing trade and competitiveness may be effective.

(4) Regional economic development

Economic development assistance includes an approach to narrow down a sector or industrial type and an approach to narrow down an area or production center. In the case of Japanese technical cooperation, an approach to narrow down an industrial type has been often applied. However, in the least developed countries, we cannot say that an approach to narrow down an industrial type reaches an effective stage. An approach to narrow down an area appears to be more effective. Many donors are providing assistance by narrowing down an area. Many donors are implementing assistance by narrowing down an area. However, almost all of the donors focus on remote least developed areas from a social point of view. It is possible for

Japan to focus areas that will have greater repercussion effects on national economies.

(5) Promoting regional cooperation

Japan and the EU are active in regional cooperation in consonance with regional economic integration. Most donors are more enthusiastic towards technical cooperation in due consideration of bilateral trade liberalization. Multilateral cooperation requires a lot of time for preparation and coordination. One could say that process required for creating a fiduciary relationship is the most important for regional cooperation. Some are anxious about the future course of the economic integration in South America. However, since it is inevitable that South American economies will be integrated from a long-term point of view, it is important to build regional cooperation by theme in consonance with such a course. The following themes and approaches to be notable in the future can be considered.

1) Cooperation through sharing and coordination of cross-border interests

JICA has implemented technical cooperation to improve packaging technology for MERCOSUR which has achieved excellent results. The adjoining beneficial interests (for example, transportation, environmental conservation and medical services) are diversified, so long-term measures are necessary.

2) Technical cooperation by Japanese-descendant experts

Technical cooperation of JICA for nations surrounding Brazil has made significant achievements through the activities of Japanese descendant-expert at the Sao Paulo office in Brazil. Although technical cooperation is provided mainly for agricultural areas, Japanese descendant-experts should play an active role in broader field such as the small and medium enterprises development in the future.

3) Research cooperation

There are many qualified researchers in the South American countries, so they frequently have exchanges with the administration or business world. It is extremely effective to support policies through collaboration with such researchers. The United Nations ECLAC (Economic Commission for Latin America and the Caribbean) which has its base in Santiago is especially noteworthy. “Creation of export dynamism” is a theme to be emphasized. The South American export promotion in the 1990s contributed to the survival (persistence) of a system dependent on primary products rather than the advancement of an industrial system. Japan and many other East Asian nations have made advancements in their industrial system with exports as leverage (means). Joint research between South American and Asian research institutions is desirable.

Actions to be Taken for the Time Being

For the time being, it may be important to begin the following activities.

(1) Project Formulation

Themes common to the four (4) less developed countries should be efficiently established. For example, the following themes can be considered. South-south cooperation could be utilized effectively in the projects formulated on these themes.

- Systematization of policies on medium and small enterprises in a country and reinforcement of human and organizational infrastructure
- Reinforcement of inspections and a certification system for agricultural and livestock farming products, quality of processed products and sanitary conditions
- Regional economy development (agriculture and medium and small enterprises) and industrial base development

(2) Preparation of Project Development on Trade for Poverty Reduction

The incorporation (integration) of promotion and poverty reduction with the collaboration of the private and public sectors is a direction to which the least developed countries and many related donors intend to move. The following preparation will be taken.

- Arrangement of data on private organizations in each area (such as chambers of commerce) and capacity analysis
- Sharing of information with other donors, assistance coordination
- Promotion of sharing information of the related organizations on the Japanese side and coordination (such as JICA, JETRO, import companies and dispatched experts)
- Utilization of experience and human resource in JICA's technical cooperation with leading countries in this region (Argentina, Brazil and Chile) in the field of trade promotion, to formulate projects for the four concerning countries and to hold the third-country training
- Sharing of information and lessons learned between trade or industry promotion agencies in the ASEAN region with which JICA has been in cooperation and the counterparts in South American countries, by holding joint seminar or workshops
- Identifying "best practices" and organizing related information about efforts to promote trade and industries and the relationship of the government and private sector seen in South America

(3) Evaluation Study

For the least developed countries to which much of the aid has been provided, an evaluation on a specific theme study should be carried out from the viewpoint of the "effects of economic development on poverty reduction".

(4) Formation of Assistance Strategies for South America

It would be just adequate if ODA is useful to the recipient side. However, ODA for South America is also very beneficial to Japan. Accordingly, from the viewpoint of our future relations with East Asia, regional assistance strategies should be prepared as quickly as possible.

List of Abbreviations

Abbreviations	Words in English or Spanish
ADSL	Asymmetric Digital Subscriber Line
AECI	Agencia Española de Cooperación Internacional
APEC	Asia-Pacific Economic Cooperation
APN	Autoridad Portuaria Nacional
APROLAB	Programa de Apoyo a la Formación Profesional para la Inserción Laboral
ATPDEA	Andean Trade Promotion and Drug Eradication Act
AXS	Axs Bolivia S.A.
BCE	Banco Central del Ecuador
BDS	Business Development Service
CAF	Corporacion Andina de Fomento
CAH	Credito Agricola Habilitacion
CAN	Comunidad Andina de Naciones; Andean Community of Nations
CAPECO	Cámara Paraguaya de Exportadores de Cereales y Oleaginosas
CDF	Comprehensive Development Framework
CDM	Clean Development Mechanism
CEPAL	Comisión Económica para América Latina
CETAPAR	Centro Tecnologico Agropecuario en Paraguay
CIDA	Canadian International Development Agency
CITES	Centros de Inovacion Tecnologica
CNG	Compressed Natural Gas
CNPC	Consejo Ncional para la reactivacion de la Produccion y la Competitividad
CODEMYPE	Consejo Nacional para el Desarrollo de la Micro y Pequena Empresa
COFIDE	Corporacion Financiera de Desarrollo
Comibol	Corporacion Minera Bolivia
CONACYT	Consejo Nacional de Ciencias y Tecnologias
Confip	Comite de Normas Financieras y Prudenciales
CONSITEC	Consejo Nacional Ciencia y Tecnologia
COREMYPE	Consejos Regionales de la MYPE
CORPEI	Corporacion de Promocion de Exportaciones e Inversiones
C/P	Counterpart
DAC	Development Assistance Committee
DNMYPE	Direccion Nacional de la Micro y Pequena Empresa
EBRP	Estrategia Boliviana de Reducción de la Pobreza
EC	European Commission
ECLAC	Economic Commission for Latin America and the Caribbean
Entel	Bolivia Entel S.A.
EPI	Estrategia de Produccion Integraciones
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FEDECAMARA	Federacion de Camaras de Comercio
FONCIT	Fondo de Ciencia y Tecnologia
FONPLATA	Financial Fund for the Development of the River Plate Basin
FSC	Forest Stewardship Council
FTA	Free Trade Agreement
FTAA	Free Trade Area of the Americas
FTZ	Free Trade Zone
GDP	Gross Domestic Product
GFTAM	Global Fund to Fight AIDS Tuberculosis, and malaria
GNI	Gross National Income
GTZ	Gesellschaft für Technische Zusammenarbeit
HACCP	Hazard Analysis and Critical Control Point

HIPC	Heavily Indebted Poor Country
IAN	Instituto Agronomico Nacional
IBR	Instituto de Bienestar Rural de Paraguay
ICJ	International Court of Justice
IDA	International Development Association
IDB	Inter-American Development Bank
IICA	Inter-American Institute for Cooperation on Agriculture
IIRSA	Iniciativa para la Integracion de la Infrastructura Regional Sudamericana
IMF	International Monetary Fund
INTN	Instituto Nacional de Technologia y Normalizacion
ISDN	Integrated Services Digital Network
ISO	International Standard Organization
ITP	Instituto Tecnologico Peru
ITT	Ishpingo-Tambococha-Tiputini Oil Field
J/V	Joint Venture
JBIC	Japan Bank for International Cooperation
JETRO	Japan External Trade Organization
JICA	Japan International Cooperation Agency
KfW	Kreditanstalt für Wiederaufbau
LAB	Lloyd Aereo Boliviano
LNG	Liquefied Natural Gas
MAG	Ministerio de Agricultura y Ganaderia
MCA	Millennium Challenge Account
MERCOSUR	Mercado Común del Sur
MIC	Ministerio de Industria y Comercio
MICIP	Ministerio de Comercio Exterior, Industrializacion, Pesca y Competitividad
MRTA	Tupac Amaru Revolutionary Movement
MSM	Movimiento Sin Miedo
MTPE	Ministerio de Trabajo y Promocion del Empleo
NAFTA	North America Free Trade Agreement
NC	Numerical Control
NGO	Non-Governmental Organization
PDVSA	Petroleos de Venezuela S.A.
PEMEX	Petroleos Mexicanos
PETROBRAS	Petroleo Brasileiro S.A.
PETRONAS	Petroliam Nasional Bhd
PP	Partnership Program
PROFECE	Programa-Femenino de Consolidacion del Empleo
PROJOVEN	Programa de Capacitación Laboral Juvenil
PROMPYME	Centro de Promocion de la Pequeña y Micro Empresa
PROPARAGUAY	Promoción de las Exportaciones e Inversiones del Paraguay
PRSP	Poverty Reduction Strategy Paper
REDIEX	Red de Inversiones y Exportaciones
SENACYT	Secretaria Nacional de Ciencia y Tecnologia
SENATI	Servicio Nacional de Adestramiento del Trabajo Industrial
SNI	Sociedada Nacional de Industrias
TECSUP	Instituto Superior Tecnologico
UIT	Taxable Income Unit
UNFPA	United Nations Population Fund
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations International Children's Emergency Fund
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
WB	World Bank
WTO	World Trade Organaization
YPFB	Yacimientos Petroliferos Fiscales de Bolivia


SOUTH AMERICA
Caribbean Sea
North Atlantic Ocean
South Pacific Ocean
South Atlantic Ocean
VENEZUELA
COLOMBIA
ECUADOR
PERU
BRAZIL
BOLIVIA
PARAGUAY
CHILE
ARGENTINA
URUGUAY
GUYANA
SURINAME
Caracas
Georgetown
Paramaribo
Cayenne
Bogotá
Quito
Lima
La Paz
Brasília
Asunción
Montevideo
Buenos Aires
Santiago
Stanley
Falkland Islands
(Islas Malvinas)
South Georgia and the
South Sandwich Islands
Scale 1:35,000,000
Azimuthal Equal-Area Projection
ANDES
AMAZON BASIN
GUIANA HIGHLANDS
BRAZILIAN HIGHLANDS
MATO GROSSO PLATEAU
ALTIPLANO
PATAGONIA

Study Outline

(1) Study Purpose

In due consideration of industry and trade development in the less developed countries in South America (Bolivia, Ecuador, Paraguay and Peru), the purpose of the Study is to provide recommendations with regard to Japanese economic cooperation, and in particular, issues on technical cooperation and measures and to be taken for those counties.

For this purpose, macro economic policy, industrial policy and development strategy, etc. subject to ten (10) member and correspondent member countries (Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay and Venezuela) of MERCOSUR (*Mercado Común del Sur*: Common Market of the South) were reviewed in the Study. Afterwards, the best method (course of action) for industrial and trade policy in each country were examined in due consideration of the movement toward regional economic integration among MERCOSUR, CAN (Community of Andean Nations) and FTAA (Free Trade Area of the Americas) and its impact. Based on the findings, recommendations on the best method to provide Japanese technical cooperation were compiled by focusing on the least developed nations of Bolivia, Ecuador, Paraguay and Peru.

(2) Basic Recognition

The Study was implemented bearing the following four (4) basic recognitions.

Basic Recognition 1: Globally important resources supply base and emerging markets

Not only for the world but also for Japan, South America is a major supply base of mineral resources and food. On the other hand, it has great marketing potential as an emerging economy. However, many nations face political, financial and social instability which often disturbs economic growth and international economic relations. At the present time, even in view of its position in the global economy, the stabilization of the South American region and its positive growth are desirable.

Basic Recognition 2: Great disparity, and economic growth necessary to overcome it

One distinct characteristic of South America is not only the great economic disparity among nations in the region, but also the great economic disparity within each nation. Although poverty reduction is an urgent task in almost all nations, the most important key is to secure certain economic growth and to create employment.

Basic Recognition 3: Potential for new economic development strategy with the progress of globalization and a borderless economy

The movement of regional economic integration which is progressing in South America has the potential to open up the economy and to rapidly advance a borderless environment. In addition, although relations with Europe and the United States are extremely strong, in the

future, it may be difficult for South America to grow without exchanges with the fast growing Asian economic bloc. Under this new international economic environment, South American nations, and in particular, industrial and trade development strategies in the least developed countries and aid packages should be reviewed from the ground up.

Basic Recognition 4: Turning point reached through Japanese technical cooperation for South America

With respect to Japanese ODA to South America, in particular, technical cooperation, both the amount and the share have been decreasing. In addition, some nations in South America are classified as “high and middle income nations”. It is therefore time to review the best method (course of action) for technical cooperation in view of Japanese ODA to South America, and the possibility of so-called “graduation”. On the other hand, in the least developed countries, growth-oriented cooperation through “production improvement”, “new industries development” and “trade promotion” should be strengthened more than in the past.

(3) Basic Policy Study Procedures

In promoting the Study, the following two policies are considered to be essential.

Basic Policy 1: Serious Consideration towards Study in Japan

Although 10 countries in South America will be subject to the Study, the situation in each individual country will not be investigated through a field survey. With respect to the South American region, it is more important to handle and arrange existing studies and research programs and materials than themes related to the Study, which sufficiently exist inside and outside the country.

Basic Policy 2: Serious Consideration of Dialogue with Four Least Developed Nations

In the case of compiling recommendations on technical cooperation policies for the four least developed nations (Bolivia, Ecuador, Paraguay and Peru), it is has been instructed to directly carried out a hearing survey from governmental personnel in each targeted nation. Dialogue with the four nations will become the core of final findings of the Study; the Study should be implemented in due consideration of this.

(4) Study Work-in-Process (Process of Operation)

The Study included three studies in Japan and a field survey implemented during the study period between April and October 2006. In addition, three study meetings were sponsored by the JICA Economic Development Department. The work-in-process is outlined as follows. In accordance with strict selection standards and methods, a survey was entrusted to a joint team of Professor Ricardo Bebczuk at the University of La Plata (Universidad Nacional de La Plata) and Mr. Daniel Berrettoni, researcher at the CEI (Centro de Economia Internacional) in Argentina. A study on two themes (i) a survey on economics and industries in ten South American nations,

and (ii) a survey on regional integration and external relations were implemented. The findings of the commissioned survey were effectively utilized as much as possible in this report and the original was attached in the appendix.

【Work-in-Process】

Preparation Work in Japan (1st Study in Japan)	[1]	Literature research (Documentation)
	[2]	Discussion with JICA on study framework
	[3]	IC/R preparation
	[4]	Preparation for re-commissioned survey
1st Field Survey	[5]	Collection of data on candidates in re-commissioned survey
	[6]	Collection of data on trend in Japanese assistance and trade investment of Japanese companies toward South America
2nd Study in Japan	[7]	Analysis of present data on economy in each nation
	[8]	Analysis of present data on development and economic policies in each nation
	[9]	P/R preparation
	[10]	Selection of candidates for re-commissioned survey
2nd Field Survey	[11]	Supplementary survey on documentation in Japan
	[12]	Contracting with candidates of re-commissioned survey
	[13]	Re-commissioned survey implementation
2nd Study in Japan (continued)	[14]	Control of progress of re-commissioned survey
	[15]	Analysis of trend in trade and investment of Japanese companies toward each nation
	[16]	Identification of major industries in each nation
	[17]	Analysis of trend in assistance in Japan and other donors
	[18]	Conformation of the contents of re-commissioned survey report
	[19]	Examination of direction of technical cooperation toward each nation
3rd Field Survey	[20]	Additional survey based on the findings of re-commissioned survey
	[21]	Hearing survey on trade and investment strategies of Japanese companies toward each nation
	[22]	Current conditions survey (hearing survey) on major industries in each nation
	[23]	Hearing survey for four least developed nations
3rd Study in Japan	[24]	Formulation of draft recommendations
	[25]	DF/R preparation
	[26]	Responding to comments on DF/R
	[27]	F/R preparations

(5) Implementation System

The Study was entrusted by the JICA to the International Development Center of Japan (IDCJ). The IDCJ organized the Study Team which consisted of the following members. This final report was prepared by the Study Team.

Team Leader／Macro Economy	Jinichiro Yabuta	IDCJ
Economic Partnership & Integration 1	Naoya Takebe	Same as above
Economic Partnership & Integration 2／Economic Analysis	Yusuke Hasegawa	Same as above
Industrial Policy & Institution	Masaaki Shiraishi	Same as above
Japanese-affiliated Trade & Investment Trend／Regional Infrastructure	Hiroo Okuda	Same as above
Assistance Trend Analysis／South American Economy	Mimi Sheikh	Same as above

In the implementation of the Study, we received many instructions, support and advice from governmental organizations and individuals in South American countries, donor agencies, the JICA Economic Development Department and JICA offices in Argentina, Bolivia, Brazil, Chile, Ecuador, Paraguay, Peru, the United States and Venezuela, members of the JICA study meetings, and Japanese embassies. We would like to express our gratitude.

The contents stated in the report are those of the Study Team and do not always reflect the views of JICA.

Part I

Actual State of South America and its Relationship with Japan

Part I
The Actual State of South America and its Relationship with Japan

Chapter 1　Outline of the South American Economy

This chapter takes a broad view of the 10 South American countries (Argentina, Brazil, Bolivia, Chile, Columbia, Ecuador, Paraguay, Peru, Uruguay and Venezuela) targeted for research in this project in terms of their features in comparison with the rest of the world and other areas based on basic economic and social indicators. Special attention is directed to the status of the four countries (Bolivia, Ecuador, Paraguay and Peru) that are the targets of this Study. After that, the broad economic trends of the overall Latin American region over the past 30 years or so are confirmed.

1-1 Status of South America in the World

1-1-1 South America in Terms of Key Economic Indicators

- Insufficient GDP ratio
- Major intra-regional disparities in terms of economy, population and national land area
- An even smaller trade ratio, but world-largest net export region of agricultural-products
- Generally a high standard in comparison with Africa and South Asia, but also including low-performance countries
- Stagnation over the past 10 years

The above points summarize the features of this region in the world based on Table 1-1, which gives the key economic indicators of the 10 South American countries. Specific explanation is given below.

First, looking at the scale of South America in the world, the 10 target countries accounted for 13% of the world's area, 6% of population and just 3% of GDP as of 2004. This indicates that economic activity, as represented by GDP, is excessively small in relation to population, etc.

The next feature is the existence of large disparities between the 10 countries in terms of each indicator. As of 2004, Brazil accounted for 49% of area, 50% of population and 51% of GDP in the whole region. In contrast, the four target countries of the Study only accounted for 18% of area, 15% of population and 10% of GDP. Looking at per capita GNI, whereas this is more than US$5,000 in Chile, it is less than US$1,000 in Bolivia. The 10 countries are broadly divided into the relatively high-income level group with income of more than US$3,000 (Brazil, Argentina, Venezuela, Chile and Uruguay) and the low-income group with income of US$2,000 or less (Columbia, Peru, Ecuador, Bolivia and Paraguay). The four target countries all belong to the low-income group.

The trade value of South America in the world is only around 2%, which is even lower than

the relative ratios of population and GDP. Again, Brazil, Argentina, Chile and Venezuela account for the majority of imports and exports, while the trade value of the four target countries accounts for just over 10% of all trade in the region. However, statistics on agricultural trade show that the South America is the largest net exporter of agricultural products in the world, with US$ 445 billion in 2004, which has been attracting more attentions as the "food supply base in the world"[1].

When compared with other regions of the world, i.e. Sub-Saharan Africa, South Asia, East Asia and Pacific, South America displays relatively high levels for GDP and per capita GDP. However, turning to the four target countries, in particular Bolivia and Paraguay, GDP is far lower than the Latin American average (US$3,576) and is below the mean figure for the East Asian and Pacific region.

In terms of comparison with conditions 10 years earlier, the ratio of South American GDP in the world economy has contracted from 4% to 3%, whereas that of the East Asia and Pacific region has expanded from 4% to more than 6%. Concerning trade, the ratio of South American exports in global merchandise trade has remained static, while the ratio of imports has gone down. As for per capita GDP, compared to the rapid growth of the East Asia and Pacific region and the steady expansion in the world average, the situation in South America as a whole has been static. There are even countries such as Argentina and Uruguay that have recorded major decline over the past 10 years.

Table 1-1 Basic Economic Indicators of the 10 South American Countries

	Land area (Mil. km²)	Population (Million)		GDP (US$ Billion)		GNI per capita (US$)		Merchandise exports (Current US$ Mil.)		Merchandise imports (Current US$ Mil.)	
	2004	1994	2004	1994	2004	1994	2004	1994	2004	1994	2004
Brazil	8.46	159.0	183.9	546.2	604.0	3,070	3,000	43,545	96,475	35,997	65,921
Argentina	2.74	34.4	38.4	257.4	153.0	7,580	3,580	15,659	34,453	21,527	22,320
Venezuela	0.88	21.6	26.1	56.5	110.1	2,640	4,030	16,089	34,210	9,187	14,995
Colombia	1.04	37.8	44.9	81.7	97.7	1,690	2,020	8,419	16,224	11,882	16,746
Chile	0.75	14.2	16.1	50.9	94.1	3,370	5,220	11,604	32,025	11,820	24,871
Peru*	1.29	23.4	27.6	44.9	68.6	1,800	2,360	4,554	12,547	5,626	10,101
Ecuador*	0.28	11.2	13.0	18.6	30.3	1,350	2,210	3,819	7,634	3,622	7,861
Uruguay	0.18	3.2	3.4	16.4	13.2	4,860	3,900	1,913	2,950	2,786	3,114
Bolivia*	1.08	7.3	9.0	6.0	8.8	830	960	1,032	2,129	1,209	1,842
Paraguay*	0.40	4.7	6.0	7.9	7.3	1,630	1,140	816	1,626	2,370	2,652
South America 10	17.10	316.8	368.4	1,086.5	1,187.2	n.a.	n.a.	107,450	240,273	106,026	170,423
(* 4 countries)	3.05	46.6	55.6	77.3	115.0	n.a.	n.a.	10,221	23,936	12,827	22,456
LAC	20.51	469.0	545.9	1,597.3	2,022.0	3,194	3,576	185,261	463,326	216,033	436,972
Japan	0.38	125.0	127.8	4,794.2	4,622.8	36,150	37,050	397,005	565,807	275,235	454,543
South Asia	5.13	1208.6	1446.8	427.5	880.2	342	594	39,235	104,394	46,987	140,502
East Asia & Pacific	16.30	1687.4	1869.5	1,062.8	2,650.9	614	1,416	289,176	966,841	297,260	903,670
Sub-Saharan Africa	24.27	569.4	725.8	280.7	523.3	509	601	64,988	143,866	63,918	141,150
World	133.48	5585	6365.0	26,624.7	41,290.4	4,758	6,329	4,330,947	9,145,028	4,384,897	9,376,651

Share of South America in the World

	Land area	Population		GDP		GNI per capita		Merchandise exports		Merchandise imports	
	2004	1994	2004	1994	2004	1994	2004	1994	2004	1994	2004
South America 10	**12.8%**	**5.7%**	**5.8%**	**4.1%**	**2.9%**	**-**	**-**	**2.5%**	**2.6%**	**2.4%**	**1.8%**
(* 4 countries)	**2.3%**	**0.8%**	**0.9%**	**0.3%**	**0.3%**	**-**	**-**	**0.2%**	**0.3%**	**0.3%**	**0.2%**
LAC	15.4%	8.4%	8.6%	6.0%	4.9%	-	-	4.3%	5.1%	4.9%	4.7%
Japan	0.3%	2.2%	2.0%	18.0%	11.2%	-	-	9.2%	6.2%	6.3%	4.8%
South Asia	3.8%	21.6%	22.7%	1.6%	2.1%	-	-	0.9%	1.1%	1.1%	1.5%
East Asia & Pacific	12.2%	30.2%	29.4%	4.0%	6.4%	-	-	6.7%	10.6%	6.8%	9.6%
Sub-Saharan Africa	18.2%	10.2%	11.4%	1.1%	1.3%	-	-	1.5%	1.6%	1.5%	1.5%
World	100%	100%	100%	100%	100%	-	-	100%	100%	100%	100%

Source: World Bank, World Development Indicators Online

[1] The South America region has been the largest net exporter of agricultural products since 1998, when it overtook United States. (Source: Ministry of Agriculture, Forestry and Fisheries of Japan; Original source: FAO, "FAOSTAT")

1-1-2 South America in Terms of Key Social Indicators

- High poverty rate in the four countries especially
- The worst income disparities in the world
- General trend of improvement in life expectancy at birth and adult literacy

The above points summarize the features of this region in terms of the key social indicators shown in Table 1-2.

First, regarding poverty, the ratio of the population living on income of less than US$1 per day is almost one-quarter in Bolivia, and it is clearly seen that the four target countries have a higher incidence of poverty than the rest of the region. Comparing with other regions of the world, Sub-Saharan Africa and South Asia have worse poverty ratios than South America, however, the four target countries now show a higher rate of poverty than the East Asia and Pacific region, which has demonstrated remarkable improvement over the past decade.

Furthermore, income differentials are large over the whole South American region. The Gini Index is more than 50% over the whole region, and hardly any countries have displayed any major improvement from the start of the 1990s. Conversely, differentials are growing wider in Columbia, Chile, Peru and Bolivia. In world terms, income differentials in South American countries are extremely high. Out of 126 countries in the world for which data was available, seven out of 10 of the South American countries were in the top 20 in terms of Gini Index, while all 10 were in the top 40 nations (see Table 1-3).

Concerning life expectancy at birth, the low level of Bolivia stands out, however, the situation is good in comparison to that in Sub-Saharan Africa and South Asia. In terms of comparison between 1990 and 2004, too, South America is generally displaying sound improvement. In terms of adult literacy, there is a slight disparity between the high-level group of Argentina, Chile and Uruguay and the other countries, but this too is generally showing improvement.

Table 1-2 Basic Social Indicators of the 10 South American Countries

	Population below $1 a day (%)		Gini index		Life expectancy at birth (years)		Literacy rate (% of people ages 15 and above)	
	1990	1998-2004[*1]	1989-1994	1998-2003	1990	2004	1990	2003
Brazil	n.a.	7.5	63.4 (1989)	58.0 (2003)	60	71	82	88.4
Argentina	n.a.	7.0	n.a.	52.8[*2] (2003)	72	75	95.7	97.2
Venezuela	n.a.	8.3	53.8 (1990)	44.1 (2000)	71	74	88.9	93
Colombia	n.a.	7.0	51.3 (1991)	58.6 (2003)	68	73	88.4	94.2
Chile	n.a.	<2	56.5 (1994)	57.1 (2000)	74	78	94	95.7
Peru	n.a.	12.5	44.9 (1994)	54.6 (2002)	66	70	85.5	87.7
Ecuador	n.a.	15.8	46.6 (1994)	43.7 (1998)	69	75	87.6	91
Uruguay	n.a.	<2	n.a.	44.9 (2003)	73	75	96.5	97.7
Bolivia	n.a.	23.2	42.0 (1990)	60.1 (2002)	59	65	78.1	86.5
Paraguay	n.a.	16.4	59.1 (1995)	57.8 (2002)	68	71	90.3	91.6
LAC	11.3	8.9 (2002)	n.a.	n.a.	68	72	85.1	89.6
Japan	-	-	24.9 (1993)	n.a.	79	82	-	-
South Asia	41.3	31.1 (2002)	n.a.	n.a.	59	63	47.7	58.9
East Asia & Pacific	29.6	11.6 (2002)	n.a.	n.a.	67	70	79.7	90.4
Sub-Saharan Africa	44.6	44.0 (2002)	n.a.	n.a.	49	46	51.1	61.3
World	n.a.	n.a.	n.a.	n.a.	65	67	-	-

*1 Latest data during the period

*2 Urban area

Source: World Bank, World Development Indicators Online; World Development Report
UNDP, Human Development Report 2005

Table 1-3 Top 20 Countries in Terms of Gini Index

Rank	Country	Year	Gini index
1	Namibia	1993	74.3
2	Lesotho	1995	63.2
3	Botswana	1993	63.0
4	Sierra Leone	1989	62.9
5	Central African Republic	1993	61.3
6	Swaziland	1994	60.9
7	Bolivia	2002	60.1
8	Haiti	2001	59.2
9	Colombia	2003	58.6
10	Brazil	2003	58.0
11	Paraguay	2002	57.8
12	South Africa	2000	57.8
13	Chile	2000	57.1
14	Panama	2002	56.4
15	Guatemala	2002	55.1
16	Peru	2002	54.6
17	Honduras	2003	53.8
18	Argentina*	2003	52.8
19	El Salvador	2002	52.4
20	Dominican Republic	2003	51.7

* Urban area

Source: World Bank, 2006 World Development Indicators

1-2 Overview of Economic Trends in Latin America from 1970 Onwards

The economy of Latin America in the second half of the 20th Century can broadly be viewed

over three phases[2]. First, there was the period of high-level growth up to the 1970s: during this period, countries adopted a policy of import-substitution industrialization based on development-oriented dictatorship government initiatives, and countries such as Mexico, Brazil and Argentina gained attention as newly industrialized countries (NICS). However, around the middle of the 1970s, the import-substitution industrialization strategy started to reach a dead end. In particular, external payment deficits arose as a result of importing large amounts of technology and expert know-how required for the said industrialization, and the foreign borrowing and issue of extra currency that was implemented in order to cover this led to the further growth of foreign debt and chronic inflation[3].

Second came the period of cumulative debt crisis of the 1980s. The cumulative debt of Latin America as a whole grew from US$68.5 billion in 1975 to US$318.4 billion in 1982 and, starting from the debt crisis in Mexico in that year, the flow of funds to the region from the rest of the world decreased sharply and Latin America was confronted with an economic and social crisis that came to be known as the "lost decade."

The third phase was the period of recovery and currency crisis during the 1990s. New democratic governments, which replaced the development-oriented dictatorships, adopted a strategy of neo-liberalist market-oriented development in order to rebuild national economies, and economic structural reforms were implemented in order to replace government initiative with market initiative. Policies comprising trade liberalization, fiscal discipline, privatization and deregulation under the lead of the IMF and World Bank were known as the Washington Consensus. As a result, the Latin American economies recovered and the 1990s witnessed higher economic growth than in the 1980s. However, amidst advancing globalization of the international financial market, the capital markets of South American countries promoting liberalization were subjected to a major impact, and Mexico in 1994, Brazil in 1998 and Argentina in 2002 experienced currency crises and major domestic economic disruption. For the region as a whole, the five years of economic slump from 1998 onwards came to be known as the "lost five years."

The recent macro economy of Latin America following the lost five years has regained its balance. Inflation has fallen to single digits in a lot of countries. GDP of the overall region, which experienced almost zero growth from 2000 to 2003, rebounded to 6% growth in 2004 and was over 4% in 2005. Another recent feature of the Latin American economy has been a growing current account surplus for three consecutive years from 2003, and this has been largely boosted by higher exports triggered by higher demand from China and other Asian countries and improvement in trade conditions due to inflation in the price of crude oil, etc.[4]. Moreover, improvement in the fiscal balance has been underpinned by a major drop in the ratio of public debt to GDP from 60% in 2002 to around 45% in 2005[5].

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[2] Akitsugi Nishijima and Akio Hosono (2004), "Latin American Economic Theory," Minerva Shobo

[3] Yuzo Kamo et al. (2005), "Latin America (2nd Edition)," Jiyukokuminsha

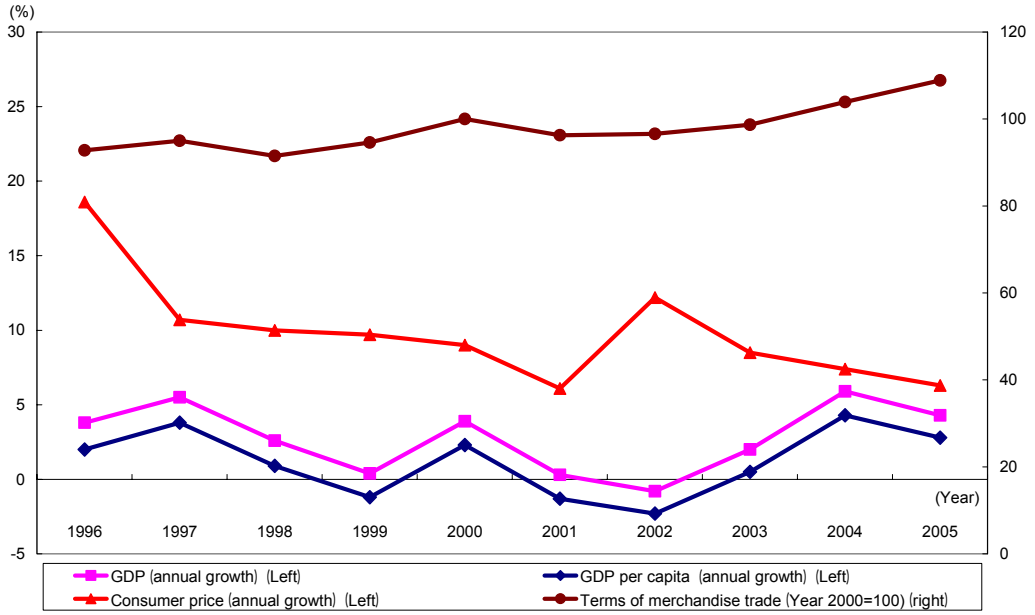
[4] Another factor has been the contribution of money transfers by immigrants mainly from Mexico and Central American countries.

[5] The figure for 2005 is an estimate value (ECLAC (2005)).

Table 1-4　Economic Development Movements in Latin American Countries in the Second Half of the 20th Century

Period	1970-80 High-level growth	1981-90 Cumulative debt crisis	1991-2000 Recovery and currency crisis
Economic growth rate (annual average, %)	5.9	1.2	3.3
Development strategy	Import-substitution industrialization	Adjustment towards transition	New liberalism

Source: Akitsugi Nishijima and Akio Hosono (2004), “Latin American Economic Theory,” Minerva Shobo



Note: Data on Latin America and Caribbean countries. 2005 data are preliminary.

Source: ECLAC, Preliminary Overview of the Economies of Latin America and the Caribbean 2005

Figure 1-1　Recent Economic Movements in Latin America

1-3 Overview of Economies in South American Countries

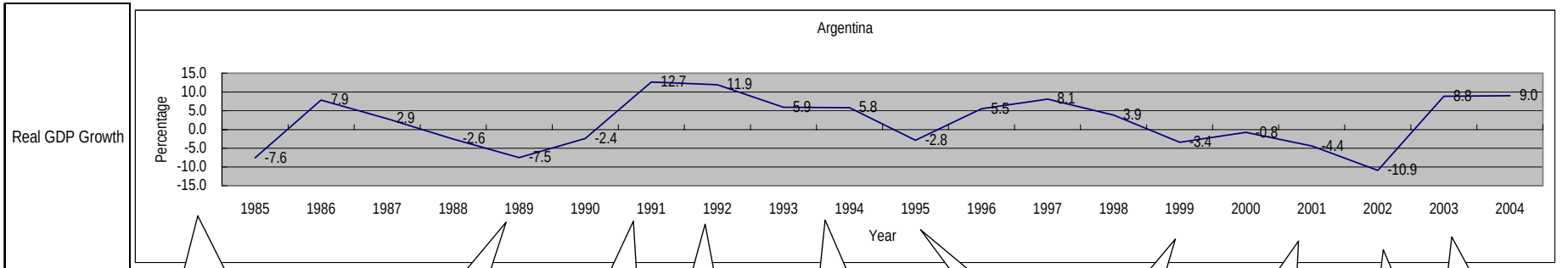
In this section, the recent economic trend in ten (10) South American nations will be independently outlined.

1-3-1 Argentina

The total area of Argentina is 2,791,810 km^2 and its population is 38.4 million (2004). The centrally located Pampas plains are considered to be the most fertile agricultural and livestock farming region in the world. In the northwest are the Andes Mountains, suitable for diversified agriculture, livestock farming and forestry. Southern Patagonia is the production center of sheep farming and is a petroleum and natural oil development zone. Argentina's per capita GNI (gross national income) is 3,680 dollars (2004), which is one of the highest in South America. More than 70% of all exports are farming products and processed farm products. Currently, the largest export destinations are Brazil, the United States, the Netherlands, Germany and Chile.

Major farming products include wheat, corn, soybeans, beef, sheep, timber, marine products (such as merluccius, cuttlefish, sea bream and shrimp), tobacco, sugar, rice, citrus fruits, grapes, and apples, etc. The manufacturing industry in Argentina has been diversified to some extent. In addition to agricultural and livestock farming products, labor-intensive manufacturing industries such as clothing, textiles and leather products and capital-intensive manufacturing industries such as iron and steel, chemistry and petrochemistry have been also developed.

The Argentinean economy went through a period of hyper inflation in the latter half of the 1980s and an economic crisis since 1998 which has now lasted more than 5 years, to finally showing signs of recovery in 2003. However, unstable factors such as the problem of private debt reorganization and an increase in the number of poor in urban areas still remain.



Real GDP Growth

Political developments

Argentina
October 1983
Presidential election held in transition to civilian rule.
December 1983
Raul Alfonsin of the Radical Party sworn in as president.
First civilian government in 8 years.
As a democratic administration, the Alfonsin administration is faced with the need to resolve many fundamental problems from the military era, including human rights problems, civilian control of the military, and reform of labor laws.

1989
Annual inflation rate of 5,000%.
Carlos Menem, of the Peronist party campaigning for economic reconstruction, is elected president.
President Alfonsin resigns in July, although his term is not scheduled to end until December. A new administration is born.

December 1990
Military uprising.

1991
Governmental graft discovered.
Administration faces difficult situation and addresses it by changing the cabinet.
Achieves economic stability and regains public support.
February 1991: 29%
December 1991: 60%

March 1991
Argentina, Brazil, and Chile sign the Mendoza Declaration prohibiting the development of chemical and biological weapons.

February 1995
Argentina independently joins the nuclear non-proliferation treaty (NPT).

December 1993
Bill requiring constitutional reform passes congress.
April 1994
Administrative assembly election held.
August 1994
Re-election of President Menem, which had been prohibited, is approved. A presidential run-off system was introduced due to the expectations of the opposition.

July 1995
President Menem begins second term.

December 1999
Fernando de la Rua sworn in as president.

Fiscal deficit and foreign debt increase rapidly at the end of the Menem administration, due to free-spending economic policies.

December 2001
President de la Rua resigns.

President de la Rua resigns to take responsibility for the social unrest caused by the economic/financial crisis that occurred in November.

January 2002
President Eduardo Duhalde sworn in.

Provisional administration of President Duhalde begins.

May 2003
President Nestor Kirchner sworn in.
April 2003
Presidential election brought forward and Kirchner elected.
Administration faced with tackling problems of unemployment and poverty, while normalizing relations with the IMF and resolving issues of debt.

Economic developments

1985
Iguazu Declaration
Begins economic consolidation with Brazil in the framework of the Latin American Integration Association.

July 1989
President Menem pursues policies different from the conventional populism of his Peronist party, such as opening the economy and privatizing state companies.

Announcement of new economic policies centering on real wage recovery, price agreements, increased rates for public services, and devaluation of exchange rate.

January 1990
In order to clear the central bank's interest burden, fixed-period savings are forcibly converted to national bonds valued in US dollars. At the same time, commodity prices, exchange rates, interest rates, and wages are entirely liberalized.
Fiscal deficits and inflation results.
March 1990
Restoration of fiscal balance by means of a temporary freeze on government spending and ban on rediscounting by the central bank. As the exchange rate stabilizes, the economy recovers.

End of 1991
Finance Minister Domingo Cavallo implements price control measures such as fixing the exchange rate, prohibiting indexation, and reducing customs duties. As well as restoring fiscal balance through sudden tax increases, a reduction in the rate of price inflation is achieved.

1992
Economic policies maintained with massive increases in tax revenue. With the sense of taking a breather from the consumption boom, the economy gently slows down.

1993
Economy stabilizes as a result of the restructuring reforms and the efforts of domestic companies, while the country is on the brink of loosing domestic and international confidence in the Convertibility Law and the exchange rate.
1995
Capital procurement becomes difficult as a result of the Mexican financial crisis.

January 1995
Mercosur established.

February 1995
Announcement of measures to balance the fiscal budget, including a reduction in the salaries of government workers.

April 1998
Meeting of Mercosur and the Andes Community.
Negotiations begin for free trade agreement to take effect from 2000.

1999
Economy worsens due to the effects of the Brazilian financial crisis in January.

Second half of 2001
Financial instability leads to financial crisis and overall economic crisis.
Social unrest triggered by measures to limit withdrawals from savings.
President de la Rua resigns. The Duhalde administration declares a moratorium on foreign debt and the abolition of convertibility. Negotiations with the IMF become difficult, but provisional agreement reached in January 2003, followed by formal agreement in September under the Kirchner administration.

The Kirchner administration rejects the policies of the Menem era and emphasizes social policy. Refusing to bow to IMF pressure, in August 2004 the administration aborts the economic restructuring reforms called for under the agreement with the IMF. Negotiations with the IMF begin again from February 2005.

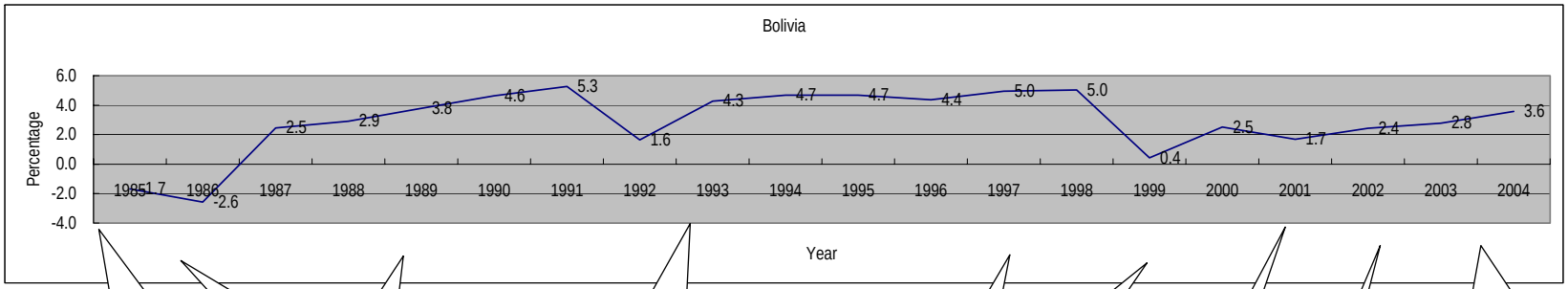
1-3-2 Bolivia

The total area of Bolivia is 1,098,581 km^2 and its population is 9 million (2004). Bolivia's per capita GNI is 960 dollars (2004) which is the lowest in South America. Bolivia is a landlocked country surrounding by five nations of Peru, Brazil, Paraguay, Argentina and Chile. Bolivian geography can be roughly divided into three regions, the highland zone of more then 3,000m in altitude and mainly comprising the Andes Mountains, the lowland zone in the foothills east of the mountain, and the plains and lowland zone in eastern region. In the Andes highlands, in addition to abundant mineral resources, traditional agriculture and light manufacturing industries have taken root. In the Andes lowlands, due to the mild climate, wheat, corn, fruits and cocoa, etc. have been cultivated. And despite the vastness of the eastern lowland zone, the district of Santa Cruz is a large-scale production base for farming products such as soy beans and sugar.

The economy of Bolivia is dependent on the mining industry, in mainly tin and natural gas and also agriculture. In particular, mineral resources such as tin and zinc account for most of the mineral resources. In addition, in terms of petroleum and natural gas, natural gas is a major export product to Argentina and Brazil. In the agricultural and livestock farming sector, in addition to traditional agriculture mainly in small-scale micro farming, soybeans, cotton, coffee, sugarcane and beef, have been produced for export in the recent years. The manufacturing industry mainly includes light industries such as food, textiles, tobacco and log processing. Since many of these are supported through the household (cottage) industry and micro enterprises, few enterprises have the international competitiveness required to stimulate economic growth.

Although the economy of Bolivia was hit by a severe depression at the end of the1990s, the recent economic growth rate shows signs of improving due to an expansion in exports that has resulted from an increase in international prices for natural gas, promotion of Andes trading by the United States, promotion of exports such as the textile, timber and leather sectors in accordance with the Andes Trade Promotion and Drug Eradication Act (ATPDEA), and an expansion in soybean exports associated with increased demand. A reduction in the fiscal deficit was realized in 2004 in accordance with an agreement with the IMF. On the other hand, ways of promoting economic activity outside an export-oriented economy and large-scale poverty reduction have become important undertakings.

Real GDP Growth



Political developments

1982 Successful transition to civilian rule.

September 1982
President Siles Zuazo sworn in.
Causes hyperinflation due to fundamental weakness of administration and pressure from labor unions.

July 1985
General election held.
Pas Estenssoro wins.

The administration of Pas Estenssoro strives to ease the country's circumstances by improving the fiscal budget soundness, pursuing neo-liberal economic policies such as liberalizing exports and imports and foreign capital transactions, and taking a hard line against labor union attacks by imposing strict martial law.

August 1989
Paz Zamora begins an administration aligned with the center-left.
Repudiates the policies of the previous administration and works tirelessly to establish democracy.

June 1993
Administration of Sanchez de Lozada begins (1993-1997).

Structural adjustments implemented based on liberal economic policies since 1985.
In order to solidify the developing democracy, "People's Participation Policy" promoted to encourage the participation of Indio peoples in politics.

August 1997
Administration of Banzer Suarez begins. (until August 2001)

January 2000
Soldiers enforcing anti-drug policies in the Chapare district are attacked and killed.
Standoff between coca producers and the government.

2001
Administration of Jorge Quiroga begins, but ends by 2002.

August 2003
Administration of Gonzalo Sanchez de Lozada begins.
Unrest occurs centering on indigenous groups opposed to the government's promotion of a plan to export natural gas to the US. The Sanchez administration ends.

October 2003
Administration of Carlos Mesa Gisbert begins.
President Mesa, elected president after being vice president, created an administration without any strong party affiliation. Holds referendum on the plan to export natural gas. However, conflict intensifies between the excessively resource-nationalistic residents of the western region (the poor and the indigenous peoples) and the residents of the eastern region (white, wealthy). In June 2005, the president steps down to take responsibility for the problem.

Economic developments

1985
20,000% annual hyper-inflation occurs.

The Pas Estenssoro administration implements new economic policies such as establishing fiscal soundness by rationalizing state companies in deficit and liberalizing imports and exports and foreign currency transactions.
Inflation rate reduced to 10.7% and 21.5% in 1987 and 1988 respectively.
The negative growth that had continued since 1982 was also halted.

1986
The IMF begins standby cooperation.
The road of debt repayment negotiations and arranging new loans begins.

1990
Investment-related laws such as the Investment Law and the Hydrocarbons Law are enacted.

1991
New Mineral Industry Law promulgated.
Liberalization measures implemented such as reducing import tariffs and reducing subsidies.

1993
Sanchez de Rosada administration.

[Capitalization Measures]
Attempts to double the assets of the six large state-run companies (the telephone, oil, airline, railway, electricity, and casting companies) by introducing private capital. This is intended to improve the productivity and profitability of the companies and allow the return of part of the profits to the citizens.

September 1994
Free trade agreement signed with Mexico.

September 1996
Achieves basic agreement with Brazil on the construction of a natural gas pipeline. The investment amount is US$1.8 billion.

December 1996
Concludes free trade agreement with Mercosur.

April 1997
The World Bank and the IMF hold a joint development committee meeting in Washington.
Agree to newly add three of the world's poorest countries struggling under heavy debt, including Bolivia, to the list of countries for which debt will be reduced.

Severe economic difficulties faced due to the effects on the informal sector of the drug eradication measures implemented from 1999.

2001
Application of the "Expanded HIPC (Heavily Indebted Poor Countries)".

2004
Achieves reduction of budget deficits under agreement with the IMF, by introducing new taxes and implementing stringent fiscal measures.
The agricultural and manufacturing sectors are strongly influenced by economic conditions in neighboring countries, but exports expand for the soybeans produced in the region around Santa Cruz, and for the sectors eligible for preferential tariffs under the Andean Trade Promotion and Drug Eradication Act (ATPDEA) (the textile, timber, gold ornaments, and leather sectors). The demand for natural gas and the good global economic conditions allow a high rate of growth to be achieved.

1-3-3 Brazil

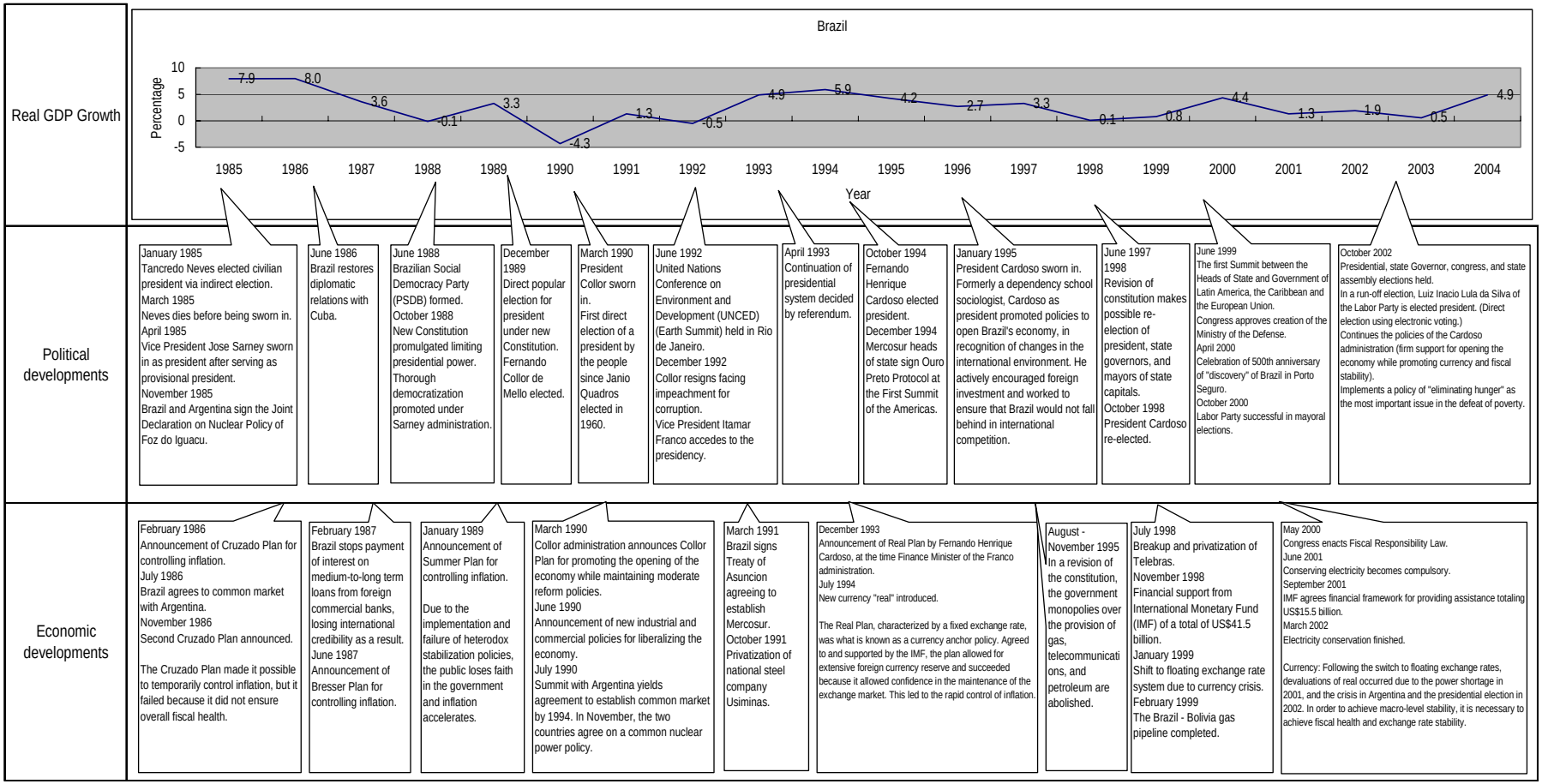
The total area of Brazil is 8,511,996 km^2 and its population is 183.9 million (2004), making it the fifth largest country in the world in both area and population, and the largest country in South America. Its per capita GNI is 3,000 dollars (2004). Brazil accounts for almost half of the eastern South American continent and borders all countries in South America except for Chile and Ecuador. 41% of its national land is at an elevation of 200 m or below and only 0.6% is 1,200 m or higher. Its climate is diversified from a tropical zone to subtropical, temperate, and semi-arid.

Brazil is a vast country, rich in natural resources and with a huge domestic market surpassing all other South American nations in both agriculture and industrial production. Agriculture accounts for only about 10% of the present GDP, and those who engaged in agriculture account for one quarter (1/4) of the total workforce, making it an important domestic industry. Major farming products include coffee, soybeans, corn, wheat, legumes, sugarcane, cotton, oranges, and tomatoes. As the largest producer of coffee, sugarcane and oranges and second largest producer of soybeans in the world, Brazil is a major player in global market of agricultural products. In terms of the mining industry, in addition to iron ore and manganese, Brazil has become one of the largest producers of bauxite and tin in the world. Furthermore, Brazil is one of the world's most industrialized nations, with a well established manufacturing industry including iron and steel, petroleum refining, automobiles, ship building and aircraft, electrical and electronic equipment to paper manufacturing, chemicals, textiles and food.

Brazil has a structure through which primary products such as coffee, soybeans or iron ore are exported conventionally and raw materials or mechanical equipment are imported for the purpose of promoting the industrialization of domestic production through import substitution policies and the diversification of export products. However, at the beginning of the 1990s, the government shifted its policy of protecting domestic industries to favoring a more open economy. If we look at the recent export structure, industrial (manufacturing) products account for the majority, mainly in hardware (metal goods), transportation equipment, machinery, machine parts, chemical products and leather products. The largest export business destination is the United States, followed by the EU and China.

However, despite progress made in Brazilian industrialization and increasing national incomes, domestic disparity still remains a major social concern. For example, the southern states, and mainly Sao Paulo, have pulled the Brazilian economy along through remarkable industrial development together with agricultural production in products such as coffee and cotton; whereas, landowners (land-owning class) in the rural northeast still maintain control of farmland run by tenant farmers, so class disparity still remains. At the same time, this has helped to bring about a social problem in urban areas of poor farmers who are forced to work away from home contributing to the problem of slums in urban areas.

Recently, the economy has improved and Brazilian markets have recovered thanks to measures taken by President Lula who assumed office in 2003 during a period of unstable money markets and a sudden drop in currency in 2002 and a rise in country risk. In addition, 2004 saw economic growth rise to 4.9% due to favorable export conditions including the export of farming products.


Real GDP Growth
Brazil
Percentage
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-0.5
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0.8
4.4
1.3
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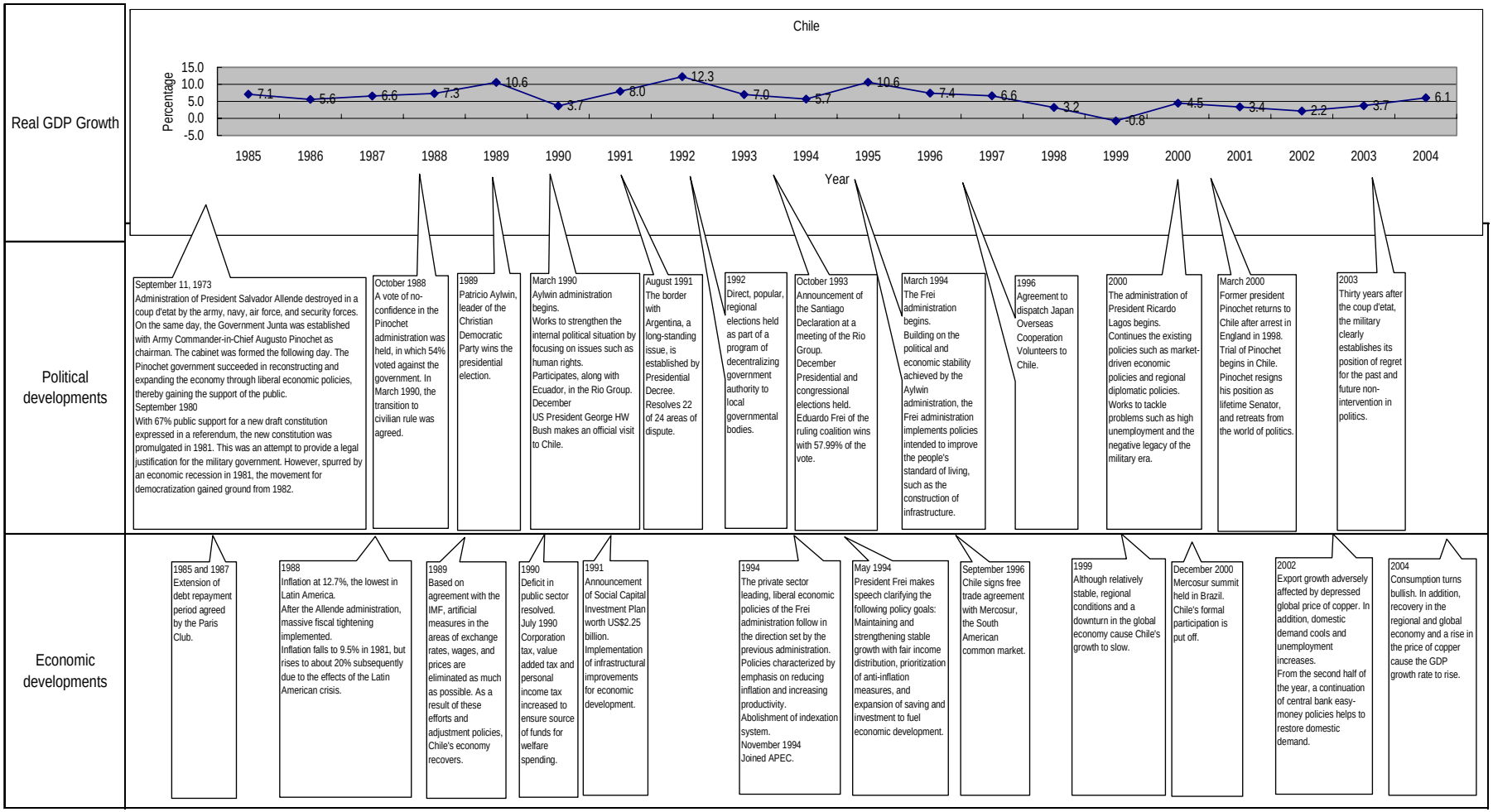
Year
Political developments
January 1985
Tancredo Neves elected civilian president via indirect election.
March 1985
Neves dies before being sworn in.
April 1985
Vice President Jose Sarney sworn in as president after serving as provisional president.
November 1985
Brazil and Argentina sign the Joint Declaration on Nuclear Policy of Foz do Iguacu.
June 1986
Brazil restores diplomatic relations with Cuba.
June 1988
Brazilian Social Democracy Party (PSDB) formed.
October 1988
New Constitution promulgated limiting presidential power.
Thorough democratization promoted under Sarney administration.
December 1989
Direct popular election for president under new Constitution.
Fernando Collor de Mello elected.
March 1990
President Collor sworn in.
First direct election of a president by the people since Janio Quadros elected in 1960.
June 1992
United Nations Conference on Environment and Development (UNCED) (Earth Summit) held in Rio de Janeiro.
December 1992
Collor resigns facing impeachment for corruption.
Vice President Itamar Franco accedes to the presidency.
April 1993
Continuation of presidential system decided by referendum.
October 1994
Fernando Henrique Cardoso elected president.
December 1994
Mercosur heads of state sign Ouro Preto Protocol at the First Summit of the Americas.
January 1995
President Cardoso sworn in. Formerly a dependency school sociologist, Cardoso as president promoted policies to open Brazil's economy, in recognition of changes in the international environment. He actively encouraged foreign investment and worked to ensure that Brazil would not fall behind in international competition.
June 1997
1998
Revision of constitution makes possible re-election of president, state governors, and mayors of state capitals.
October 1998
President Cardoso re-elected.
June 1999
The first Summit between the Heads of State and Government of Latin America, the Caribbean and the European Union.
Congress approves creation of the Ministry of the Defense.
April 2000
Celebration of 500th anniversary of "discovery" of Brazil in Porto Seguro.
October 2000
Labor Party successful in mayoral elections.
October 2002
Presidential, state Governor, congress, and state assembly elections held.
In a run-off election, Luiz Inacio Lula da Silva of the Labor Party is elected president. (Direct election using electronic voting.)
Continues the policies of the Cardoso administration (firm support for opening the economy while promoting currency and fiscal stability).
Implements a policy of "eliminating hunger" as the most important issue in the defeat of poverty.
Economic developments
February 1986
Announcement of Cruzado Plan for controlling inflation.
July 1986
Brazil agrees to common market with Argentina.
November 1986
Second Cruzado Plan announced.
The Cruzado Plan made it possible to temporarily control inflation, but it failed because it did not ensure overall fiscal health.
February 1987
Brazil stops payment of interest on medium-to-long term loans from foreign commercial banks, losing international credibility as a result.
June 1987
Announcement of Bresser Plan for controlling inflation.
January 1989
Announcement of Summer Plan for controlling inflation.
Due to the implementation and failure of heterodox stabilization policies, the public loses faith in the government and inflation accelerates.
March 1990
Collor administration announces Collor Plan for promoting the opening of the economy while maintaining moderate reform policies.
June 1990
Announcement of new industrial and commercial policies for liberalizing the economy.
July 1990
Summit with Argentina yields agreement to establish common market by 1994. In November, the two countries agree on a common nuclear power policy.
March 1991
Brazil signs Treaty of Asuncion agreeing to establish Mercosur.
October 1991
Privatization of national steel company Usiminas.
December 1993
Announcement of Real Plan by Fernando Henrique Cardoso, at the time Finance Minister of the Franco administration.
July 1994
New currency "real" introduced.
The Real Plan, characterized by a fixed exchange rate, was what is known as a currency anchor policy. Agreed to and supported by the IMF, the plan allowed for extensive foreign currency reserve and succeeded because it allowed confidence in the maintenance of the exchange market. This led to the rapid control of inflation.
August - November 1995
In a revision of the constitution, the government monopolies over the provision of gas, telecommunications, and petroleum are abolished.
July 1998
Breakup and privatization of Telebras.
November 1998
Financial support from International Monetary Fund (IMF) of a total of US$41.5 billion.
January 1999
Shift to floating exchange rate system due to currency crisis.
February 1999
The Brazil - Bolivia gas pipeline completed.
May 2000
Congress enacts Fiscal Responsibility Law.
June 2001
Conserving electricity becomes compulsory.
September 2001
IMF agrees financial framework for providing assistance totaling US$15.5 billion.
March 2002
Electricity conservation finished.
Currency: Following the switch to floating exchange rates, devaluations of real occurred due to the power shortage in 2001, and the crisis in Argentina and the presidential election in 2002. In order to achieve macro-level stability, it is necessary to achieve fiscal health and exchange rate stability.

1-3-4 Chile

The total area of Chile is 756,626 km^2 and its population is 16.1 million (2004). Its per capita GNI is 5,220 dollars (2004) which is the highest in South America. Although its territory covers more than 4,300km, from east to west the country is only 80km to 375km wide at its minimum and maximum points respectively. Chile is located at the southeast end of South America facing the Pacific Ocean and 80% of its territory is mountainous and part of the Andes range. Although the north is unsuitable for agriculture due to its arid dessert-like climate, there are rich mineral resources including copper. The climate in the central region is warm so it has become a center of agricultural production. Metropolitan Santiago is also located here making it an area of dense population and industrial activity.

Chile is the largest producer of copper in the world in both output and deposits, which overwhelmingly sets it apart from other countries. Copper is the nation's largest export. Since it broke away from a monoculture-type economy controlled by international copper prices; an ongoing issue facing the nation; despite a drop in the export share of mineral products due to an increase in other export products under the government's policy of industrial diversification, and protection and development of the manufacturing industry, the basic structure has not changed significantly. In terms of agriculture, by utilizing natural conditions or seasonal differences with the Northern Hemisphere, fruit cultivation has become an important activity in recent years and has become a key export in the agricultural sector. In addition, in the fisheries, in addition to fish meal, as fish cultivation of salmon and trout continues to develop, the export of frozen and fresh fish and shellfish continues to expand. In addition to minerals, agricultural, forestry and marine products and goods processed from them, others include processed and semi-processed products such as wood products, paper and pulp and hardware.

Since the middle of the 1970s Chile has enthusiastically endorsed an open economic policy so that its degree of trade dependency (ratio of the total amount of trade in GDP) is 68% which is the highest in South America (2005). At the end of the 1990s the economy began to slow due to the effects of the global economy and the Asian currency crisis. However, since then it has shown signs of recovery; so economic diplomacy from the viewpoint of free trade continues due to a uniform reduction in foreign customs duties to 6% since 2003, a positive attitude towards the conclusion of a bilateral free trade agreement, and active participation in the WTO.


Real GDP Growth
Chile
Percentage
15.0
10.0
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12.3
7.0
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Year
Political developments
September 11, 1973
Administration of President Salvador Allende destroyed in a coup d'etat by the army, navy, air force, and security forces. On the same day, the Government Junta was established with Army Commander-in-Chief Augusto Pinochet as chairman. The cabinet was formed the following day. The Pinochet government succeeded in reconstructing and expanding the economy through liberal economic policies, thereby gaining the support of the public.
September 1980
With 67% public support for a new draft constitution expressed in a referendum, the new constitution was promulgated in 1981. This was an attempt to provide a legal justification for the military government. However, spurred by an economic recession in 1981, the movement for democratization gained ground from 1982.
October 1988
A vote of no-confidence in the Pinochet administration was held, in which 54% voted against the government. In March 1990, the transition to civilian rule was agreed.
1989
Patricio Aylwin, leader of the Christian Democratic Party wins the presidential election.
March 1990
Aylwin administration begins.
Works to strengthen the internal political situation by focusing on issues such as human rights.
Participates, along with Ecuador, in the Rio Group.
December
US President George HW Bush makes an official visit to Chile.
August 1991
The border with Argentina, a long-standing issue, is established by Presidential Decree.
Resolves 22 of 24 areas of dispute.
1992
Direct, popular, regional elections held as part of a program of decentralizing government authority to local governmental bodies.
October 1993
Announcement of the Santiago Declaration at a meeting of the Rio Group.
December
Presidential and congressional elections held.
Eduardo Frei of the ruling coalition wins with 57.99% of the vote.
March 1994
The Frei administration begins.
Building on the political and economic stability achieved by the Aylwin administration, the Frei administration implements policies intended to improve the people's standard of living, such as the construction of infrastructure.
1996
Agreement to dispatch Japan Overseas Cooperation Volunteers to Chile.
2000
The administration of President Ricardo Lagos begins.
Continues the existing policies such as market-driven economic policies and regional diplomatic policies.
Works to tackle problems such as high unemployment and the negative legacy of the military era.
March 2000
Former president Pinochet returns to Chile after arrest in England in 1998.
Trial of Pinochet begins in Chile.
Pinochet resigns his position as lifetime Senator, and retreats from the world of politics.
2003
Thirty years after the coup d'etat, the military clearly establishes its position of regret for the past and future non-intervention in politics.
Economic developments
1985 and 1987
Extension of debt repayment period agreed by the Paris Club.
1988
Inflation at 12.7%, the lowest in Latin America.
After the Allende administration, massive fiscal tightening implemented.
Inflation falls to 9.5% in 1981, but rises to about 20% subsequently due to the effects of the Latin American crisis.
1989
Based on agreement with the IMF, artificial measures in the areas of exchange rates, wages, and prices are eliminated as much as possible. As a result of these efforts and adjustment policies, Chile's economy recovers.
1990
Deficit in public sector resolved.
July 1990
Corporation tax, value added tax and personal income tax increased to ensure source of funds for welfare spending.
1991
Announcement of Social Capital Investment Plan worth US$2.25 billion.
Implementation of infrastructural improvements for economic development.
1994
The private sector leading, liberal economic policies of the Frei administration follow in the direction set by the previous administration.
Policies characterized by emphasis on reducing inflation and increasing productivity.
Abolishment of indexation system.
November 1994
Joined APEC.
May 1994
President Frei makes speech clarifying the following policy goals: Maintaining and strengthening stable growth with fair income distribution, prioritization of anti-inflation measures, and expansion of saving and investment to fuel economic development.
September 1996
Chile signs free trade agreement with Mercosur, the South American common market.
1999
Although relatively stable, regional conditions and a downturn in the global economy cause Chile's growth to slow.
December 2000
Mercosur summit held in Brazil.
Chile's formal participation is put off.
2002
Export growth adversely affected by depressed global price of copper. In addition, domestic demand cools and unemployment increases.
From the second half of the year, a continuation of central bank easy-money policies helps to restore domestic demand.
2004
Consumption turns bullish. In addition, recovery in the regional and global economy and a rise in the price of copper cause the GDP growth rate to rise.

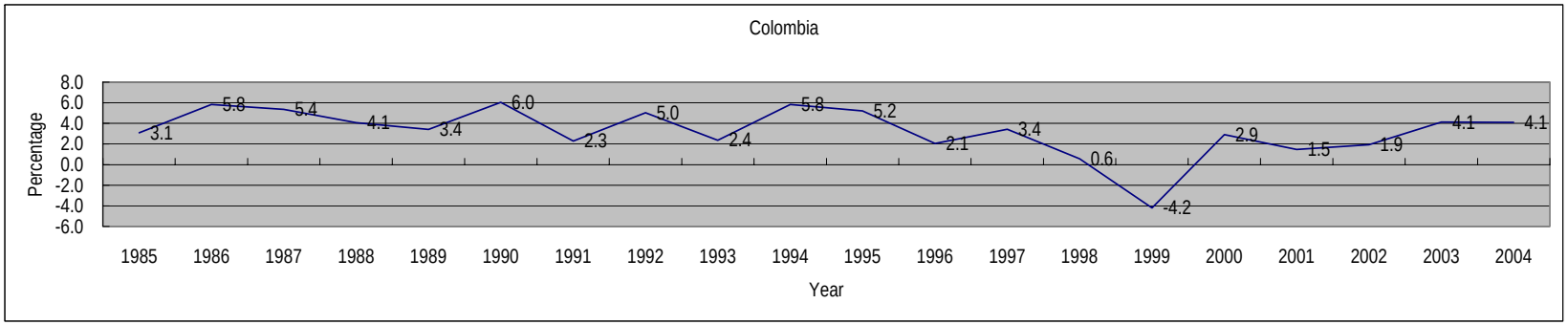
1-3-5 Columbia

The total area of Columbia is 1,138,914 km^2; its population is 44.9 million (2004). Its per capita GNI is 2,020 dollars (2004). Columbia is located in the northeast region of South America bordering Panama in Central America, Ecuador and Peru to the south, and Brazil and Venezuela to the east. The western half of the country, or approximately 40% of its territory, is a mountainous plateau; the eastern half or other 59% is open plains and forests.

Major agricultural products make up approximately 20% of the GDP and include coffee, bananas, sugar, fresh flowers, potatoes and rice. In particular, it is the second largest producer of coffee in the world after Brazil and almost its entire land area is between 200m and 2,000m in elevation. Columbia is also blessed by natural resources such as petroleum, coal, natural gas, gold and emeralds. Traditionally, the economy has relied strongly on coffee. Although exporting of petroleum and coal began due to the government's policy of promoting the mining industry in the 1980s, most production still concentrate on primary products despite a decrease in dependency. In terms of manufacturing, the chemical industry and metal processing industry have been developed in addition to traditional light industries such as food and beverages, textiles and leather. Since joint ventures mainly through foreign capital investment have also been launched in the auto industry, products are not only sold on the domestic market, but also exported to neighboring countries. The United States is Columbia's largest trading partner in both exports and imports, and in February 2006 the country was the first nation of the Community of Andean Nations (CAN) to conclude a bilateral free trade agreement. Other major trading partners in South America include Venezuela, Ecuador and Brazil.

Columbia is one of the few nations that did not opt for debt rescheduling even during the debt crisis of Central and South America in the 1980s and has consistently recorded positive growth since 1932 under reliable economic management. Negative growth was recorded in 1999 for the first time due to the global recession and a slump in coffee prices. Since 2000, however, a positive growth rate has once again been realized. Thanks to its rich agricultural and mineral resources Columbia appears to have the potential for high economic growth, and is the second most densely populated South American nation after Brazil. Moreover, its education standards are among the highest.

Real GDP Growth



Political developments

Civilian administration maintained / Two major parties: Liberal Party and Conservative Party
Conflict with left-wing guerrillas

1986
Virgilio Barco Vargas of the Liberal Party wins the presidency.
With the elimination of absolute poverty as the administration's basic policy, promotes various projects such as national reconstruction projects.

From the beginning of the administration, there is an expansion of extralegal power groups such as left-wing guerrillas, the drug mafia, and extreme right-wing organizations.
Democratic system at risk.

1990
Cesar Gaviria Trujillo of the Liberal Party wins the presidency.
December 1990
A Constituent Assembly election held.

February 1991
The assembly is convened, with participation of representatives of guerrilla groups that have laid down their arms.
July 1991
New constitution promulgated.

1992
Peace talk breaks down between the government and the two larges guerrilla groups, the FARC and the ELN.

July 1993
Signs agreement to establish the Association of Caribbean States.

1994
The Gavilia administration signs peace accord with the CRS guerrilla group.
Ernesto Samper of the Liberal Party wins the presidential election.

June 1998
Andres Pastrana of the Conservative Party wins the presidential election.

January 1999
President Pastrana begins peace negotiations with the FARC.
February 2002
Peace negotiations ended after terrorist action.

August 2002
President Alvaro Uribe sworn in.
With the restoration of security the main priority, succeeds in disarming the extreme right-wing paramilitary organizations.

President Uribe continues the "Plan Colombia" from previous administrations.

2003
The "London donor governments' meeting" and "London meeting on international support for Colombia" are held.
International society confirms commitment to assisting Colombia.

Economic developments

During the Central and South American debt crisis of the 1980's, only Colombia did not reschedule its debt and achieved consistent positive growth, strong economic management and good performance.

In the same years, as part of government policies to develop industry, exports of oil and coal begin in earnest in 1986 and 1987 respectively.

In 1991, oil became the country's top export, ahead of coffee.

The market opening measures begun at the end of the Barco administration are continued by the Gaviria administration that began in 1990. These measures are implemented seriously for the purpose of internationalizing and modernizing the economy.

1991
Exchange rate system greatly liberalized.
It becomes possible for residents of Colombia to obtain overseas assets.

1991
Reform of the system of financial institutions implemented, abolishing limits on capital and the types of investors.

1992
Reform of tax system implemented. In the following year, the fiscal deficit had fallen to 0.2% of GDP.

1994
The Samper administration basically continues the market opening policies.
Emphasizes the need for the people to reap the benefits of improvements in productivity in Colombian industry, increased competition, and market opening.
To promote exports, corrects the high value of the peso.

1994
Free trade agreement with Chile takes effect.

1995
G3 free trade agreement with Mexico and Venezuela takes effect.

March 1996
Agreement to form the "Andean Community" as a free trade zone is reached at a summit of the Andes Group.

1999
Colombia records minus growth for the first time since 1932.
Performance improves again after 1999.

November 2002
Announcement of "Draft National Development Plan"
• Security measures
• Sustainable economic development and expansion of employment
• Correction of social inequalities
• Improved transparency and efficiency in state bodies

December 2002
Bills to reform the tax, pension and employment systems approved by congress.

2004
Begins negotiations with all of the Andes countries except Venezuela to conclude a free trade agreement with the US.
Final agreement to be reached in February 2006, and preparations are expected to be completed by July 2007.

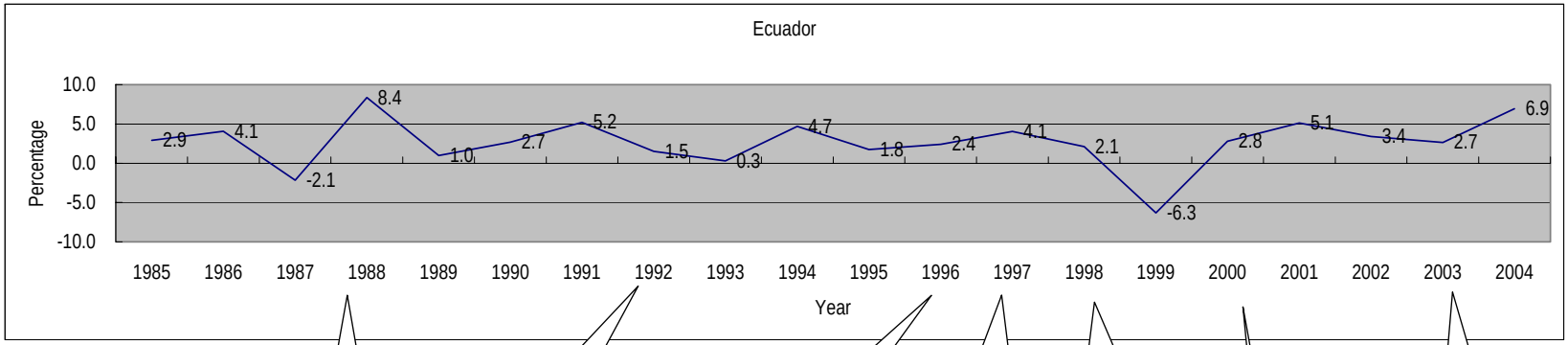
1-3-6 Ecuador

The total area of Ecuador is 27,670 km^2 and its population is 13 million (2004). Ecuador traverses the Andes Mountains from east to west. The mountainous central region, where the capital Quito is located, is home to its many indigenous peoples (most are poor) and is an area of diversified agriculture and livestock farming. Ecuador's per capita GDI is 2,210 dollars (2004). Since the development of plantation agriculture in bananas and coffee along the coast west of the Andes, Guayaquil, the nation's first urban center has become a base for exports mainly in farming products. The northern coastal area is home to many African immigrants, who are also poor. Although much of the eastern Andes region is native jungle, the area is also a rich petroleum-producing zone.

The leading industries in Ecuador are, from top to bottom, petroleum, agriculture and fisheries, and are the most important export sectors. Ecuador is the largest exporter of bananas in the world and the country is also a major producer of shrimp. Other important exports include coffee, cacao and flowers. Ecuador is a member of CAN, so it has close economic ties with Peru and Columbia. Its major trading partners are the United States, Peru, Italy and Columbia.

Of all South American nations, Ecuador has had the most changes in administration, which has also become a barrier to economic modernization. The degree of progress made in the export of primary products in this country is the lowest among South American nations. The primary reason for the frequent change in administration is a deep-rooted rivalry between the coastal region, mainly in Guayaquil where trade and investment relations with advanced nations (especially with the United States) are emphasized, and the mountainous region, mainly in Quito where ownership of domestic resources and improvement in the living standards of indigenous people are of major importance.

Real GDP Growth



Political developments

August 1988
Rodrigo Borja Cavallos (center-left) becomes president.
Domestic priorities include improving the people's level of education and health and addressing labor issues. Also emphasizes dialogue with indigenous peoples.

August 1992
Administration of Sixto Duran Ballen (center-right) established.

August 1996
Abdala Bucaram (populist) becomes president.
Criticism mounts of bribery, confusion of public and private funds at the highest levels of government, including the president, as well as the administration's authoritarian posture and reckless fiscal policy.

1997
Public movement in opposition to increased costs for public services results in the overthrow of the Bucaram administration. In February 1997, the congress votes to impeach Bucaram. Congress president Fabian Alarcon becomes interim president.

August 1998 - January 2000
Jamil Mahuad administration

An election is held under President Alarcon, and Jamil Mahuad is elected president. Due to his party's minority status, the basis of his presidency is weak. Fiscal policies end in half-measures, which leads to social instability and anti-government unrest.

May 1999
Border dispute with Peru resolved.

January 2000 - January 2003
Gustavo Novoa administration

Dollarization policies continued from the previous administration.
In addition to establishing a Basic Law for Economic Reform, the administration promotes economic structural adjustment reforms such as rebuilding the financial system, reforming the tax system and privatizing state companies.

April 2000
Final agreement with the IMF.
New investment of US$2.045 billion over three years.
Announcement of increases in pension and civil service wages and in the price of fuel the following month.

January 2003 - April 2005
Lucio Gutierrez administration

Lucio Gutierrez becomes president with the support of the general public and the poor. Attacked by indigenous groups for following the course laid by the IMF. The alliance with the indigenous people's political organization (Pachakutik) dissolves.

Economic developments

1980's
Worsening conditions in the global oil market means less income from oil production. New projects depend on foreign investment. Consequently, foreign debt becomes an issue from mid-1982.
1984
The administration of Leon Febres Cordero pursues liberal economic policies, implementing economic deregulation and encouraging foreign investment.
1985
Surpluses in both international balance of payments and fiscal budget.

1987
Oil pipeline cut by an earthquake. Oil exports stopped. Ecuador's economy consequently plunges into crisis.

In contrast to the economic liberalization of the previous administration, the Borja administration implements more interventionist policies.
A certain level of economic stability achieved.
Administration loses popular support due to the burden on the people from the administration's stringent fiscal policies and the president's lack of leadership. Crawling peg exchange rate system introduced.

The Duran administration takes the control of high inflation and fiscal deficits as its main policy objectives, in line with IMF policies. Structural reforms of the public sector are also implemented.
Crawling peg system abolished.

February 1993
Tariffs eliminated between countries of the Andes Community.
December 1993
National Modernization Law established.
As part of efforts to reduce the budget deficit, the public sector is scaled down and privatization pursued.
State cement and sugar companies privatized.

June 1994
At the Ibero-American Summit, Ecuador applies for membership to the G3 and is approved.

Second half of 1997
A collapse in the global price of oil and the Asian financial crisis, along with the damage caused by torrential rains of the El Nino phenomenon, cause the economy to worsen.

The Mahuad administration aims to move away from the traditional export-dependent economic model.
This sparks opposition throughout the country, to which the administration responds with concessions such as a fuel price freeze and a postponement of tax increases.

February 1999
In response to the devaluation of Brazil's currency the previous month, Ecuador changes to a floating exchange rate system from the currency band system.
Declares partial default on payment of interest on international debt.

Economy still dependent on oil exports and income from emigrants.
Gutierrez administration tackles issues of increasing export competitiveness and FTA negotiations with the US.

1-3-7 Paraguay

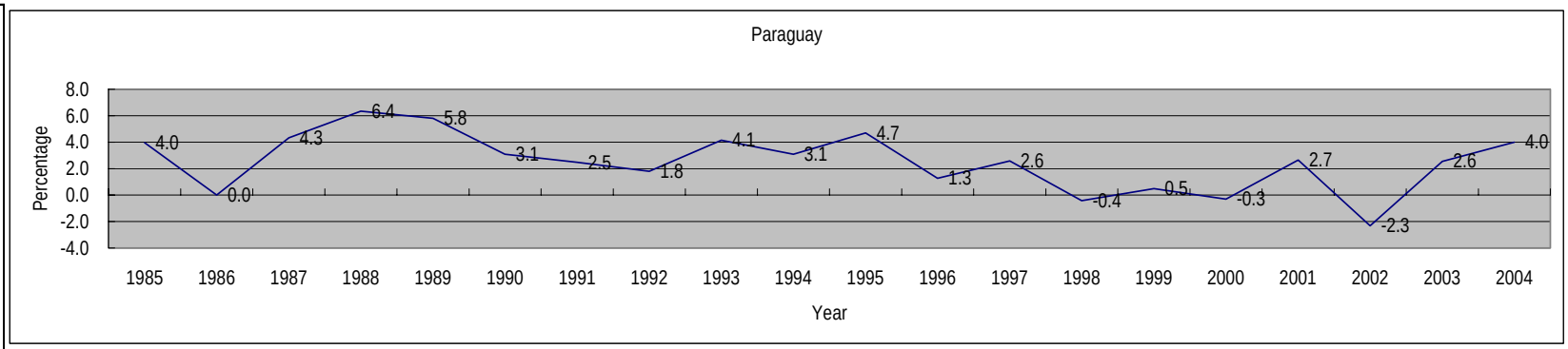
The total land area of Paraguay is 406,752 km^2 and its population is 6.07 million (2004). Paraguay's per capita GNI is 1,140 dollars (2004). Paraguay is a landlocked nation surrounded by the three countries of Brazil, Argentina and Bolivia. It is a plateau. The country is divided geographically into east and west. Eastern Paraguay is comprised of hilly forested areas and flat ground interwoven by the Paraguay and Parana Rivers. In particular, the area bordering Brazil is a farming region blessed with fertile soil. Western Paraguay consists of a great plain with many bushes accounting for approximately 6% of the national land, morass and deserts in the river basin and in the north.

The economy of Paraguay consists mainly of agriculture production, livestock farming and forestry and export of these products. Major products include soybeans, cotton, edible meats and timber. Traditionally, agricultural production consists of perennial crops such as mate, citrus fruits, tung oil trees and coffee. However, since the latter half of the 1970s production of cotton and soybean has rapidly expanded and they have become leading exports. Since import substitution industrialization was not adopted in other South American nations, the manufacturing industry's share in the national economy is small. Light manufacturing industries, especially in agricultural products processing, predominate, and the majority of products are produced for the domestic market. Agriculture-related sectors includes food processing and beverages, cotton-spinning, lumber, oil expression and sugar manufacturing; whereas, sectors other than agriculture include petroleum refining, cement and chemistry.

On the other hand, one industry that is unique to the Paraguay's economy is commerce and trade, including the informal sector. In bordering cities such as Este (*Ciudad del Este*), general consumer goods such as electric appliances and tobacco are officially imported and smuggled from third countries through vigorously transactions to sell to travelers from the neighboring countries of Brazil and Argentina. Although such economic activities that utilize policies adopted to protect trade in both countries have supported the economy of Paraguay both formally and informally, the activities have been greatly affected by the abolition of regional customs duties with the inauguration of MERCOSUR.

Paraguay's economy has recently achieved excellent results in a series of macro economy such as an increase in foreign currency reserves followed by an IMF stand-by credit agreement since 2003, control of inflation and an expansion in tax revenues. On the other hand, despite encouraging economic figures, growth continues to be slow, and still shows no noticeable signs of improvement from an incomes and employment point of view.

Real GDP Growth



Political developments

Alfredo Stroessner Administration
Seized power in coup d'etat in 1954, continues until 1989.

Rodriguez Administration
Under banner of "democratization and respect for human rights".

Wasmosy Administration
Civilian administration

Cubas Administration

Gonzalez Administration

Duarte Administration

February 1989
President Stroessner falls in coup d'etat by General Andres Rodriguez.
May 1989
Rodriguez elected president in election. Movement to democracy accelerates.

June 1992
Promulgation of democratic new constitution. Constitutional republic with separation of three powers.

August 1993
First civilian administration in 39 years established. President Wasmosy achieves political results in terms of respect for human rights, renewed legal authority, respect for the constitution and establishing democracy.
Works especially hard to eliminate interference from the military.

August 1998
Administration of Raul Cubas begins. Establishes legal system, invigorates the economy, and reduces crime, demonstrating an active effort to strengthen democracy.
However, comes into conflict with the congress and the Supreme Court over the problem of releasing General Lino Oviedo. The investigation stagnates, and there is a movement to impeach the president. In the midst of this crisis, the vice president is assassinated and the president is forced to take responsibility for the unrest.

April 1999
Administration of Luis Gonzalez Macchi begins. With the resignation of Cubas, president of the Senate Gonzalez becomes president in accordance with the constitution. There are moves to dismiss him after he is sworn in, but these were defeated in the senate in February 2003.

August 2003
President Nicanor Duarte sworn in. Demonstrates leadership as president in the resolution of issues such as corruption, but working with the ruling and opposition parties and gaining their cooperation.
Political and economic conditions are generally stable, and as of 2006 the administration is rated highly inside and outside of Paraguay.

Economic developments

1989
The Rodriguez administration aims for sound macroeconomic management and implements the unification and liberalization of multiple exchange rates (March 1989), the reduction of public investment, and the reform of the tax system.

1990
Liberalizes interest and foreign currency savings. Promulgates the Export Promotion Law in the same year.

1992
Under the guidance of the IMF and the IDB, implements reform of the tax system. The aim of the reform is to simplify and improve the efficiency of the collection system and introduce new taxes such as value added tax, special consumption tax, income tax, and stamp duty.
Foreign currency reserves are dismantled to allow repayment of foreign debt, and the devaluation of the real exchange rate is difficult.

1993
The Wasmosy administration continues the economic liberalization policies and aims to convert the structure of the economy by stabilizing the macro economy and privatizing state-run companies.

January 1995
Joins Mercosur.
The Mercosur countries have strong political as well as economic ties and the association is seen to be important in the region.

Since 2000, Paraguay's economy has been adversely affected by the economic recessions in Argentina and Brazil. In this period, there has been the possibility of non-fulfillment of loan repayments due to the large drop in people's income levels. The previous Gonzalez administration was in the end unable to apply particularly effective measures to resolve the difficulties.
The current Duarte administration allocates economic teams appropriately where they are needed and has from the outset succeeded in obtaining IMF standby support.
The administration is making progress on such reforms as improving macroeconomic indicators, reforming the tax system, and setting new tax rules, and is highly rated by international bodies.
However, income and employment levels are not improving and there are elements of dissatisfaction among the people.

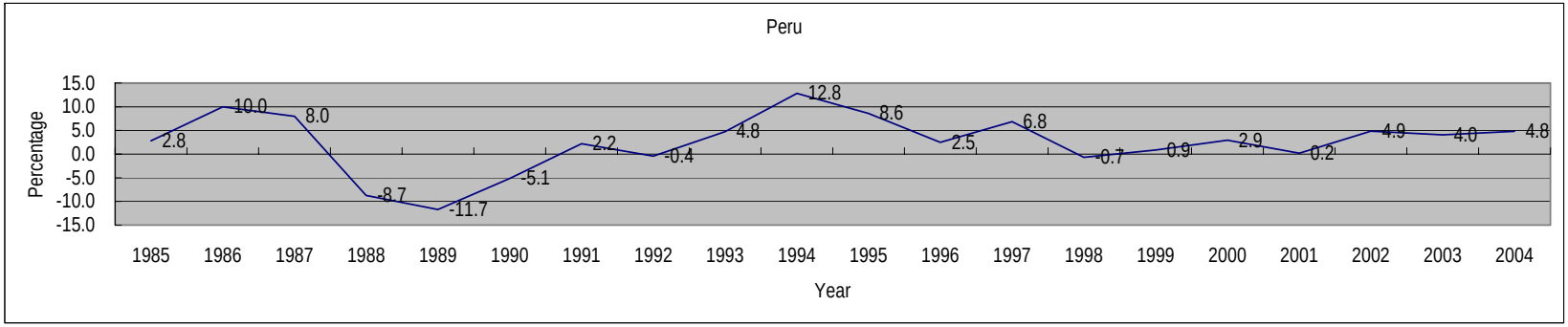
1-3-8 Peru

The total area of Peru is 1,285,220 km^2, its population is 28 million (2004) and per capita GNI is 2,360 dollars (2004). The Andes Mountains run through its territory, which is comprised of a coastal zone in the west, a mountainous zone in the central region, and a forestry zone in the east. The economic zone is an oasis at a mouth of a river and scattered along the coast, and the largest city is the capital Lima. Lima is also the largest city on the Pacific coast of South America. Since the development of agricultural production in sugar, cotton, coffee, rice, fruits and vegetables along the coastal zone, agricultural investment from neighbor countries such as Chile have increased. Copper, gold and molybdenum mines are concentrated in mountainous regions, and diversified farming products are produced and many indigenous peoples reside at various elevations. Wool from llamas, vicunas and alpacas are products unique to the region. Although much of the forest zone in the east remains undeveloped, it is a major cocoa producing region. Major export items include copper, gold, textile products and fish meal. Its major trading partners are the United States, China, the EU and Chile.

The domestic population is approximately 28 million, with approximately 8 million concentrated in Lima where certain industries for consumer goods are located. However, the goods are produced for the domestic market so competitiveness in exports is weak, except for textile products to the United States.

In economic terms, the recent macro economic conditions in Peru are the most stable in South America due to improving international prices for resources, a stable administration, and free trade policies under each administration. However, poverty amongst indigenous peoples living in mountainous regions and the poor in urban areas like Lima is a serious problem, and has become a priority of the new administration.

Real GDP Growth



	Alan Garcia Administration (1985 - 1990) / Re-elected 2006	Fujimori Administration (1990 - 1995)	2nd Fujimori Administration (1995 - 2000)	3rd Fujimori Administration ↓ Paniagua provisional administration	Toledo Administration (2001 - 2006)
Political developments	1980 Maoist group Sendero Luminoso (Shining Path) begins terrorist campaign. 1985 Alan Garcia, of the APRA party, wins the presidential election. The radical nationalistic administration announces that debt repayment will be 10% or less of annual exports. Confrontation with international financing bodies such as the IMF. Opposes orthodox economic adjustments favored by Washington. Aims to overcome economic difficulties by such means as raising wages, expanding employment, and increasing effective demand. Up until 1986 - 1987, a certain level of success is achieved, but thereafter the economy flounders due to insufficient foreign currency reserves, increasing budget deficits, high inflation and a decline in real wages. Loses public confidence amid terror campaign and hyperinflation.	1990 Non-aligned independent candidate, the second-generation Japanese Alberto Fujimori wins the presidential election. Aims primarily to return to international financial community, stabilize the economy, and implement structural adjustments. Implements tough shock policies such as price adjustments to stabilize the economy, tax system reforms, and stringent fiscal policies. Succeeds in controlling 4-digit hyperinflation. (Inflation rate) 1991: 139% 1992: 57% 1993: 40% 1994: 13% September 1991 Returns to international financial community. April 1992 Announces a partial suspension of the constitution. Total concentration of power under the auspices of a "state of emergency / national reconstruction government". December 1993 Issues constitution for a constitutional republic. Sets forth republican system with protections for basic human rights and separation of three powers.	January 1995 Border dispute with Ecuador erupts. Continues until conflict monitoring group is dispatched in March from the guarantor countries of the Rio Protocol. August 1996 A bill to interpret the constitution so as to allow President Fujimori to stand for president a third time is approved by a majority in congress. December 1996 Japanese embassy hostage incident occurs. March 2000 Allegations that the Fujimori administration bribed opposition congressional representatives. Fujimori resigns before end of term.	Third Fujimori administration collapses. Administration of Alejandro Toledo begins after a provisional administration.	Main priorities include creating employment, fighting poverty, and eliminating corruption. Administration troubled by conditions making it difficult to fulfill its promises.
Economic developments	1987 Implements state takeover of banks. In the 1980's, Peru's cumulative foreign debt is more than US$10 billion.	March 1993 Agrees economic plan with the IMF. May 1993 A meeting of Paris Club held. Debt rescheduling approved.	July 1995 In a presidential address, President Fujimori emphasizes intention to maintain economic growth by expanding domestic savings and investment and promoting exports.	August 2000 Announcement of goal of privatizing state companies worth as much as US$3 billion dollars, so as to achieve economic recovery through foreign investment.	2002 to present Due to steady high prices for minerals internationally, fiscal conditions are sound. High economic growth achieved. Accumulated foreign debt in 2004 of US$28.6 billion.

1-3-9 Uruguay

The total area of Uruguay is 176,000 km^2 and its population is 3.4 million (2004). Uruguay is located between the plains of Argentina and the southern plateau of Brazil and forms part of the immense Pampas (prairies). It is a nation of agriculture and livestock farming where cattle and sheep graze on the Pampa and the development of related industries. Income levels are relative high and per capita GNI is 3,900 dollars (2004), which is the third (3^{rd}) highest in South America after Chile and Venezuela.

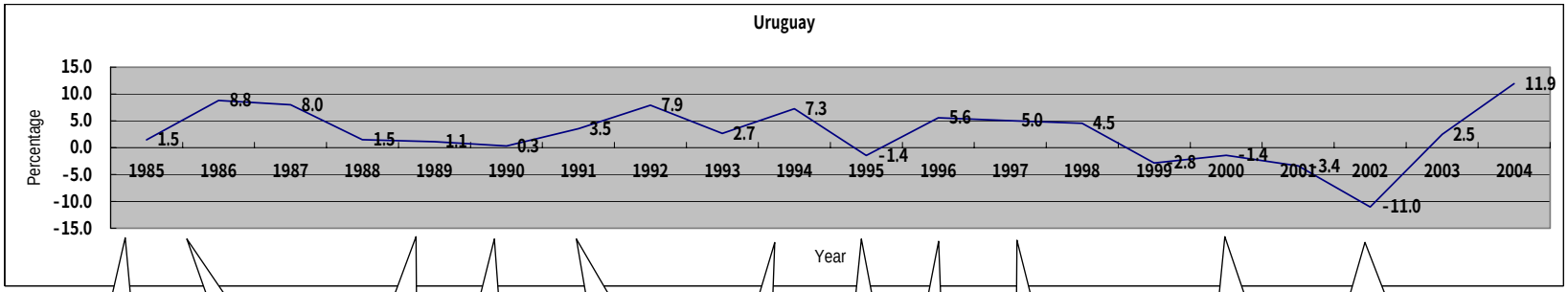
Major agricultural, livestock farming and marine products include beef, wool, rice, wheat, corn, flaxseed, beets, sunflower seeds, sugar, potatoes, merluza (hake) and squid. Beef and wool are traditionally important exports. If leather-related products, rice and marine products are included, these account for the majority of the exportation. The government intends to promote diversification in export markets. Other major trading partners include Brazil, Argentina, Germany and China.

Since the manufacturing industry in Uruguay is composed of many small enterprises, its productivity and external (foreign) competitiveness does not appear to be high. In line with the recent policy of open economy, the number of imported goods continues to increase. Therefore, corporate culture (business quality) should be promoted through industrial reorganization.

The economy of Uruguay is characterized by its financial sector. Since there is no control of exchange and overseas withholding of income taxes in Uruguay, capital transactions, interest and overseas remittances, etc. are carried out freely. Consequently, most of the outstanding private savings is in the form of foreign currency-denominated deposits including that from neighboring countries. Through this relationship, Uruguay has become a nation of tourism and neighboring countries its market. In addition, the secretariat of MERCOSUR is located in Montevideo, the capital of Uruguay.

The economy of Uruguay has shown negative growth since a shift to floating exchange rates in Brazil in 1999 and experienced minus 11% during the economic crisis of 2002. Since then, the economy has shown signs of recovery due to favorable conditions in the export of primary products. However, during the economic crisis of 2002 30% of the population was considered poor. And despite the recent economic recovery, the poor still face severe conditions.

Real GDP Growth



Political developments

1984

Announcement of transition to civilian rule based on agreement between the army and political parties.

March 1985
President Julio Maria Sanguinetti sworn in (Colorado Party).
Administration works steadily to reform or abolish the undemocratic legal system of the military era, restoring freedom of expression and granting amnesties for political prisoners.

October 1985
Restores diplomatic relations with Cuba.
Constitutional constraints eliminated in the transition to civilian rule in 1985.
Constitution establishes democratic republican system, separation of powers, protection for human rights, etc.
September 1986
Hosts GATT Uruguay Round.

Traditionally, elections contested between the Colorado Party and the National Party.
However, in the general election of 1989, the leftist party Frente Amplio (Broad Front), which has been gaining ground since the 1970's wins the mayoral election in the capital city of Montevideo.
This party takes over the presidency as the Vazquez administration in March 2005.

March 1990
The Luis Alberto Lacelle Administration begins.
Forms loose coalition with the Colorado Party to ensure congress works smoothly.
The focus of the administration is to improve economic conditions such as high inflation.

September 1991
Privatization bill passes the congress. Legal preparation for privatizing state companies takes place.
However, as a result of a referendum called for by Frente Amplio in December 1992, the teeth are taken out of the legislation.

May 1994
The Lacelle administration dissolves the coalition in preparation for the general election the following year.

March 1995
The administration of Julio Maria Sanguinetti (Colorado Party) begins.
Announces intent to maintain democracy and market opening policies and continue along internationalist lines.

December 1996
Referendum held on draft to reform the constitution.

April 1997
Agreement to locate Mercosur office in Montevideo approved by the senate.

March 2000
Administration of Jorge Battle begins.

Following the start of this administration, Uruguay is severely effected until 2003 by the economic recession in Brazil and Argentina.
The administration is occupied with responding to the crisis. A certain level of economic recovery achieved in 2004.

Conscious of its position as a small country, Uruguay has traditionally practiced pragmatic diplomacy. As a buffer state, it seeks to maintain balance between its large neighbors. Actively pursues diplomacy through regional international organizations such as Mercosur, the Organization of American States, and the Rio Group.
The Battle administration has promoted the expansion and diversification of trade accords in addition to Mercosur.

Economic developments

The Sanguinetti administration that began in 1985 devoted its efforts to promoting domestic industry by promoting exports and expanding domestic demand.
In 1986 and 1987, the international price of wool increased the value of Uruguay's exports and high growth was achieved, driven by the increased private consumption accompanying increased wages.

1988
Reduced agricultural production due to drought.
1989
Stringent fiscal policy and inflation reduce investment and consumption.

1989
Offshore banking system established.

1990
Investment banking system established.

Financial liberalization.

1990 - 1993
Consumer demand increases with an increase in real household income, primarily for consumer durables such as automobiles and electrical appliances.
Increased tourism, primary from Argentina, boosts the commercial sector.
1992
Loosening of import restrictions and reduction of import duties.
1993
Sluggish exports, a manufacturing slump, and reduced consumer demand cause low growth.

1995
Joins Mercosur.
Brazil and Argentina push for common market mechanism. Uruguay, being dependent on both countries, feared isolation and worked with Paraguay to achieve full participation in the common market.
In March 1991, the Asuncion Treaty is concluded and the common market is launched in 1995.

Uruguay's economy is adversely affected by the devaluation of the Brazilian currency in 1999 and high crude oil prices.

From 2000 on, efforts at fiscal restraint have been made, but with the drought, an outbreak of foot-and-mouth disease, and the worsening of the Argentinean economy, minus growth continues until 2002.

2002
Fears of a financial crisis. The government suspends the operation of the banks and establishes the "Basic Law to Strengthen the Banking System".

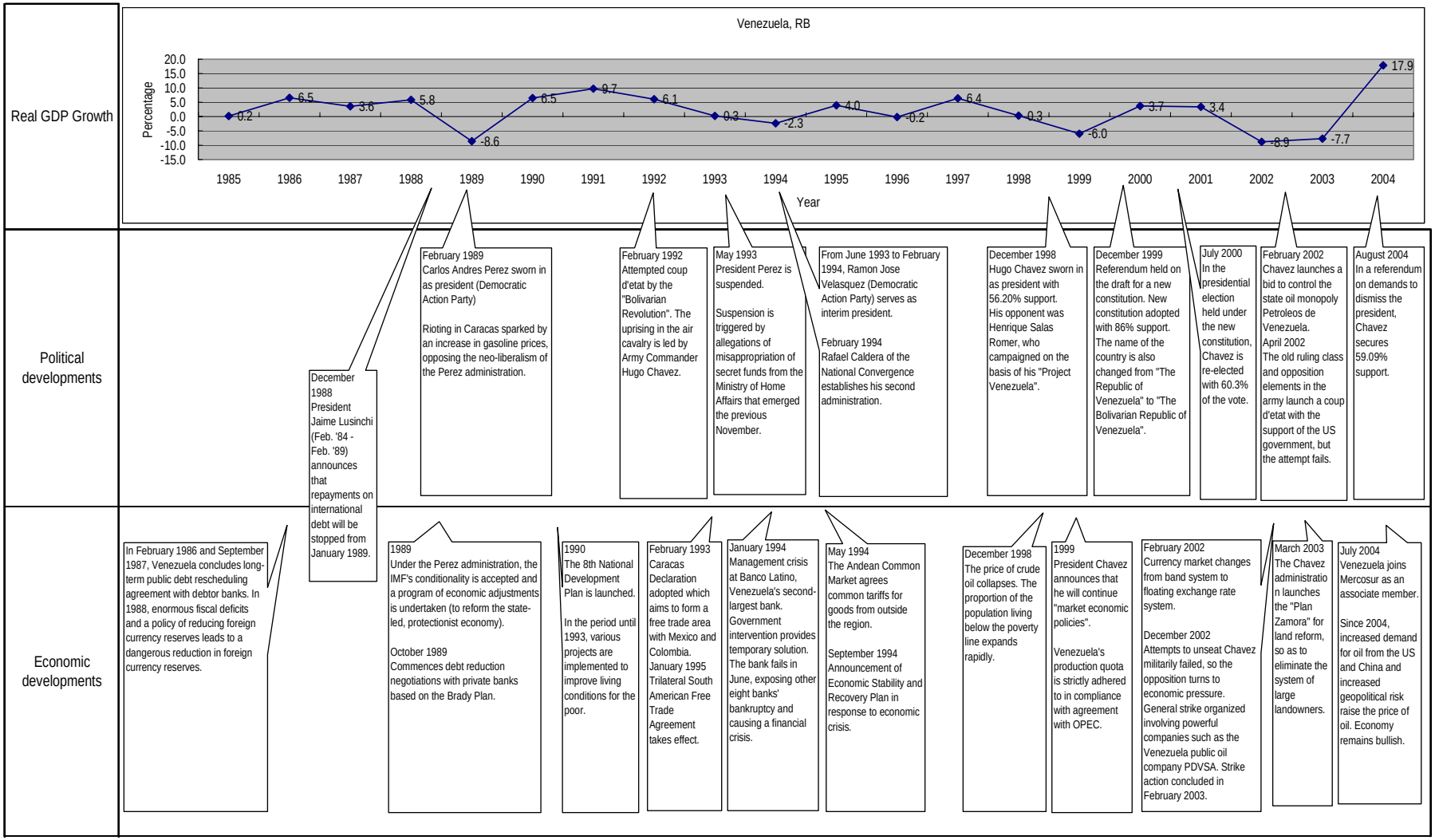
2003 - 2004
A series of financial measures is successful.
Favorable conditions for agricultural and livestock products and an increase in exports mark the beginning of economic recovery.
Positive growth restored in 2003 - 2004.

1-3-10 Venezuela

The total area of Venezuela is 9,102,050 km^2 and its population is 44.9 million (2004). Venezuela is one of the largest oil-producing nations in the world and is also a founding member of OPEC (Organization of the Petroleum Exporting Countries). Approximately 80% of its exports and approximately 60% of the country's fiscal revenue is dependent on petroleum and petroleum products. Its potential reserves are also one of the largest in the world, so it is one of the few nations able to produce a reliable supply of petroleum worldwide. The country is also rich in natural gas resources which is made it the center of attention in the South American region in recent years. A per capita GNI of 4,030 dollars (2004) places it second (2^{nd}) ranking among South America after Chile. From an economic point of view, Venezuela has a strong bilateral relationship with the United States. Half of the country's exports go to the United States, and half its foreign investment originates there. In addition to the United States, other major trading partners include the Netherlands, Columbia, Cuba and the United Kingdom.

As an oil-producing country among developing nations, Venezuela has developed a strong downstream sector, so its share of exports in petroleum products has reached a level of approximately two-thirds (2/3). In line with this, Venezuela is also aggressive in its diversification of sales channels through capital participation in multinational business firms. Other than petroleum gas, Venezuela is also a major producer of iron ore, coal, bauxite, gold and diamonds. From these resources, manufacturing industries such as iron and steel, petrochemical and aluminum refining have developed. Furthermore, this industrial foundation has helped to nurture non-resource based manufacturing industries such as daily necessities, automobile parts and tires.

On the other hand, since its economy is greatly dependent on petroleum, agriculture and livestock farming and the rural economy have stagnated. Wheat, sugar and beef, etc. still depend on imports. In line with the stagnation of international petroleum prices since the 1980s and an accumulating debt, poverty has been increasing. Faced with these problems, in 1999 the Chavez administration came to power on a wave of radical nationalism. Despite a slow start, the said administration has been able to revive itself with the sudden rise in petroleum prices in 2004, and has become a leading challenger to US regional integration in South America.


Real GDP Growth
Venezuela, RB
Percentage
20.0
15.0
10.0
5.0
0.0
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-10.0
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3.6
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-8.6
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6.1
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2003
2004
Year
Political developments
December 1988
President Jaime Lusinchi (Feb. '84 - Feb. '89) announces that repayments on international debt will be stopped from January 1989.
February 1989
Carlos Andres Perez sworn in as president (Democratic Action Party)
Rioting in Caracas sparked by an increase in gasoline prices, opposing the neo-liberalism of the Perez administration.
February 1992
Attempted coup d'etat by the "Bolivarian Revolution". The uprising in the air cavalry is led by Army Commander Hugo Chavez.
May 1993
President Perez is suspended.
Suspension is triggered by allegations of misappropriation of secret funds from the Ministry of Home Affairs that emerged the previous November.
From June 1993 to February 1994, Ramon Jose Velasquez (Democratic Action Party) serves as interim president.
February 1994
Rafael Caldera of the National Convergence establishes his second administration.
December 1998
Hugo Chavez sworn in as president with 56.20% support.
His opponent was Henrique Salas Romer, who campaigned on the basis of his "Project Venezuela".
December 1999
Referendum held on the draft for a new constitution. New constitution adopted with 86% support.
The name of the country is also changed from "The Republic of Venezuela" to "The Bolivarian Republic of Venezuela".
July 2000
In the presidential election held under the new constitution, Chavez is re-elected with 60.3% of the vote.
February 2002
Chavez launches a bid to control the state oil monopoly Petroleos de Venezuela.
April 2002
The old ruling class and opposition elements in the army launch a coup d'etat with the support of the US government, but the attempt fails.
August 2004
In a referendum on demands to dismiss the president, Chavez secures 59.09% support.
Economic developments
In February 1986 and September 1987, Venezuela concludes long-term public debt rescheduling agreement with debtor banks. In 1988, enormous fiscal deficits and a policy of reducing foreign currency reserves leads to a dangerous reduction in foreign currency reserves.
1989
Under the Perez administration, the IMF's conditionality is accepted and a program of economic adjustments is undertaken (to reform the state-led, protectionist economy).
October 1989
Commences debt reduction negotiations with private banks based on the Brady Plan.
1990
The 8th National Development Plan is launched.
In the period until 1993, various projects are implemented to improve living conditions for the poor.
February 1993
Caracas Declaration adopted which aims to form a free trade area with Mexico and Colombia.
January 1995
Trilateral South American Free Trade Agreement takes effect.
January 1994
Management crisis at Banco Latino, Venezuela's second-largest bank. Government intervention provides temporary solution. The bank fails in June, exposing other eight banks' bankruptcy and causing a financial crisis.
May 1994
The Andean Common Market agrees common tariffs for goods from outside the region.
September 1994
Announcement of Economic Stability and Recovery Plan in response to economic crisis.
December 1998
The price of crude oil collapses. The proportion of the population living below the poverty line expands rapidly.
1999
President Chavez announces that he will continue "market economic policies".
Venezuela's production quota is strictly adhered to in compliance with agreement with OPEC.
February 2002
Currency market changes from band system to floating exchange rate system.
December 2002
Attempts to unseat Chavez militarily failed, so the opposition turns to economic pressure.
General strike organized involving powerful companies such as the Venezuela public oil company PDVSA. Strike action concluded in February 2003.
March 2003
The Chavez administration launches the "Plan Zamora" for land reform, so as to eliminate the system of large landowners.
July 2004
Venezuela joins Mercosur as an associate member.
Since 2004, increased demand for oil from the US and China and increased geopolitical risk raise the price of oil. Economy remains bullish.

Chapter 2　Trade, Investment and Industrial Structure

This chapter takes a broad view of trade and investment conditions and industrial structure in South America. Here, we look at the "South American region" referring to economic activities in 10 South American countries, and we examine the three countries of Brazil, Argentina and Chile, which account for a major share of economic activities in the region[6].

2-1　External Trade

Exports of the 10 South American countries expanded from US$62.4 billion per year on average in the mid 1980s to US$ 215.8 billion at the start of the 2000s[7]. In terms of export destinations, exports within the South American region grew sharply from 10% to 23% by the middle of the 1990s, after which they dropped back to 19% (see Table 2-1). More than half of exports outside of the region went to the United States and the EU. However, the ratio of exports to advanced nations including Japan has displayed a trend of decrease over the past 20 years. However, developing countries in Asia and other areas have taken their place, with South American exports to these countries increasing in response to growing demand in line with economic growth. China in particular has demonstrated rapid growth as an export destination; whereas it only accounted for less than 2% of the total value of exports up to the mid 1990s, it now accounts for 6%. Agricultural products and natural resources such as minerals, etc. account for a large proportion of exports to China.

Meanwhile, imports in South America over the same period have increased from US$38.2 billion to US$157.3 billion, with the ratio of imports within the region growing from 17% to 28%. In line with this, the ratio of imports from outside the region has fallen from 83% to 72%. Looking at the trends of import partners, a similar trend to exports can be seen. In other words, whereas imports from major partners such as the United States and EU and advanced nations such as Japan have declined, the ratio of imports from Asia including China and ASEAN, etc. has steadily increased. Almost all imports from China consist of manufactured goods such as machines, electric instruments, clothing and other light industrial products. This seems to indicate that goods that were previously procured from other advanced nations are being replaced with Chinese products.

2-2　Intra-Regional Trade

South American trade as a ratio of global trade accounts for less than 2%, and trade within the South American region accounts for just one-fifth of all South American trade (total imports and exports). The three countries of Brazil, Argentina and Chile account for two-thirds of intra-regional trade in South America and this figure has gradually increased over the past 20

[6] Concerning economic activities in terms of local economic integration (Mercosur, Andean Community of Nations, etc.), see Part II (Chapters 6 and 7); concerning the four least developed countries in South America (Ecuador, Peru, Bolivia, Paraguay), see Part III (Chapters 8-12). Regarding South American trade and investment with Japan, see Chapter 4.

[7] Annual average value for 10 countries in South America. Calculated based on Commissioned Survey B: Table A.1.

years. Brazil, the largest economic power in South America, also plays the central role in intra-regional trade and exports widely to all of South America including not only Mercosur but also the Andean Community of Nations (see Figure 2-1). However, considering that Brazil's ratio of trade to GDP is low and its level of dependence on intra-regional trade in South America is relatively small, it is not all that different from Argentina in terms of the scale of its intra-regional trade[8]. Argentina, exploiting it geographical advantage of being situated between Brazil and Chile, mainly conducts trade with these two nations and is the second largest trading nation in South America. Meanwhile, in the northern part of South America, trade flows are formed centering on Columbia and Venezuela.

The major trade flows in South America comprise manufactured goods from Brazil and Argentina and energy exports of petroleum, etc. from Columbia and Venezuela. Out of Brazil's exports to the region, 80% consist of manufactured goods (machines, transport equipment and chemical products, etc.), while agricultural products (including processed goods) and minerals and energy account for around 10% each. As for Brazilian imports from within the region, agricultural products, minerals/energy and manufactured goods account for around one-third each[9].

Table 2-1 South American Trading Partners and Movements in the Area Ratio

Export (%)

Year,Partner	South America	Mexico	USA	EU*	Japan	China	ASEAN	India	Others
1983-1985	9.8	0.7	29.3	25.7	5.0	1.6	0.7	0.7	26.5
1993-1995	23.3	1.6	24.9	23.7	5.8	1.6	2.2	0.5	16.4
2003-2005	19.2	3.2	24.4	21.2	3.6	6.0	1.9	0.9	19.7

Import (%)

Year,Partner	South America	Mexico	USA	EU*	Japan	China	ASEAN	India	Others
1983-1985	17.0	2.5	26.6	20.1	6.3	1.2	0.6	0.0	25.7
1993-1995	22.7	2.0	25.0	26.9	7.2	1.8	1.5	0.3	12.6
2003-2005	27.5	2.5	18.9	19.3	4.2	6.6	2.3	0.9	17.9

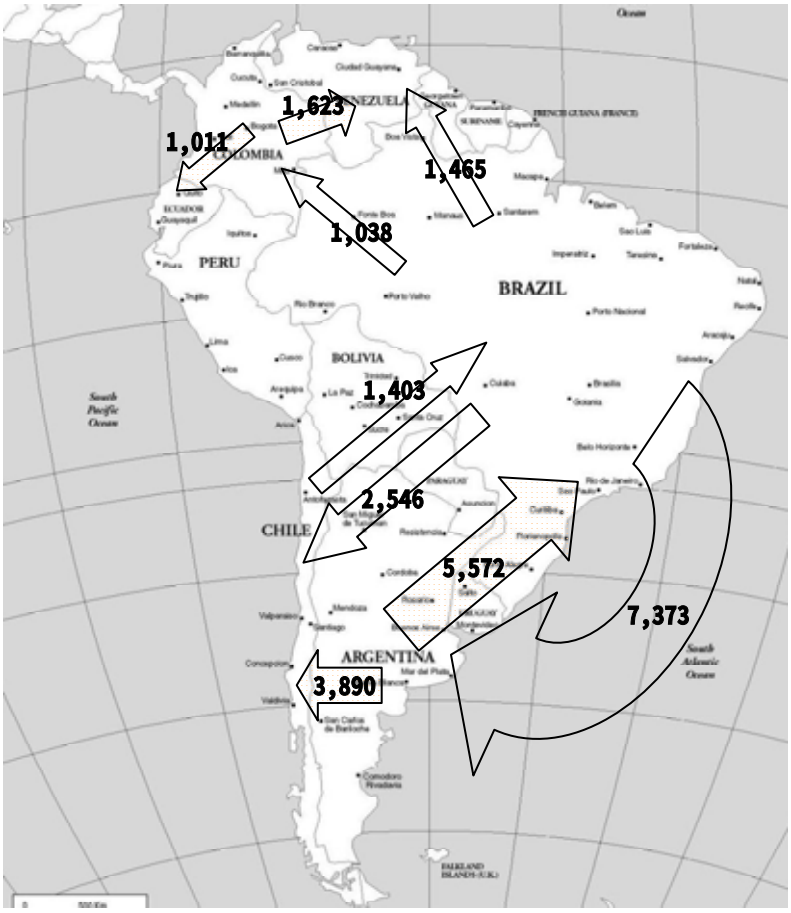
Note: *EU 15 countries

Source: Compiled by Study Team based on Table A.1-4 in the commissioned study B

[8] Out of South American intra-regional trade in 2003-05, Brazil accounted for 29%, Argentina for 25% and Chile for 14%. See Brazil Commissioned Survey B: Table 1 and Table A. 1-4.

[9] Data including Central America in 2004 (source: WTO, World Trade Statistics 2005)

US$ Million



Note: Trade flows over a billion US$ are indicated

Source: Compiled by Study Team based on Direction of Trade Statistics Yearbook 2005, IMF

Figure 2-1 Main Trade Flows in the South American Region (2004)

2-3 Investment

Looking at movements in the amount of direct investment received by the world's major developing regions, South America and Central America combined accounted for more than 10% of all investment in the world from the mid 1970s to the start of the 1980s, placing it far ahead of Asia (see Table 2-2). As was mentioned in the previous chapter, the 1970s were a period when Latin American countries achieved high economic growth rates because of adopting a strategy of import-substitution industrialization. For the receiving side, direct investment from overseas served their capital-intensive and high technology needs for promoting import substitution, while for investing corporations the goal was to realize domestic production and retailing in the invested countries. However, in the subsequent 10 years, the direct investment ratio to Asia, which took the lead in advancing export industrialization, increased, whereas Latin America experienced an exodus of capital and decline in direct investment starting from the debt crisis. In the second part of the 1990s, overseas direct investment to South America recovered mainly in line with the

privatization of state enterprises that was promoted based on new liberalism, and investment of more than US$220 billion was directed to the region over fiver years. From 2000 onwards, private sector investment flattened out and the flow of investment from overseas went into decline because of the currency crises in Brazil and Argentina, political turmoil in other countries and opacity of the economy. In the period between 2000-04, the ratio of direct investment in South America was just 4.4% of the world total.

Table 2-2 Ratio of Major Developing Regions in Terms of Incoming Direct Investment in the World

%

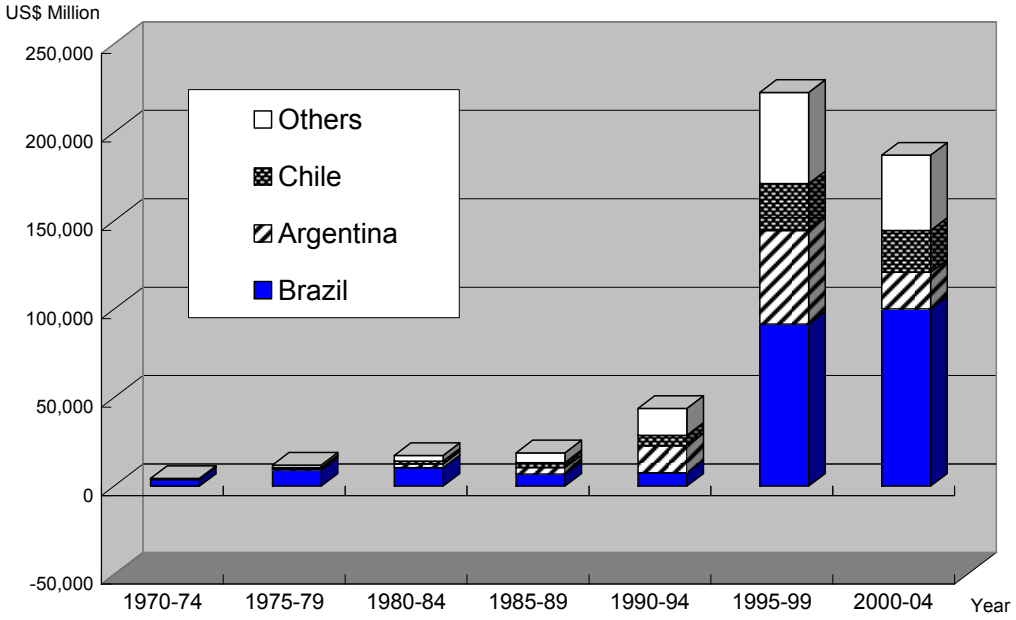
Year	1970-74	1975-79	1980-84	1985-89	1990-94	1995-99	2000-04
South America	4.9	7.7	5.9	2.8	4.3	7.4	4.4
Central America	3.5	3.5	4.2	2.1	2.9	2.2	2.3
East Asia	1.7	1.9	3.7	5.5	11.0	10.2	10.4
South Asia	0.3	0.2	0.3	0.2	0.4	0.6	0.6
South-East Asia	4.7	5.2	5.3	3.7	7.4	4.8	2.3
Africa	6.2	3.7	2.5	2.2	2.1	1.4	1.9
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: UNCTAD Homepage (FDI Inflows by Host Region and Economy, 1970-2004)

Looking at South American incoming direct investment by country, Brazil accounts for the most by far since the 1970s, and is followed by Argentina and Chile (see Figure 2-2). Looking at the country-separate ratios of incoming direct investment to 10 South American countries between 1970 and 2004, the three countries of Brazil (45.3%), Argentina (19.0%) and Chile (12.1%) account for almost 80%, whereas Venezuela accounts for 7.0%, Columbia for 6.9%, Peru for 4.7%, Ecuador for 2.4%, Bolivia for 1.5%, Uruguay for 0.7% and Paraguay for 0.4%.

Looking at the countries that have invested in Brazil, Argentina and Chile in the past 10 years, the United States and Spain are the largest investors in each case. In terms of investment by sector, 28% of investment in Brazil is directed to the industrial sector, which is higher than in other countries. In Argentina, the most important sector is natural resources, which accounts for 40% of incoming investment. Chile is characterized by a small ratio of investment (11%) to the industrial sector[10].

[10] See the Commissioned Survey B: Table C.2.



Source: UNCTAD Homepage (FDI Inflows by Host Region and Economy, 1970-2004)

Figure 2-2 Movements in Direct Incoming Investment in 10 South American Countries

2-4 Industrial Structure in the Major Countries of South America

Next, looking at the industrial structure of Brazil, Argentina and Chile, which account for 70% of GDP in South America, each country is similar in that primary industry including agriculture accounts for a small share, whereas the service sector accounts for a large one[11]. However, as is shown in Table 2-3, the features of each country become apparent when attention is turned to each industrial sector.

Brazil shows a far higher ratio of manufacturing than the other two countries, and it also has a higher ratio of agriculture, forestry and fisheries. In other words, Brazil combines the features of both an agricultural nation and an industrial powerhouse. In reality, Brazil boasts some of the world's top production in terms of soybeans (second in the world), sugar cane (first), coffee (first), oranges (first), beef (second) and chicken (second)[12]. On the other hand, its industrial sector covers a wide range from light to heavy industries including foods, chemicals, petroleum refining, iron and steel, machines, electric machinery and transportation equipment[13]. Major industrial exports of Brazil are automobiles, for which production reached 1.6 million units in 2004, and aircraft.

Argentina displays a high ratio of services such as commerce and real estate, and its ratio of

[11] See Commissioned Survey A: main text (page 7) and Tables 48-65.
[12] JETRO Sao Paulo Center "Brazil Overview". The order of production is based on 2003 data (source: FAO).
[13] See Commissioned Survey A: Tables 72-74.

manufacturing within GDP is the lowest of the three countries. Looking at the breakdown in terms of industrial sector, food processing and beverages are the biggest sector accounting for one-third of production value, and other important sectors are iron and steel, chemical products and transportation instruments, etc.[14]. Out of exports in 2004, agricultural and stockbreeding processed items accounted for 35% and manufactured goods for 28%, however, in the area of manufactured goods, trade friction is arising with neighboring Brazil over automobiles, which are a major export item, and competition with incoming products from Brazil. Compared to Brazil, the industrial sector of Argentina is weak, and the issue facing the country will be how to raise competitiveness in the sector.

Table 2-3 GDP Ratio by Industry in Major South American Countries

Unit: %

	Brazil		Argentina		Chile	
Year	1997	2003	1995	2002	1997	2003
Agriculture, forestry and fishing	7.1	10.4	3.9	5.4	2.3	2.6
Mining	3.7	4.1	0.6	1.1	9.5	11.1
Manufacturing	25.1	27.9	13.1	15.5	18.6	16.1
Electricity, gas and water	3.4	3.5	1.5	2.3	2.2	2.5
Construction	8.6	6.9	4.1	6.2	9.9	8.4
Trade, restaurant and hotels	9.0	8.3	13.2	17.2	14.0	13.4
Transportation, storage and communication	4.7	4.3	6.1	9.0	8.0	9.6
Financial services	5.2	6.4	4.1	7.6	15.9	16.9
Real estate services	13.0	9.7	12.7	16.1	8.1	8.1
Public Administration	15.4	14.6	4.3	5.2	4.0	3.8
Other services	4.7	4.0	36.4	14.5	7.4	7.6
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Compiled by Study Team based on Tables 48-65 in Commissioned Survey A.

Regarding Chile, the mining sector accounts for a larger share than in the other two countries. Looking at major sectors in manufacturing, too, non-metal and metal processing account for high ratios. In addition, food processing, chemicals and petroleum refining are conspicuous, whereas machine industry and heavy industry are not so well developed[15]. The issue facing Chile will be how it can grow out of the industrial structure that places too much dependence on mineral resources development centering on copper.

[14] See Commissioned Survey A: Tables 66-68.
[15] See Commissioned Survey A: Tables 75-77.

Chapter 3　Regional Structure and Infrastructure

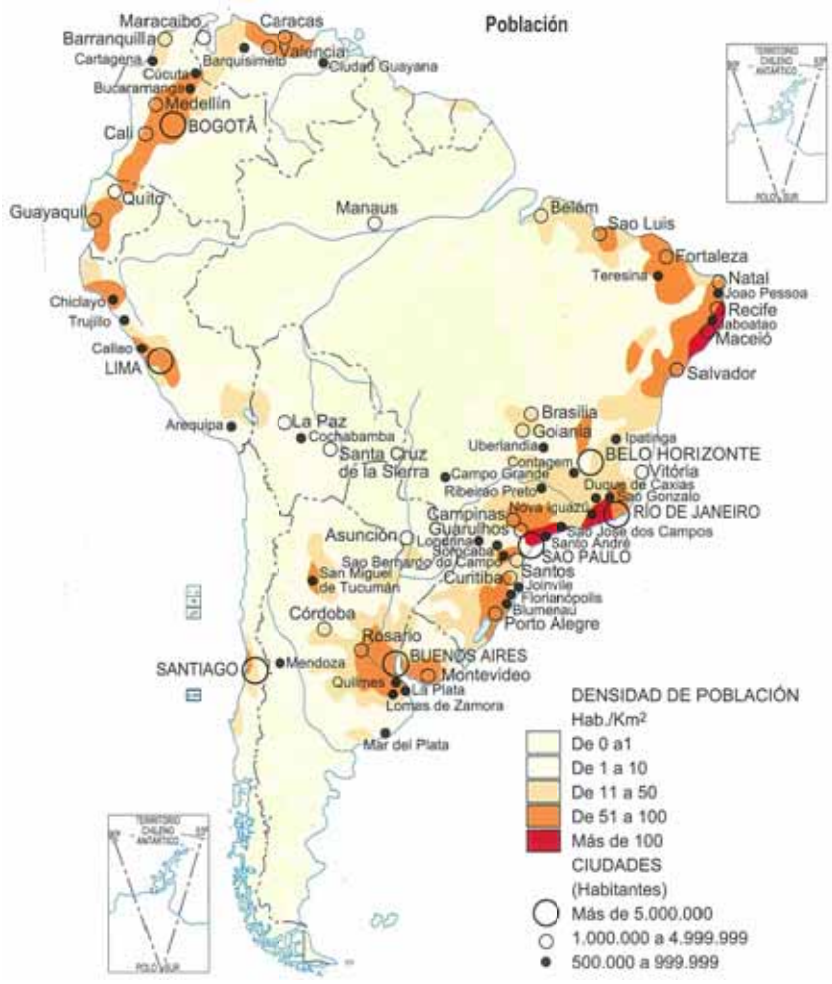
3-1 Regional Structure

The regional structure of the South American continent is decisively affected by topographical conditions and weather conditions. The Andes split the continent in two between the east and west: the east is dominated by flatlands and tablelands, whereas the west has mountains that continue down to the Pacific seaboard. Transport routes that cross the Andes are extremely limited. On the east side, plantations, large-scale agriculture and stockbreeding have developed utilizing the vast land area and river transport. Products from here are largely transported to Atlantic countries. The western side is mountainous and is home to varied agriculture practiced under diverse weather conditions from tropical climate on the coast to cooler weather in the highlands. This area also produces a wide variety of mineral resources such as copper, silver and zinc, etc. Topographical conditions dictate that the west side of the Andes is not as expansive as the east side.

Source: Instituto Geografico Militar de Chile, Atlas Mundial

Figure 3-1 Topographical Map of South America

The South American continent is further divided between north and south according to weather conditions. The cities of Rio de Janeiro, Sao Paulo, Asuncion and Antofagasta are located almost on the tropic of Capricorn. The area south of this has mild temperature and the seasons are relatively clearly discernible (incidentally, Hong Kong and Taiwan, etc. are located along the tropic of Cancer). Modern cities and modern industries in South America have mainly developed south of the tropic of Capricorn. The areas north of the tropic are sub-tropical or tropical. Native peoples live in relatively cool highlands, and numerous European immigrants have also colonized these areas. Bogota, Quito and La Paz are highland cities that have developed in this manner (see Figure 3-2).



Source: Instituto Geografico Militar de Chile, Atlas Mundial

Figure 3-2 Cities and Population Distribution in South America

The South American continent is huge. The distance moving from Quito, the capital of Ecuador, in the north to Santiago, the capital of Chile, in the south is equivalent to the distance between Tokyo and Bangkok, whereas the distance from Sao Paulo, Brazil in the east to Lima, Peru in the west is equivalent to the distance between Tokyo and Hanoi. Brazil is especially large,

and this single country shares borders with all the other South American countries except for Chile and Ecuador. Accordingly, economic collaboration also has two aspects, i.e. collaboration between national economies via trade and trade systems, and overland collaboration between regional economies via physical distribution and investment. Concerning overland collaboration, Brazil cannot be viewed as a single country. Different parts of the country form localized economic zones straddling different borders, i.e. the north of Brazil and the Andean nations, and the south of Brazil and the countries of Mercosur.

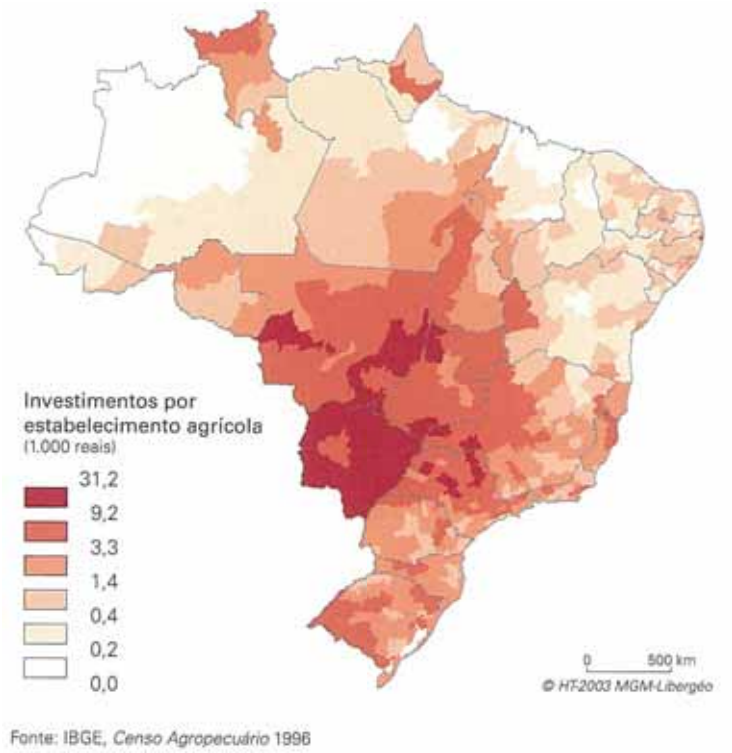
In terms of the location of economic activities, between one-third and a half is concentrated in the metropolitan regions of each country. This basic pattern is unlikely to change much in the future (see Figure 3-3).

Source: Commissioned Survey A: Maps 57-58

Figure 3-3 Regional Distribution of South American GDP

However, location of economic activities in Brazil is changing, and this is having an impact on economic activities in surrounding nations too. In particular, the following four points are attracting attention.

(1) Investment in large-scale agriculture is moving westward (inland) from the environs of Sao Paulo. The effects of such agricultural investment are spreading over the border into Paraguay (See Figure 3-4).



Source: Herve Thery et al., Atlas do Brasil, EDUSP, 2005

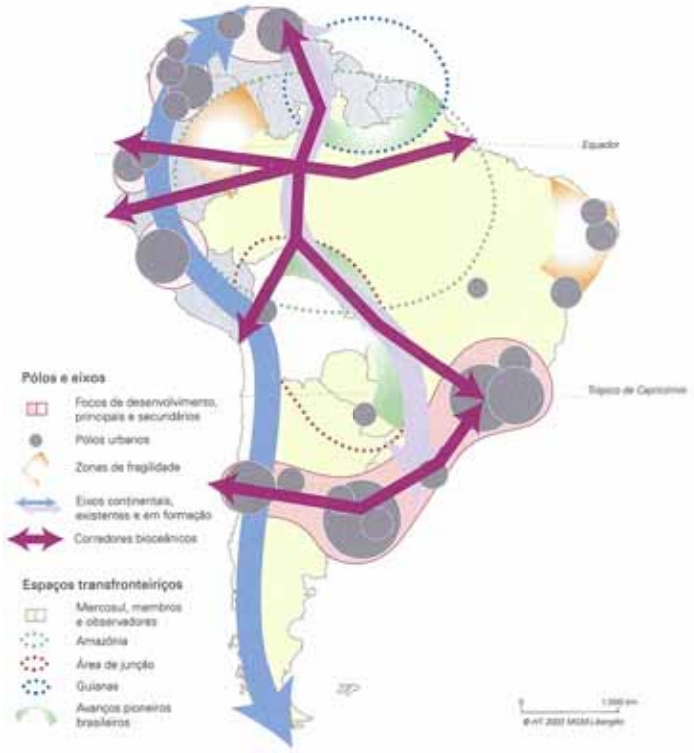
Figure 3-4 Regional Deployment of Agricultural Investment in Brazil

(2) Major automobile, electric and food corporations, etc. are moving their head offices and plants from Sao Paulo to cities in surrounding provinces.
(3) The industrial city of Manaus (also home to 32 Japanese-affiliated corporations) in the middle reaches of the Amazon River was originally constructed under the policy of import-substitution industrial promotion, however, within the recent trend of intra-regional economic integration, it is becoming more and more export-oriented. Exports to the United States and Europe via Caracas Port in Venezuela are currently increasing. In future, it is planned to construct transportation routes and export products to Pacific nations via the ports of Piura in Peru and Iquique in Chile.
(4) Concerning new location, the impact of industrial attraction competition through preferential tax benefits in Brazilian provinces is large. Since decentralization is expected to progress

further in terms of administration and finance in future, it is thought that economic activities will become more dispersed and have impacts on the surrounding countries.

Intra-regional trade in South America is dominated by the triangular flow of trade between Brazil, Argentina and Chile (see Chapter 2, 2-2 Figure 2-1). Looking at the four poorest countries, more than 80% of exports from Ecuador and Peru on the Pacific coast go outside of the region. Meanwhile, approximately half of the exports of landlocked Bolivia and Paraguay constitute intra-regional trade. Both these countries supply more than half of their exports to Brazil and Argentina, and Paraguay also has a high export share to Uruguay.

Under the influence of the inland deployment of agriculture and stockbreeding investment, diversification of exports from inland to outside the region, permanent establishment of economic integration systems and decentralization, etc., it is likely that the location pattern of economic activities in South America will continue to change, albeit slowly, in future. Moreover, it is likely that changes in the industrial structure and industrial location pattern of Brazil will drive this trend. Figure 3-5 shows the future regional structural picture of South America from the viewpoint of Brazil. The wide area infrastructure that is described below is considered to be largely based on this future image.



Source: Herve Thery et al., Atlas do Brasil, EDUSP, 2005

Figure 3-5 Future Image of Regional Structure in South America (prepared by Sao Paulo University)

3-2 Regional Infrastructure

The Initiative for the Integration of Regional Infrastructure in South America (*Iniciativa para la Integracion de la Infrastructura Regional Sudamericana*：IIRSA) plays the central role in wide area infrastructure development in the region.

The IIRSA, which was established in September 2000 based on an agreement reached at the First South American Summit Conference held in Brazil the previous month, is a plan to develop wide area infrastructure in the areas of transportation, energy and telecommunications in order to physically integrate the 12 countries of South America and conduct fair and sustainable regional development.

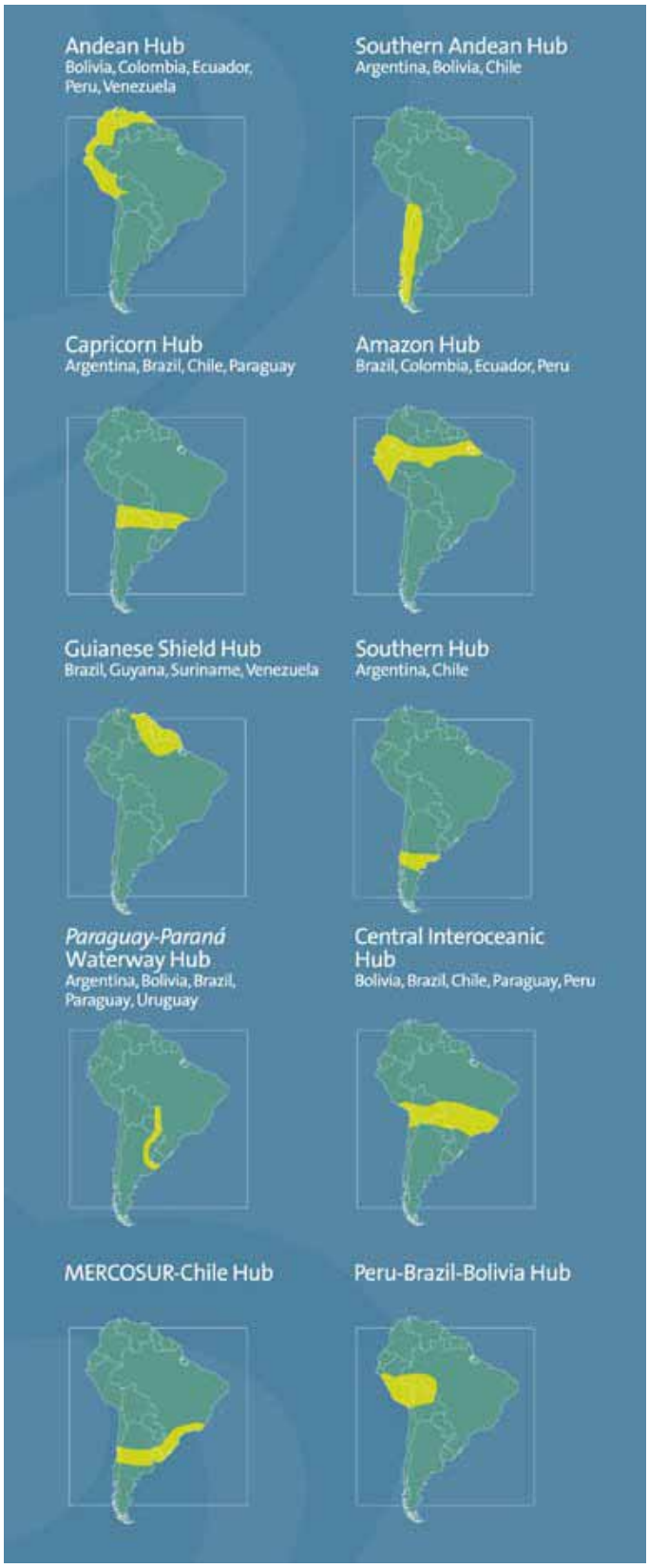
In organizational terms, the IIRSA is composed of the related government ministries of the 12 member nations and three international financial agencies - the Inter-American Development Bank (IDB), the Andes Development Fund (*Corporacion Andina de Fomento*: CAF) and the Financial Fund for the Development of the River Plate Basin (FONPLATA 3). The secretariat is established in Buenos Aires and the following three committees are established in order to coordinate between each country:

- Executive Steering Committee (CDE): This comprises the ministers in charge of infrastructure (or planning) from each country. It is the supreme decision-making agency within the IIRSA. It clarifies strategic guidelines and approves action plans.
- Executive Technical Groups (GTEs): Composed of high-ranking bureaucrats and experts appointed by each country's government, this organization is mainly responsible for implementing plans. The GTEs are organized according to each integrated development hub (EID) and sector-separate integration process (PSI), and they analyze specific items and clarify specific action plans across national borders.
- Technical Coordination Committee (CCT): Composed of two representatives each from the IDB, CAF and FONPLATA, this committee provides technical and financial support.

In addition, each country appoints country-separate coordinators in order to adjust relations with multiple government offices, government-related agencies, the private sector, regional and local governments, universities and research agencies, NGOs and so on.

The basic policies of the IIRSA are, 1) open regionalism, 2) creation of hubs for integration and development, and 3) economic, social, environmental, political and organizational sustainability. For these goals, projects are arranged according to integrated development hubs (EID) in 10 regions based on the viewpoints of economy, society and environment, and issues are analyzed and examined according to each sector in the sector-separate integration process (PSI) in seven different fields, i.e. information and communication technologies, air transport, border crossings, maritime transport, energy integration, multi-modal transport and financial instruments.

Incidentally, the IIRSA does not hold any finances for implementing projects. For this reason, funding for projects is determined case-by-case in negotiations between each country's government, financial agencies and donors.



Source: IIRSA Homepage (http://www.iirsa.org)

Figure 3-6 IIRSA Integration and Development Hubs

Within the framework of IIRSA, the member governments have raised US$ 37.47 billion and organized 335 infrastructure development projects in the fields of transport, energy and telecommunications. However, the Paraguay-Parana Waterway Hub and the Southern Andean Hub are not included here because projects have not yet been finalized in them.

Table 3-2-1 Groups, Projects and Investment in Each Hub

Integration & Development Hub	Groups	Projects	Estimated Investment (US$billion)
Andean Hub	11	74	5.00
Capricorn Hub	4	34	2.00
Amazon Hub	6	44	2.00
Guinese Shield Hub	4	32	0.37
Southern Hub	2	21	1.10
Central Interoceanic Hub	5	44	3.30
MERCOSUR-Chile Hub	5	68	12.10
Peru-Brazil-Bolivia Hub	3	18	11.60
Total	40	335	37.47

Source: IIRSA Homepage (http://www.iirsa.org)

Moreover, as a result of the Executive Steering Committee that was held in November 2004, the member nations agreed to work on 31 priority projects that are considered to have an especially large impact between 2005-2010.

Source: IIRSA Homepage (http://www.iirsa.org)

Figure 3-7　31 Priority Projects of IIRSA

The following table indicates the state of progress in each project as of June 2006.

Table 3-2 State of Progress in Priority Projects

	Project Name	HUB Name	Project Cost (US$ million)	Lead country (countries concerned)	Progress (as of June 2006)
1	Duplication of Route 14	MERCOSUR-	370	AR (BR)	Under preparation
2	Remodeling of the Rio Branco-Montevideo-Colonia-Nueva Palmira Corridor	MERCOSUR-Chile	176.8	UY (AR-BR)	Under implementation
3	Building of the Jaguarão-Rio Branco International Bridge	MERCOSUR-Chile	12	BR-UY	Under preparation
4	Duplication of the Palhoça-Osorio Leg (Rodovia Mercosur)	MERCOSUR-Chile	800	BR (AR-UY)	Under implementation
5	Los Andes-Mendoza Railway Project	MERCOSUR-	251	AR-CH	Open
6	International Route 60-CH (Valparaíso-Los Andes Leg)	MERCOSUR-Chile	286	CH (AR)	Under implementation
7	Northeast Argentina Gas Pipeline	MERCOSUR-	1,000.00	AR (BO)	Under preparation
8	Building of the Salvador Mazza-Yacuiba Binational Bridge	Capricorn	10	AR-BO	Under preparation
9	Presidente Franco-Porto Meira New Bridge and Border Center	Capricorn	55	PY-BR	Under preparation
10	Building of the Pailón-San José-Puerto Suá rez Road	Central Interoceanic	435.3	BO (BR-CH-PE)	Under implementation
11	São Paulo Railway Ring (North and South	Central	300	BR	Under preparation
12	Infante Rivarola-Cañada Oruro Border	Central	1.2	BO-PY	Under preparation
13	Building of the Cañada Oruro-Villamontes-Tarija-Estación Abaroa Road (first stage)	Central Interoceanic	60	BO (PY)	Open tender/concession
14	Toledo-Pisiga Road	Central	76	BO (CH)	Under implementation
15	Rehabilitation of the Iquique-Colchane Road	Central	19.2	CH (BO)	Under implementation
16	Rehabilitation of the El Sillar Leg	Central	30	BO (BR-CH-	Under preparation
17	Desaguadero Border Center	Andean	7.5	BO-PE	Under preparation
18	Cúcuta-San Antonio del Táchira Border	Andean	2	CO-VE	Under preparation
19	Recovering of Meta River Navigability	Andean	108	CO-VE	Open
20	Pasto-Mocoa Road	Amazon	183	CO	Under preparation
21	Paita-Tarapoto-Yurimaguas Road, Ports and Logistic Centers	Amazon	338	PE (BR)	Under implementation
22	Lima-Tingo María-Pucallpa Road, Ports and Logistic Centers	Amazon	589	PE (BR)	Open tender/concession
23	Francisco de Orellana Port	Amazon	105.3	EC	Under preparation
24	Paving of the Iñapari-Puerto Maldonado-Inambari, Inambari-Juliaca / Inambari-Cusco	Peru-Brazil-Bolivia	1,055.00	PE (BR)	Under implementation
25	Bridge over the Acre River	Peru-Brazil-	12	BR-PE	Under implementation
26	Boa Vista-Bonfim-Lethem-Georgetown highway (first stage: studies)	Guianese Shield	3.3	GY-BR	Under preparation
27	Bridge over the Takutu River	Guianese Shield	10	GY-BR	Under implementation
28	Venezuela (Ciudad Guayana)-Guyana (Georgetown)-Suriname (Paramaribo) Road (first stage)	Guianese Shield	0.8	VE-GY-SU	Under preparation
29	Improvements in Nieuw Nickerie-Paramaribo-Albina Leg and International Bridge over the Marowijne River	Guianese Shield	105	SU-GY	Under preparation
30	Exports through Postal Services for SMEs	ITCs	1.2	All countries	Under preparation
31	Implementation of a Roaming Agreement in South America	ITCs	1	All countries	Under preparation
	Total		6403.6		

Source: IIRSA Homepage (http://www.iirsa.org)

There is no doubt that IIRSA is an important initiative that will play the central role in the development of wide area infrastructure in South America. However, difficulties have been pointed out in that it is hard to secure continuity due to changes of government and replacement (or absence) of each country's coordinators, and there are problems regarding the confidentiality of geographical information and databases (in particular, Chile and Brazil are not keen on disclosing information). In consideration of such points, it is thought that a lot of time will be required in order to realize all the projects.

Chapter 4　Japan's Relations with South America

4-1　Past Relationship

South America is geographically distant from Japan. Even so, Japan and South America previously had strong social and economic ties founded largely on emigration, natural resources, markets, corporate location and investment, and ODA.

4-1-1　Immigration

There were said to be three major waves of emigration, that is the period immediately following the Russo-Japanese War, the period following the world depression, and the period following the Korean War. In each case, these were times of economic hardship for Japan, and emigrants mainly originated from least developed areas of Japan such as Hokuriku, Tohoku and Okinawa. The mass migration that took place after WWII was greatly supported by the Japan Emigration Service (now absorbed into JICA). Many Japanese descendants worked in agriculture and contributed to farmland development and diversification of agricultural products. There are now more than 1,500,000 people of Japanese descent living in South America (see Table 4-1). Emigration more or less ended in the 1960s, when Japan embarked on a period of high-level economic growth. Now the trend has been reversed, with many Japanese descendants flowing back into Japan in search of work opportunities. Ever since the employment of second generation Japanese was recognized under the revised immigration law, the number of such people has rapidly increased and currently stands at around 300,000.

Table 4-1 Number of Japanese Descendants in South America in 2004 (Unit: 1000 people)

Brazil	1,400
Peru	80
Argentina	32
Bolivia	10
Paraguay	7
Chile	2
Colombia	1
Venezuela	1
Uruguay	1
Total	1,534

Source: Ministry of Foreign Affairs, Japan

The homes of these Japanese descendants have produced numerous politicians, businessmen, educators, researchers, doctors and other people who have contributed to the development of their countries in managerial and specialist capacities. Citizens of Japanese descent, as well as their

networks, have also played an important role as local partners and staff in the South American activities of Japanese affiliated corporations. Concerning ODA too, experts of Japanese descent (for example, in the agricultural field) are playing an increasingly important role in transfers of technology between South American countries.

The ties that have been built by Japanese descendants in 100 years since the Meiji Restoration have been a valuable asset in terms of fostering mutual understanding and trust between Japan and South America.

4-1-2 Resources

For Japan, up until the 1970s, when it sustained high-level economic growth based on heavy industrialization, supplies of industrial raw materials from overseas were very important. South America was one of its vital supply sources. However, Japan's industrial structure has since changed and, with the advance of resource saving and energy saving, it no longer needs overseas raw materials so much. Moreover, in line with appreciation of the yen from the second half of the 1980s, Japan's resource import sources have become more diversified. As a result, the relative importance of South American imports for Japan has declined over the past 30 years (see Table 4-2).

Table 4-2 Ratio of Latin America in terms of Total Imports to Japan (unit: %)

Year	1970	1975	1980	1985	1990	1995	2000	2005
Ratio	7.3	4.4	4.0	4.8	4.2	3.5	2.9	3.1

Source: Ministry of Finance, Trade Statistics

Now, however, Japan relies on South American imports to supply 50% of its gold requirement, 40% of its silver, and 25% of its mineral ores and many other resources including rare metals. In the area of agricultural products, it imports a wide range of foodstuffs from South America include almost two-thirds of its coffee and 20% of its soybeans.

4-1-3 Market

The manufactured products market of South America was a major market compared to that of Japan before it became an economic superpower. Now, South American GDP only amounts to 38% that of Japan (as of 2005), although it corresponded to 80% 30 years ago (1970). As a result of the rapid growth of Asia, it has come to play an increasingly important role as an overseas market for Japan. As a result, the relative importance of South America in terms of Japanese exports has gone down.

Table 4-3 Ratio of Latin America in terms of Total Exports from Japan (unit: %)

Year	1970	1975	1980	1985	1990	1995	2000	2005
Ratio	6.2	8.5	6.7	4.8	3.6	4.4	4.4	4.2

Source: Ministry of Finance, Trade Statistics

4-1-4 Corporate Advancement and Investment

Investment into South America by Japanese corporations was extremely active up to the 1970s. 27% of Japan's cumulative overseas investment until 1971 was directed to South America, exceeding the 21% directed towards Asia. The import-substitution industrialization policy that the countries of South America adopted at this time acted as a strong motivation to locate plants for Japanese corporations that were seeking export markets for their products. A typical example of his was the rapid advancement by Japanese corporations into the Brazil-Manaus Free Zone that was established in 1970. 32 companies including representative Japanese corporations are operating with European and American corporations in Manaus, and they account for approximately one-quarter of production turnover in the area. Around the same time, Japanese resource-based diplomacy in the wake of the first oil shock stimulated the advance of capital into resources and resource processing in South America.

However, entering the 1980s, the status of South America within the overseas investment of Japanese corporations declined. Due to the economic confusion and cumulative debts (which partially occurred as a result of the Brady Plan of international debt relief measures) in South American countries, many Japanese-affiliated corporations came to adopt a circumspect attitude towards South America. Moreover, due to appreciation of the yen that ensued the Plaza Accord, Japanese corporations sought inexpensive export centers overseas, and Southeast Asia became the main location of this. From the 1990s onwards, the South American economy regained its stability. One of the biggest reasons for this was the investment and economic revitalization generated by the privatization of state-owned enterprises. The amount of privatization investment in developing countries throughout the world between 1990-1996 was US$155.8 billion, and 53% of this was directed towards Central and South America. Privatization truly brought about an investment boom in Latin America at this time. However, the main movers behind this were European and American corporations. Their Japanese counterparts continued to adopt a careful approach, and this was reinforced by collapse of the bubble economy that occurred around the same time. The privatization business, unlike investment into the opening of new plants on idle land, entails the restructuring of existing operations. For many Japanese corporations, which have head offices and concentrated business management functions located so far away, purchases of state-owned enterprises, etc. were not investments that offered good paybacks. For these reasons, the relative importance of Japan in South America in terms of investment has been in decline (see Table 4-4).

Table 4-4 Ratio of South America in Overall Overseas Investment by Japan (unit: %)

Year	1965	1970	1975	1980	1985	1990	1995	2000	2004
Ratio	31.4	3.1	9.0	4.1	2.8	1.8	1.2	0.7	0.9

Note: Based on reports and notifications by 10 South American countries (flow). The above does not include disinvestments.
Source: JETRO homepage

4-1-5 ODA

Seen from the South American side too, the relative importance of the Japanese economy has

declined. The ratio of Japan within South America's imports and exports is in decline. Whereas the private sector has been in retreat from South America, ODA has dominated Japan's presence in the region. Including numerous large-scale development projects (Carajas iron ore development, Selado soybean development, etc.) and economic policy support (trade and investment promotion surveys in Chile and Argentina), the contents of ODA have also been enhanced. However, Japan's ODA to South America has started to rapidly fall off following the onset of the 21st Century (see Table 4-5).

Table 4-5 Ratio of South America in Japanese Net ODA Expenditure (unit: %)

Year	1970	1975	1980	1985	1990	1995	2000	2004
Ratio	-4.2	4.9	4.5	5.5	4.4	5.1	5.8	2.8

Note: South America here refers to the 13 countries of Bolivia, Chile, Columbia, Ecuador, Falklands, Guyana, Paraguay, Peru, Surinam, Uruguay and Venezuela.
Source: DAC International Development Statistics

4-2 Future Relations

Will ties between Japan and South America continue to contract in the private and government sectors? When the following is considered, this seems unlikely.

4-2-1 Japan- South America Relations in the Asia Pacific Age

The international trade picture that surrounds South America is growing more diversified in terms of both institutions and actual conditions. Particularly conspicuous is the spread of free trade agreements between the United States and Asian countries on one side and South American Pacific coastal nations on the other. The United States has signed an agreement with Chile, and Peru has decided to follow suit. With respect to Asian Pacific countries, too, Chile has reached agreements with South Korea, New Zealand, Singapore and Brunei and has also started negotiations with China and India. Peru has reached a pre-FTA agreement with Thailand and has also started discussions with Singapore. These discussions are considered to be taking place in anticipation of a free trade agreement between China and ASEAN. In this way, it is predicted that the economic triangle of relations between South America, Pacific coastal nations, the United States and Asia will become more diverse and close-knit. Further, it is thought that Atlantic coastal countries such as Brazil and Argentina will also become involved in this trend.

For South American exports, China, which is confronted with shortages of resources, represents a massive market. At the same time, cheap Chinese manufactured goods are expanding their share in South American markets. China has already overtaken Japan to become the largest Asian importer in Brazil, Argentina, Peru, Venezuela, Uruguay and Paraguay. However, it is unlikely that Japan will be left out of this larger trend that envelops the Asia-Pacific region. Moreover, such a situation must not be allowed to occur. There are 15 different products for which South America accounts for more than 20% of global production: niobium (84%), sisal hemp (68%), coffee (48%), copper (44%), soybeans (42%), sugar (42%), silver (37%), molybdenum (34%), bananas (31%), oranges (30%), tin (28%), pineapples (25%), iron ore (24%), bauxite

(22%) and lemons (22%). In particular, concerning agricultural and livestock products, South America abundantly produces items such as meat, fish, grapes, tomatoes and grapefruits, etc. that are essential for the everyday diet of Japanese people. Moreover, many South American countries are putting energy into the diversification and quality improvement of their exported agricultural products and improvement of hygienic conditions. On the other hand, in order for the Japanese economy to survive in the global environment, it is indispensable for Japan to diversify and expand its imports of agricultural products. Judging from such trends, it is predicted that trade ties between South America and Japan will inevitably become closer once again.

In terms of direct investment, too, in addition to the expansion of free trade agreement networks, it is possible that industrial production centers with access to al parts of the Americas will be formed along, for example, the Pacific coastline of South America.

In that case, there is no little possibility that Japanese corporations will advance into such centers. The technical capacity and high quality of Japan's manufacturing industry gives it high competitiveness within the manufacturing industry of the Asia-Pacific region, and it is considered to have high expectations in the South American market too.

4-2-2 Relationship between the Maturing Japanese Economy and South America

The Japanese economy in the 21st Century will be removed from its former structure, in which it imported raw materials from all over the world and processed them into products for retailing. It is thought the future structure will entail creating sophisticated technologies, information systems and uniqueness and turning these features into products and markets in overseas investment destinations. In other words, Japan will make the transition from a trading nation to an investing nation. At the same time, the ageing population combined with a dwindling birthrate will accelerate, making Japan more dependent on overseas labor and earnings.

It is likely that South America will once again become an important investment destination for Japan. Various parts of the world, in particular the Old Continents, will be troubled by destabilizing factors such as terrorism, internal unrest and nuclear proliferation for the immediate future, and Asia will be no exception to this. In comparison, the New Continents including South America are relatively peaceful and are likely to remain so in the future. South America can offer high investment security.

4-2-3 ODA in the Japan-South America Relationship

In consideration of the above-mentioned Asia-Pacific age, Japan as an investing nation, and the future scenario for sustained economic growth in South America, there is a strong possibility that, rather than weakening, economic relations between Japan and South America will once again be revitalized.

The role to be played by ODA is especially important at the current time, with the economy in recession. Continuation of Japanese assistance aimed at poverty reduction and economic integration in South America would send an important message to South American countries concerning their partnership with Japan, and it would also stimulate expansion in trade investment. Various new needs are emerging with respect to technical cooperation that considers the possibility of free trade agreements, wide area cooperation in terms of policy support, regional

economic promotion support that links trade to poverty reduction, and so forth.

Regional exchange activities in wide-ranging fields centering on economy and policy can also play an important role in complementing bilateral ODA. For example, the Forum for East Asia - Latin America Cooperation (FEALAC), which was staged for the fourth time in Tokyo in June this year and has been ongoing since 2001, is participated in by 30 countries and is attracting attention. Topics for discussion at the 4th FEALAC were reduction of poverty, promotion of small and medium enterprises, ICT and CDM. Although Japan and Singapore have so far played the initiative in this forum, ASEAN and China also regard it as important. Moreover, Brazil and Argentina, which lie outside of APEC, are actively involved. Furthermore, south-south cooperation currently being deployed by the UNDP has so far promoted exchange of development experiences between Africa and Asia, however, due to support by the Government of Japan, this is planned to promote exchange between Latin America and Asia in future and will attract attention as an example of exchange activities on the regional level similar to FEALAC.

Chapter 5　Economic Development Issues as Seen by Japanese Corporations

5-1　Outline of the Survey

5-1-1　Objective

In the survey of Japanese-affiliated corporations, we directly visited Japanese-affiliated corporations in South American countries and gathered “real voices” concerning the following questions: 1) How do corporations assess South American countries, 2) What are the economic development issues of South American countries as seen by corporations, and 3) What are expectations regarding ODA?

5-1-2　Survey Method

In conducting the survey, each corporation was visited and direct interviews were held with responsible persons. Moreover, although it was originally intended to conduct a questionnaire survey of Japanese corporations established in South American countries, it was decided to conduct direct visits for the following reasons:

- Even in Chile, which has a reputation for stable policies and institutional arrangements, there is opacity in various respects and it is not possible to obtain a grasp of reality without talking to people who have a good understanding of conditions. Reports given by people with only limited experience of South America have been known to include mistaken information. (We confirm authenticity with some experienced members).
- Japanese corporations receive lots of surveys, however, they are not sure how these are beneficial to them and some questionnaire surveys that are unilaterally sent seem to cause more trouble than good because they are separated from reality and corporations do not known how to respond[16].
- Even though it appears that Japanese corporations have advanced into countries, (depending on the area of business), they sometimes only have agency or trading company functions. Uniformly seeking the opinions of such companies that are only partially involved in local countries is not a very effective measure.

In this survey, in order to understand the true feelings of the corporate side, corporations were requested to accept interviews on condition that the contents of individual interviews would not be disclosed. As a result, we think we were able to obtain information that could not be acquired in conventional questionnaire surveys. Moreover, concerning the responses given by corporations, rather than identifying the problems that face each corporation, effort was made to garner common issues. Incidentally, individual responses were not adopted in consideration of compatibility, etc.

[16] Before starting the visit surveys, it was necessary to first obtain consent from the board of directors and president of the chambers of commerce and industry in Chile and Brazil respectively. Both chambers spoke of past experiences where corporations were subjected to survey visits and questionnaires but ended up being troubled and wasting their time with no benefit, so they needed to listen to and accept the objectives of the survey here.

5-1-3 Survey Targets

The survey focused on the three countries of Brazil, Argentina and Chile, where many Japanese corporations have located, while conditions in other countries were surveyed as far as possible in connection with other survey items. The number of Japanese corporations in each country and the corporations and chambers of commerce and industry visited in this study are shown in Table 5-1 and 5-2.

In the final analysis, because numerous corporations locate their South American administrative functions in Brazil and many of the personnel dispatched from Japan have experience of working in numerous Latin American countries, we were able to obtain a certain degree of knowledge concerning South American countries.

Furthermore, in order to clarify the conditions faced by corporations and problems confronting the future nurturing of corporations and promotion of industry in JICA priority assistance countries such as Ecuador, Paraguay, Peru and Bolivia, visits were also made to local small and medium enterprises and corporate associations, etc.

Table 5-1 Numbers of Locating Japanese corporations

Country	Number of Corporations	Country	Number of Corporations
Columbia	20	Venezuela	26
Peru	13	Ecuador	8
Bolivia	2	Chile	31
Brazil	204	Paraguay	3
Argentina	29	Uruguay	(No data)
		Total	336

Source: List of Overseas Advancing Corporations (country-based) 2006, Toyo Keizai Shinposha[17]

Table 5-2 The Number of the Japanese corporations and Chambers of Commerce and Industry visited in this Study

Country	Corporations	Chambers of Commerce and Industry	Country	Corporations	Chambers of Commerce and Industry
Columbia	(Not visited in this Study)		Venezuela	0	1
Peru	4	0	Ecuador	2	0
Bolivia	1	−	Chile	13	1
Brazil	8	2	Paraguay	1	1
Argentina	9	0	Uruguay	(Not visited in this Study)	
			Total	38	5

[17] The number of Japanese-affiliated corporations is based on survey by Toyo Keizai Co., however, upon conducting survey on the ground, it emerges that corporations other than registered ones also have permanently assigned personnel and so on. Moreover, maybe due to difference between the time of the survey and the time when this work was issued, some of the corporations contained in the list do not exist any more.

5-2 Overall Trends

5-2-1 Reason for Locating in South America

Responses to the questions of why did corporations locate in South America and what assessment do they give of South America can broadly be divided into three types.

(1) Recognition of Resources in South America

Concerning the reasons for locating in South America, most corporations responded that this was to obtain resources or to establish a base in South America with a view to securing resources in the future.

Resources here mostly referred to mineral resources, agriculture, forestry and fisheries resources, although energy resources such as petroleum and natural gas were also raised.

1) Mineral Resources

Well-known mineral resources in South America comprise iron ore from Brazil and copper from Chile, however, South America also holds abundant reserves of non-metal resources, and the Andes in particular are thought to contain various mineral veins on both sides. Development conditions differ in each country, however, reserves of copper in Chile are becoming exhausted, whereas Bolivia, Peru and Argentina are attracting increasing attention for their possessions of Andean mineral veins.

However, because the Andes are located on the western side of the South American continent, even if mines are developed in inland Bolivia and Argentina, it is a difficult task to carry minerals to the coast (as compared to mineral veins on the more accessible Atlantic Ocean side). Moreover, Bolivia has a history of political instability, and the situation there is made even more uncertain by the fact that the Morales administration, which was established in 2005, has plans to nationalize the country's resources. In the case of Peru, the political situation is relatively stable, however, the areas containing mineral deposits are also home to indigenous communities, and large-scale development will be difficult unless this issue is overcome first. Even so, out of the countries that are anticipated will have copper reserves in the future, i.e. Zambia, Congo, Iran, Kazakhstan, Pakistan and Peru, the one with the greatest stability and best potential for development is Peru.

Corporations have already started investing in Peru and Bolivia in addition to Chile while considering the risks. Since China is also working flat out to secure resources, Japanese corporations will need to move quickly.

2) Agriculture, Forestry and Fisheries Resources

South America has great potential in terms of agriculture, stockbreeding and forestry. In particular, because the plains are blessed with fertile soil and population is small in relation to land area, South America may be the region with the greatest potential for increased food production in the world. Similarly, fertile and plentiful land basically supports the forestry and stockbreeding sectors too. For Japan, which has a grain self-sufficiency ratio of approximately 28%, it will be necessary in the middle to long-term to build a mechanism for procuring food

from South America.

Another noteworthy feature of agriculture is that, in areas where population pressure is low and there are many poor small-scale farmers, agricultural chemicals and fertilizers, etc. have not been used much in the past and, as a result, conditions are in place for making organic agricultural products.

Furthermore, although not linked solely to agriculture, South America, in particular the region stretching from Brazil and Argentina to Paraguay, is home to between 20-30% of the world's freshwater, and this is an extremely important resource amid growing concerns over global water shortages.

Furthermore, because there is land to spare in South America, technologies such as dividing land into blocks and setting aside fallow land every year in order to restore soil fertility are not disseminated. As a result, there are also said to be areas where the soil is badly impoverished.

Concerning fisheries, the waters around South America contain abundant fisheries resources with latent potential for more development. Moreover, countries such as Argentina, which have fisheries resources but do not consume many of these, are important for a major fish-consuming nation such as Japan. In recent years, it is said that China has been catching fish in large quantities just outside of the territorial waters. There are fears that over-fishing will lead to the depletion of fisheries resources.

Something that can be said about agriculture, forestry and fisheries resources in general is that food resource exports from South America include a lot of low-processed items and are labor-intensive. Accordingly, attention needs to be directed to the fact that, due to increasing wage pressure brought about by policies aimed at protecting workers' rights, there are numerous sectors that are no longer as profitable as they used to be.

3) Energy Resources

South America is home to a number of energy powerhouses such as Venezuela with petroleum and Bolivia with natural gas, etc. Until now, no major investment was made from Japan due to country risks and sheer distance from Japan, etc.

However, believing it necessary to hedge risks in terms of energy security and considering there to be little difference in terms of time-distance between supplying from the Middle East through the Straits of Malacca and supplying from the Pacific coast of South American, a number of corporations are directing attention to the possibilities of energy development in the future.

(2) Recognition of the South American Market

Another reason for setting up in South America has been to target the South American consumer market and consumer market. In particular, corporations are interested in Brazil, which has a large population and is demonstrating rapid economic growth, and Chile, where incomes are increasing not only among the traditional wealthy classes but also the middle-income classes. Moreover, a number of corporations have advanced into Argentina and Peru because of the size of the markets there.

However, the methods of entry vary depending on conditions in each country: for example,

since Brazil has a large consumer market and various barriers to imports, corporations are unable to discard such market potential and have to advance into the country by themselves; however, in cases where corporations set up in pursuit of high class niche markets, they only establish retailing or agency functions so that they can import from centers throughout the world and conduct retailing.

(3) ODA Project Association

The third reason given for setting up in South America was in order to exploit business chances made possible by Japanese ODA. This is why trading corporations station permanent staff in Bolivia and Paraguay. This reasoning is removed from corporate entry based on the recognition of South America's potential.

5-2-2 Thinking regarding Economic Integration in South America

Generally speaking, Japanese corporations regard South American economic integration neither as a major chance nor a threat. This is partly because it is difficult to forecast how things will turn out, however, since corporations determine destinations and methods of advancement (company establishment, agent contracts, plant construction, etc.) upon taking into account the business environment and country risks at the time, if economic integration progresses and the environment does change, they will simply adjust in the best way possible.

For example, Toyota has plants in Brazil and Argentina, and these coordinate the production of parts between each other as well as producing different vehicle models; however, another reason for having two plants is in order to hedge risks while monitoring conditions such as currency fluctuations, inflation in labor costs and other expenses and non-tariff barriers, etc. in both countries. Naturally, another condition is that sufficient market scale can be anticipated in order to ensure that production earns payback. In another example, Yakult has a plant in Brazil, from where it supplies products to Argentina. The reasons for this are that the market in Argentina is too small to guarantee that building a plant there would be profitable, while the existence of relatively good roads between Brazil and Argentina ensures that products can be transported quickly enough to maintain quality even after considering customs clearance problems. Accordingly, plant location is selected upon making a comprehensive judgment.

Scenarios where regional economic integration could impart merits to corporations are, 1) the case where institutions and institutional arrangements including customs clearance become standardized and more transparent in the integration process, and 2) the case where economic integration triggers economic development and growth of the consumer market, thereby expanding business chances for corporations.

Rather, the biggest concern of corporations now is the issue of EPA/FTA with Japan. For example, taking the case of Chile, where market liberation is advancing, Japanese corporations find themselves at a cost disadvantage in competition with South Korea and China, which have signed FTA with that country. Since it is possible that similar situations will arise in other countries in the future, corporations strongly hope that Japan signs similar FTA as soon as possible. If agreements are signed first between Mercosur, CAN, the EU and North America, Japanese corporations will be confronted with extremely harsh competition.

Naturally, since the major Japanese corporations have manufacturing centers dispersed in various countries, just because one country binds a FTA with China, this does not necessarily mean that the corporation will placed at a disadvantage. However, since issues arise concerning recognition of the country of origin and so on in such cases, it is difficult to forecast outcomes.

An obvious example of a demerit here is the case of transportation between Mercosur member nations. Since only corporations that are based in member nations are able to conduct transportation, this acts as a barrier to entry.

5-2-3 Issues in Economic Development

The common issues that confront the countries of South America in terms of economic development are described below. Issues specific to each country are described later.

(1) Stability and Transparency of Policies and Institutional Arrangements

In the case of South America, the greatest problem area concerns the stability and transparency of policies and institutional arrangements. Whenever a government administration changes in South America, the personnel filling the top posts are replaced and even policies are greatly altered in many cases. This phenomenon can be seen on every level from central government ministries down to local municipalities.

A trend of populism, in which politicians seek to win the popularity of the masses, is thought to be in the background to such sudden policy and system changes; furthermore, since there are numerous countries possessing abundant natural resources and energy, etc. in South America, the fact that the attention of governments is turned to the domestic front also has an effect. For example, Argentina has recently adopted a policy whereby high taxation is placed on exports in order to boost domestic distribution when domestic beef and petroleum prices increase, however, such a policy is only possible because Argentina has plenty of energy and food to ensure it can survive even if the country becomes closed.

Corporations are naturally unable to conduct long-term investment with peace of mind in countries where policies and institutional arrangements undergo such dramatic change. When viewed in the long term, this has an impact on the economic development of the countries concerned, however, in South America, rather than stable development based on the long-term perspective, policies aimed at obtaining short-term popularity are sometimes seen. Sometimes there are cases where a single presidential decree can change policies and institutional arrangements without the decision-making process being made public, and this adds to the level of uncertainty in the region. Problems of corruption are also said to be involved here, and some corporations reckon that all matters are handled politically in South America.

(2) Legislation Oriented towards Protection of Workers

Due to the legacy of socialist regimes in the past, many countries in South America have labor laws that lean towards socialist and worker protection principles, although there are disparities in the degree of such legislation in each country. Seen from the side of corporations, such legislation is an obstacle to conducting investment and expanding businesses.

For example, corporations are obliged to pay workers' wages even when workers are on strike,

and they are required to provide other good benefits. As for the courts that administer labor problems, these are extremely biased towards the workers, and corporations are often unable to win cases even when they are in the right. Accordingly, corporations need to employ numerous lawyers in preparation for court cases, and this leads to expensive legal costs.

As wages continue to rise, since employing workers represents too much of a risk for corporations, they sometimes postpone plans to expand business, and this is an impediment to long-term industrial development.

(3) Social Structure

South American countries have historically formed class societies in varying degrees. This problem is deeply linked to poverty, and the thing that makes poverty in South America different from in other regions is the way it is structuralized within the local economy and society.

Social structural problems exert an influence on economic development in both actual terms and psychological terms. For example, in Paraguay, powerful families representing a small percentage of the population own most of the national land, while in Bolivia too, certain families control rights around Santa Cruz. In terms of psychology, traditional corporations tend to only recruit people from families that are of a certain class or higher.

When society is structured so that certain classes of people control privileges in this way, it is possible that these groups might become an obstacle to social structural reforms. That is, for industries that survive by openly utilizing illegal foreign labor force and for classes in society that make an easy living by using illegal workers[18], the empowerment of lower classes will hinder their rights and there is concern that willingness to really reform society will not be born.

5-3 Conditions and Corporate Management Issues in Each Country

5-3-1 Conditions in the Main Countries Entered by Japanese corporations

(1) Brazil

1) Overview

Numerous Japanese corporations have advanced into Brazil, and many of them concentrate their South American control functions here. Advances by Japanese corporations into Brazil reached a peak in the 1970s; many corporations withdrew or downsized when the Brazilian economy encountered problems in the 1980s; since Japan was faced with an economic crisis just as the Brazilian economy showed signs of recovery in the 1990s, it is only recently that the situation has improved. For the corporations that set up there now, even though problems exist concerning poor law and social order and so on, Brazil is an attractive destination as a source of mineral resources typified by iron ore and food resources typified by soybeans, and it also offers large-scale and high-growth potential as a consumer market.

Brazil is a veritable treasure trove of natural resources and has great potential in this area;

[18] For example, the middle and upper classes in Chile regard it as perfectly natural to employ migrant workers, some as young as children, from Bolivia and Peru, as housemaids and drivers for minimal wages. In Argentina too, a certain company president said that the entry of illegal workers from Bolivia couldn't be avoided because Argentina is economically superior, and he went on to say that such workers were the cause of social problems.

moreover, concerning farmland, out of the national land area of approximately 8,500,000 km^2, approximately 5,000,000 km^2 is cultivatable and only 20% of this is currently utilized. Concerning energy, too, 82.7% of generated electricity is derived from regenerable hydropower; moreover, since possibilities for bio-diesel energy generation are also emerging, there is a lot of room for development including potential for CDM projects in this sector. Also, since Brazil is home to 20% of the world's freshwater resources and has a population of approximately 180 million, it has room to spare in terms of water too[19].

2) Current Conditions of the Japanese Manufacturing Industry

Japanese-affiliated manufacturing companies tend to enter Brazil in order to avoid import barriers[20]. In Brazil's case, importing components and raw materials is not a problem, however, expensive taxes are placed on imported finished products. Since Brazil cannot be overlooked as a consumer market, Japanese corporations should choose either establishing agents to import from other countries and selling or manufacturing locally. By looking at the balance between negative factors such as rising personnel expenses and positive factors such as incentives[21] in addition to the high import barriers, it is currently more advantageous to conduct manufacturing in Brazil.

With respect to manufacturing, the general trend seems to be that corporations have components and products that entail sophisticated technology sent from Japan, while they manufacture the majority of products around Manaus. Although there are some corporations such as Toyota that are becoming increasingly able to procure all components apart from engines and computers, etc. from European, American and local corporations[22], in general, manufacturers are hindered by the fact that subcontractors and associated suppliers are not willing to follow them like in Asia.

Japanese corporations generally target high-class niche markets[23], whereas European and American corporations (automobiles, etc.) and Chinese corporations (domestic electrical appliances and general merchandise, etc.) control the large-volume popular markets. It is difficult for Japanese corporations to target volume zones because corporations from around the world engaged in harsh price competition, under high interest rates and unstable financial infrastructure is unstable.

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[19] For example, China has 7% of the world's freshwater resources but a population of 1.3 billion, so its water shortage is growing more serious.

[20] However, against the background of a growing economy, there are moves to concentrate the manufacture of specific products in Brazil and supply to the rest of the world, and this trend will be closely watched in the future.

[21] Concerning incentives, manufacturing corporations from throughout the world have gathered in Manaus Free Zone in the Amazon River basin, however, since Manaus is badly positioned for domestic logistics (4,000 km from Sao Paulo), the appeal of the domestic market is not so operative. However, if corporations aim to export to North America, proximity to North America is highly evaluated.

[22] Among European and American automakers, there are companies such as Volkswagen and FIAT that have a localization rate approaching 90%. Such makers export the vehicles they manufacture in Brazil to North America and Europe, etc.

[23] For example, the Toyota Corolla is retailed in the luxury car segment in Brazil. However, from the closed economy of the 1980s through to the 1990s, Toyota conducted small-scale operations centering on imported cars, and it wasn't until the 2000s that it embarked on full-scale local deployment. Accordingly, it may also be said that Toyota is only able to bring in specific goods.

3) Instability of Institutional Arrangements

Brazil has experienced hyperinflation in the past. However, apart from high interest rates in excess of 15%, the economy is stable and the only risk now facing corporations is instability in institutional arrangements. Even though institutional frameworks are in place, institutional arrangements are frequently changed and they are not operated properly.

For example, concerning law, officials have too much authority and tend to make arbitrary decisions. Differing judgments are made depending on which accounting firm or law firm you go to. Furthermore, there have even been cases where buildings owned by foreign corporations have been forcibly requisitioned and the corporations ordered out and forced to accept payment by installments over decades in order to make way for a law court[24] will move in there. This is indicative of how business is conducted in a world that crosses the bounds of legal common sense.

Concerning taxation, which raises approximately 38% of GDP, it is said that not only tax rates are very high[25], but also tax systems are extremely complicated and are frequently revised, and the lack of clarity in legal interpretations means that officials can make arbitrary decisions and exert a major influence. Moreover, transfer pricing tax, whereby tax is levied on a percentage of dealings with parent companies in Japan since this is viewed as revenue for local corporations, places a major burden on Japanese corporations, and moreover the way in which such taxation is certified is a gray zone[26].

Concerning incentives for attracting corporations too, although criteria are stipulated, these are said to differ from one corporation to another.

4) Employment and Labor Problems

Brazil's labor law is based on the Italian labor law that was established in 1942, and it is said to be one of the most worker protection-oriented legislation in the world. Furthermore, the present labor party administration gives priority to workers. Corporations brace for labor disputes by employing in-house lawyers and so on, however, different lawyers and judges give differing interpretations of labor legislation, and this is one of the areas that cause incoming corporations to Brazil the greatest trouble.

Concerning employment, wage systems are rigid and it is difficult to introduce performance-related wages. As a result of negotiations with sector-separate unions, the principle of equal pay for equal work, whereby uniform wages are set irrespective of each company's conditions, is adopted. As a result, wage levels become too high and costly for long-term employees, so corporations are forced to let people go even if they are highly capable.

However, the wage levels of workers in Brazil are still lower than in Japan[27]. Human resources in Brazil are generally considered to be earnest, although extremely low education

[24] In Brazil, building ownership divided according to floors is recognized.
[25] In addition to taxes, corporations must also pay towards the social integration fund PIS, which aims to provide health, pensions and social relief to citizens, and the COFINS social security contribution, etc.
[26] Accordingly, numerous Japanese corporations make local corporations directly import and get commission.
[27] Concerning management classes, there is little difference with Japan. Regarding the director class, some corporations pay higher levels than in Japan.

levels are a problem in the north of the country. Having said that, even if incentives are available, rather than working as hard as they can, since Brazilian workers tend to work to a certain extent and then enjoy life, they do not work as much as employers anticipate.

5) Technical Capacity

Technical capacity in resources and energy-related industries is fairly high. However, there are doubts about the level of technology in general manufacturing sectors. For example, Embraerl Co., which is the fourth largest private sector aircraft maker in the world and was the largest exporter of large-size products in 2005 with US$3.2 billion, reportedly imports its major components and mainly conducts assembly work in Brazil. As a result, the economic structure is such that when exports increase, there is a corresponding increase in imports too.

6) Bipolarization, Unemployment and Law and Order of Society

The Brazilian economy forms a bipolar structure: whereas the southern part of the country based around Sao Paulo has high economic sophistication, the Amazon region in the north has a lot of poverty and low education levels. As a result, the social structure is such that poor people from the north perform menial labor in the south; moreover, unemployment and crime levels are increasing in line with the advance of urbanization[28]. Unemployment reached its worst level of 13% in April 2004, however, it recovered to 9.6% by the end of that year in line with economic recovery. Law and order, on the other hand, is very poor. There are professional corporate theft groups and some corporations are robbed once every two months. As for the urban centers such as Sao Paulo, etc., conditions are bad as well.

7) Other Points

Another problem causing concern to Japanese corporations in Brazil is the signing of free trade agreements. In the case where agreements with the EU or FTAA have been signed ahead of agreements with Japan, for example, Japanese agricultural chemicals that rely on imports for 90% of raw materials cannot compete with rival products from Europe and America. Since most products of Japanese corporations are already in competition with European and American counterparts, the issue of whether or not free trade agreements can be signed first affects the very survival of such enterprises.

(2) Argentina

1) Overview

A lot of Japanese corporations set up in Argentina during prosperous times in the past, however, many of these withdrew from the country before and after the economic crisis. The recent improvement in international competitiveness has largely been due to devaluation of the currency from US$1 = 1 pesos to US$1 = 3 pesos, and even though the picture is bright when looking at macroeconomic indicators alone, in reality it is difficult to say that economic and social conditions are stable. A Japanese business manager with long-term experience of

[28] The crime rate and risk rate in Brazil are considered to be so bad that they cannot even be estimated.

working in South America said that the best place for Japanese to invest right now is Brazil in spite of its problems, and this is followed by Chile and then, if there is still room, in Argentina.

Argentina is accustomed to exporting resources and agricultural products such as energy, cereals (mainly soybeans), nonferrous metals and aluminum, etc. in the largely unprocessed state in bulk quantities. It does not export many added value products in containers; moreover, it displays little effort or desire to develop products suited to the Japanese market in the same way as Chile[29]. Moreover, because Chile exports so may low added value products, freight costs have a major impact on business. Japanese-affiliated trading companies, too, do not necessarily export to Japan. Argentinean corporations would rather sell bulk products to Europe, America and China rather than adjust to the detailed demands of Japanese consumers.

Concerning agricultural products, there are various problems that are not acceptable for the Japanese market: for example, the foot and mouth disease problem has not been resolved concerning beef; soybeans lack sufficient protein content to satisfy Japanese criteria due to insufficient sunshine; and the red color of Argentinean sweet corn means it cannot even be sold as livestock feed.

As a consumer market, Argentina is considered to have potential because it has traditionally possessed a wealthy class and it has a relatively high population for South America of approximately 37 million. However, since the investment environment is extremely poor, many Japanese corporations prefer to establish agencies for retailing products rather than setting up production centers in Argentina.

2) Instability of Policies and Institutional Arrangements

The greatest problem attributed to Argentina is that it is impossible to read economic policies and industrial policies[30]. One of the biggest issues facing the country is high inflation of 12%, however, rather than taking a long-term approach to this from a global perspective, the government adopts a short-term approach from the domestic perspective[31].

For example, when commodity shortages arise on the domestic market, the government responds by suddenly applying exorbitant export duties[32] (for example, 45% was placed on petroleum exports at the start of 2006) or enforcing trade embargoes (for example, a 180-day ban on beef exports). Furthermore, such measures are determined based on presidential decrees without undergoing the proper process of discussion in the national diet[33].

In April 2006, the government and industrial groups reached an agreement to reduce prices for general consumer goods such as detergents and clothing, and this was unilaterally notified to corporations[34]. Because such decision-making processes are invisible, corporations cannot

[29] Some local corporations question the necessity of spending time and money on raising the added value of products that can be exported in bulk as they are.
[30] For example, farmers cultivate soybeans when it seems that soybeans will be profitable and they switch to ranching when it appears that this will be profitable, and the government adopts no clear policy regarding this.
[31] Since Argentina is self-sufficient in food and energy, it is said this leads it not to consider the needs of other countries.
[32] It is said that the government targets products with a good export record in order to grab tax revenues.
[33] President Kirchner explains that since the country has not fully recovered from the economic crisis and is still in a state of emergency, the emergency ordinance that concentrates various policymaking authority in the president is still in effect.
[34] However, since only a few Japanese-affiliated corporations conduct business in this sector, there is little effect.

forecast the future. Many Japanese corporations point out that decisions in Argentina are made via invisible processes and are unilaterally notified through official journals and the media.

Even agreements reached with the government are subject to arbitrary revision. Moreover, even though the fisheries law was established in 1998 in order to counter the over-exploitation of marine resources, the government has still not designated quotas in spite of promises to the contrary.

Due to the uncertainty of policies, products that could otherwise be exported at high prices end up being sold on the domestic market for low prices, and the government holds down the prices of consumer goods in general. When corporations look at such conditions, they become unwilling and unable to reinvest profits or to continue and expand their businesses. As a result, in the long run Argentinean industry loses its competitiveness, while in the short run corporations become exasperated. Taking another example, concerns are raised over sudden changes in the economic environment (hyper-inflation) in the case where prices that are currently subject to control are suddenly raised.

3) Employment and Labor Problems

Labor issues are another major problem area in Argentina. Because the country adopts excessively favorable policies towards workers, corporations are faced with major constraints.

For example, it is legally prescribed that wages should automatically increase at least as much as the rate of inflation; wage increase rates are unilaterally decided in government discussions[35], and corporations and management have no choice but to adhere to these decisions. Moreover, wage hikes are high (around 19% in fiscal 2006, although this varies according to sector), and these are a major cause of cost inflation for corporations.

Argentina has conventionally had pro-worker systems. However, the law became even more biased towards workers as a result of recent revision. For example, under the newly revised labor law, the upper limit on compensation for industrial accidents was removed, and retirement allowances in cases where corporations lay workers off were raised without any upper limit. As a result, there are cases where it is more costly to dismiss workers rather than keep them on. Thus, it has become difficult for corporations to dismiss workers, and since workers are also entitled to wages even when they are on strike[36], corporations are powerless to prevent strikes or stop workers from making only a half-hearted effort in their jobs. Even corporations that currently show good performance are choosing to postpone expanding businesses because they don't want to employ additional workers. Another problem for corporations is the existence of so-called "picketeros," i.e. demonstration groups that blockade roads and attack shops during strikes.

Another labor problem is the fact that there are said to be many Bolivians unlawfully employed in Argentina. This may be regarded as a response by corporations to the excessively pro-labor policies and systems of Argentina. Many Bolivians seem to work as low-wage labor

[35] Corporation representatives are theoretically requested to take part in such discussions, however, Japanese-affiliated corporations at least do not have any involvement at all and the government unilaterally makes decisions.

[36] In 2005, a certain fisheries company was confronted with a 103-day strike by crewmembers and a 4.5-month strike at its plant, and the company had to pay all basic wages during these periods.

in the textile industry and on building sites[37], and it may be no exaggeration to say that these workers support these sectors in Argentina.

4) Tax System

The tax system is complicated and there are numerous types of taxes, however, in general tax levels are high. Moreover, tax rates and types vary according to each city. An expensive distribution tax of 21% is applied to sale prices of imported finished products[38], and there are temporary tax payment schemes, cheques charged on money transfers and various other tax types. For this reason, a Japanese electrical appliance maker transports parts for assembly to the special tariff zone in the far south of the country, and it ships products back up north to Buenos Aires, etc. for retailing.

5) Finance

Concerning the financial market, on the surface it appears to be recovering from the economic crisis of 2001, however, from the viewpoint of local corporations, confidence has still not been restored. For example, banks still impose a ceiling on the amount of money customers can withdraw in a day, and many people prefer to save dollars under the floorboards or invest in real estate and cars rather than deposit their savings in banks[39]. Moreover, because the longest financial commodities are only three months, corporations are unable to raise long-term funds (thereby making long-term investment difficult).

(3) Chile

1) Overview

Chile has the reputation of having the most stable politics and economy in South America, and it also has a relatively high degree of transparency in its policies and institutional arrangements. In fact, Japanese corporations in Chile generally responded that there are no particular problems in terms of policy and institutional arrangements when setting up in the country[40]. In terms of politics, a new administration was elected in the last elections, however, unlike in other South American countries, it is thought there will be no drastic policy revisions.

In terms of market, Chile only has a population of 15,120,000 people[41] and is very small. The country has no manufacturing base and with the geographical disadvantage of being partitioned from the other countries of South America by the Andes, it is not a destination for Japanese manufacturers to conduct plant investment. The only companies to have set up in Chile for manufacturing purposes are Japan Fisheries, which conducts salmon farming, and KIMICA, which produces alginic acid from seaweed obtained in Chilean seas. The structure of

[37] This may be more of a cultural issue, but Argentineans consider themselves to be Europeans and believe that they should only perform intellectual work rather than manual labor. Accordingly, it is thought this is why Argentina gives tacit recognition to illegal workers from Bolivia.

[38] When corporations import components and assemble products in the free trade zone on Fuego Island in the southern tip of the country, VAT is 0%.

[39] This is thought to be one of the reasons why car sales in Argentina have been so good in recent years.

[40] According to a survey by the World Bank in 2005, Chile ranked 25th in the world in terms of the ease of conducting business and was the only South American country to enter the top 30. Japan was 10th and South Korea was 27th.

[41] Based on the national consensus of 2002. his corresponds to around one-ninth the population of Japan.

the Chilean economy is such that mineral deposits such as copper, processed agricultural products such as wine and primary products such as cultured fish are exported and the resulting earnings are used to develop service industries; however, the manufacturing sector is weak.

Because the economy is growing in spite of the small domestic market, a new class of nouveau riche has emerged in addition to the traditional upper class and propertied class and a market for luxury products is developing. However, there is a problem with the widening of disparities.

In view of these circumstances, the corporations that advance into Chile from Japan are divided into two types: 1) those that seek resources, and 2) those that seek to establish niche markets for luxury products.

When advancing in order to secure resources, Japanese trading companies, etc. invest in mining development companies, etc. while striving to acquire stable supply of resources. Recently, investment into the Escondida copper mines[42] by a Japanese corporate alliance (Mitsubishi Corporation, Mitsubishi Materials and Nippon Mining and Metals Co., Ltd.) caused a stir. Concerning mineral resources, the basic strategy of Japanese corporations is to secure a stable share via investment, however, in peripheral sectors, there are cases of joint technical development utilizing traceability and so on such as that between Chilean State Copper Corporation CODELCO and NTT in Japan. In the mining sector based around copper, because Chile can boast high levels of technology in international terms, this is an attractive sector for Japanese corporations in terms of both resources and technology. Moreover, the price of copper has increased from 80 cents per pound in 2000 to 350 cents per pound recently, making this a very profitable sector for involved corporations.

Japanese corporations are also involved in Chilean wine and salmon farming, etc. The Chilean wine industry, whether it is conducted by local large-scale wineries or by small-scale producers, is competitive because it utilizes low-wage workers, and some of the Japanese corporations admitted to feeling a dilemma between the problem of social disparities and the need to supply products at competitive prices. As for salmon farming and shellfish canning, etc., since processing levels are low and work is mainly conducted manually, it is becoming difficult to obtain profits due to appreciating currency[43].

Moreover, although this may be more of a problem for the Japanese market, amidst growing consumption of fish throughout the world, Chilean corporations are avoiding the Japanese market with its stringent specification requirements and choosing instead to export to North America and Europe. In addition, against the background of abundant forest resources, interest is growing in the CDM business.

As a consumer market, amidst overall economic development and rising incomes among the middle classes, Chile is an attractive market for expensive products. However, because the population is small and products from other countries are able to easily enter due to Chile being one of the most liberated economies in the world, corporations are exposed to harsh price

[42] However, since investment is conducted via third countries for taxation reasons and so on, this does not count as Japanese investment in official statistics.

[43] Concerning the currency, the US dollar has appreciated almost 30% from approximately 700 pesos to 500 pesos in recent years, and this pressures the businesses of export industries.

competition. In particular, when compared to products from countries such as China and South Korea that have already signed free trade agreements with Chile, products from Japan, which so far has no FTA, are immediately disadvantaged by tariffs and have trouble competing. Price differentials resulting from differences in free trade agreements are very big problem.

In such an environment, for example, a Japanese car have almost a 30% share of the market, however, this may be the result of promoting differentiation with cheap South Korean cars[44] and aiming for the luxury car market[45] through fitting double airbags[46] that are not required under Chilean law and providing after-sale services. Concerning electrical products, corporations survive by selling both luxury products and cheap models with limited functions that would not normally sell in Japan. Even so, Chilean markets are based on price competition. Moreover, some European and American corporations establish their South American centers or call centers covering Spanish-speaking countries in Chile.

2) Employment and Labor Problems

Human resources in Chile have a good reputation, and the country has internationally recognized universities such as the University of Chile. Furthermore, since there is a shortage of job opportunities, it is not difficult to secure human resources, although doubts remain over the motivation and responsibility of some workers. In particular, respondents pointed to inadequate cooperation and a tendency among middle managers to cause confusion by acting too arbitrarily. The labor market is said to be thin. Concerning manual laborers, when for example there is a construction boom, workers tend to flow into construction work thereby creating a shortage of grape pickers in the wine industry. Accordingly, laborers tend to migrate between multiple sectors.

5-3-2 Conditions in Other South American Countries

Here, problems confronting economic development in the JICA priority countries of Ecuador, Peru, Bolivia and Paraguay are roughly described based on the findings of visit surveys of Japanese corporations, local corporations and industrial groups, etc. Adopting a different viewpoint, the problems raised here may be regarded as the background to why not many Japanese corporations have become established in these countries[47].

Incidentally, leaving aside problems in the business environment, it is noted that these four countries are friendly towards Japan.

(1) Instability and Opacity of Policies and Institutional Arrangements

As was mentioned above, South American countries have unstable and opaque policies and

[44] Looking at actual import statistics, sales of South Korean cars were growing from before the signing of the free trade agreement, and it is thought that this was because the price range (cheap) of Korean cars was suited to the Chilean market. Concerning the FTA problem, since many Japanese cars are high-performance and correspondingly expensive, tariff rates of just a few percent can result in large price differences.

[45] In Chile, an 85% luxury tax was placed on vehicles of a certain CIF price or higher, and this was a major burden for corporations. However, this luxury tax has been phased down since fiscal 2004 and is expected to become 0% in 2007.

[46] This refers to fitting airbags not only on driver seats but also on passenger seats.

[47] On the other hand, since Japanese corporations can make judgments from Tokyo, it is said it is easy for them to decide whether or not to set up locally simply by looking at the country risk and macroeconomic indicators.

institutional arrangements, albeit to varying degrees. The four target countries are confronted with major difficulties in this area.

In particular, Bolivia and Venezuela have adopted an anti-American stance and have greatly revised basic policy direction in recent years. For corporations, it is difficult to tell how polices and institutional arrangements will change in the future, and they cannot calculate risks.

Moreover, since main government personnel change every time when administration changes, past policy efforts in all areas including international cooperation tend to go back to scratch[48].

Concerning corruption, this is reported in every country, but it seems to be particularly bad in Bolivia and Paraguay.

(2) Market Scale

Except for Peru, these countries have small populations compared to national land area, and their domestic markets are small. This means there is little appeal for corporations as consumer markets. Since market size is determined not only by size of population but also purchasing power, Japanese corporations enter countries like Chile where niche markets exist, however, concerning countries like Peru that have large population but low overall purchasing power, for a company like Ajinomoto selling products that can be purchase by general consumers, it may be worth entering in order to secure market volume; however, for added value manufacturers of Japanese specialties such as cars, electric machines and electronic products, such products are overwhelmed by cheap and second-hand products, and even if there is enough market to set up an agency and retail through that, it is not worth Japanese corporations themselves setting up.

(3) Mutual Distrust in the Business Community

In South America, there are considered to be numerous countries where some businesses do not trust each other. Concerning the background to this, because institutional arrangements are not in place, there are numerous cases where placing trust in other companies leads to trouble.

Concerning the problems that arise from these kind of conditions, division of labor and cooperation do not advance in industry so, even if a certain corporation succeeds in exporting, other companies are not involved and the sector concerned fails to develop as an industry of certain size. In particular, micro, small and medium enterprises only tend to concentrate on what they can do for themselves.

Another factor is the shortage of agencies for teaching appropriate technology. Corporations concentrate on obtaining and remembering technology, however, because they are afraid of other people finding out their know-how and becoming rivals, technology and know-how frequently end up being passed on from parents to children in family-run businesses. In other words, because technology is only developed and passed on within such a limited scope, industrial competitiveness is not enhanced. Moreover, for micro, small and medium enterprises, it is difficult to independently introduce new technologies and machinery[49].

[48] A good example for showing the difference in conditions between Chile and Bolivia is the case of IIRSA country coordinators. In Bolivia, when the administration changed, the post became vacant and all previous examinations and activities were negated, whereas in Chile, the same coordinator remained on the job and ongoing activities were possible even when the government changed.

[49] The situation is such that a certain small enterprises in Peru that realized the importance of introducing new

In addition, since large quantities of very cheap Chinese products have flooded markets in recent years, small enterprises that have no technical capability are drawn into price competition, making them even less able to conduct re-investment.

Generally speaking, this mutual distrust generates higher transaction costs in business and leads to inefficiency throughout society as a whole.

(4) Education and Training

One of the problems facing Japanese corporations is that, because South America is so far away, subcontractors cannot move out together. Therefore, attention turns to the level of local corporations, however, in the four target countries, particularly the manufacturing industry, technical capacity is still low.

Experts belonging to local corporate associations pointed out that businessmen are not willing to spend money on improving their own business technology skills. Many people agree that skilled human resources can be found in these countries, and many people point out that the main problem is management capability. However, many businessmen (owners in many cases) have little desire to spend money on training to hone management ability; for example, an NPO in Bolivia established a leadership training program, however, it cancelled it because of a lack of participants. Since many businessmen belong to micro, small and medium enterprises, they are more concerned with immediate technology rather than management techniques. This lack of interest in training is a problem inhibiting the modernization of industry.

Moreover, there are voices that express doubt over the contents of education at higher education institutions such as universities. For example, even if students learn about car engine design at university, they have nowhere to apply that learning in industry. Meanwhile, universities do not teach about the skills that are really required, for example, lathe processing or machine tool maintenance[50]. Therefore, there is a gap between actual needs and education contents.

There are some places that teach practical skills suited to the actual situation in industry, however, the problems are that corporations do not spend money on educating employees, and the admission requirements of training institutions (high school graduate or higher, university graduate, certain number of years experience, etc.) are prohibitive to workers in micro, small and medium enterprises that have only ever been to elementary school and so on.

(5) Informal Economy

Since many micro, small and medium enterprises have not registered and the actual situation is unknown, it is difficult for governments and donors to take measures.

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technology was able to become the top exporting small and medium enterprise in its sector simply by saving up and buying a secondhand NC machine tool. This corporation manufactures industrial kitchen equipment, however, because it imports almost all raw materials, uses the NC machine tool to conduct high-precision processing and then conducts manual finishing on products for exporting, the processes apart from the MC machining are not particularly original. Even so, overall industrial technical levels are such that this company was able to greatly improve competitiveness simply by introducing one machine.

[50] At a certain small/medium enterprise in Peru, a university graduate engineer said that he couldn't obtain the technology to make ingots for making metal components, so he devised his own method. From a Japanese viewpoint, this is a commonplace technology of around technical high school level, however, the corporation in question treats it as though it is an important corporate secret.

As for markets, since imitations are jointly sold with official products, the situation is such that corporations that do register and pay taxes are placed at a disadvantage in competitive terms. Moreover, a lot of smuggling and black market selling from neighboring countries as well as smuggling to neighboring countries is also seen.

Of course Japanese corporations in Brazil and Argentina are also worrying about measures to counter imitations and contraband, and 40% of the Brazilian GDP is said to be derived from the informal economy. Therefore, this problem is by no means limited to just these four countries. However, there are differences in extent; for example, in Bolivia, it is said that almost 90% of micro, small and medium enterprises are unregistered.

Efforts to encourage corporations to register can be seen in these four countries, however, corporations that have so far not paid taxes cannot see the merits of registering[51]. Moreover, registration procedures are too rigid and the authorities can be seen trying to make corporations pay social insurance dating back to the past.

5-4 Expectations from Corporations concerning ODA

During the visits to the Japanese corporations, we asked about their expectations towards ODA, but they generally gave no response. There may be a difference in they way the government and private sector view conditions due to their differing standpoints, however, some corporations were heard to harshly say that the Japanese Embassy and government agencies gave no help when the corporations were in need.

When the true feelings of corporations including the above kind of opinions are rearranged, it becomes apparent that Japanese corporations hope for the following things from ODA and the Japanese government.

5-4-1 Relationship Building based on the Long-term Viewpoint

One of the things that Japanese corporations hope for is the building of bilateral relations based on the long-term viewpoint. Corporations recognize the resource and market potential of South American countries and insisted that they would become even more important in the long term in terms of food, mineral resources, energy and water. However, since corporations need to make profits in order to survive, they reported that some countries carried too much risk and did not have adequate business environments to enable profits to be made at the current time. In consideration of these conditions, corporations hope that governments can build proper relationships from the long-term viewpoint so that corporations will be able to advance into countries in the future.

In particular, concerning food, much domestic consumption in Japan is dependent on other countries, however, up and coming nations such as China, India and Russia are already working to secure food resources for themselves and procurement is becoming more and more difficult.

[51] One of the reasons why many micro enterprises survive despite having so many technical problems and other difficulties is their activities in the informal sector, which enables them to avoid paying taxes, and the black market, which extends to neighboring countries. In comparison, unless the merits of registration are made clear, it will be difficult to register and legalize such corporations.

When one considers that countries with food producing reserve capacity are limited in the world, it was pointed out that building good relations with South American countries and developing a food security setup to guard against future emergencies is an important issue not so much for Japanese corporations but for Japan as a whole.

Taking a slightly different viewpoint, the common view among people who have lived and worked in Japanese corporations in South America for a long time was that the biggest problem is the low level of interest in South America. This situation is directly reflected in the low level of coverage South America receives in the Japanese media[52], however, also considering that South America accepted large numbers of Japanese immigrants in the past, there was a strong feeling that Japan as a whole should give more attention to this part of the world.

Although no specific suggestions were given, the interviewees expressed the desire to build friendly long-term relations with South American countries, which include many pro-Japan nations, through implementing sustained assistance, without necessarily having to spend huge amounts of funds.

5-4-2 System of Cooperation between the Government and the Private Sector

The Government of Japan, based on the stance of respecting the independence of the private sector, adopts the attitude of offering indirect support to corporate activities but not interfering.

However, unlike Southeast Asia, where numerous Japanese corporations have advanced and established a footing, many corporations in South America are fighting a lone battle and strongly hope for positive cooperation from the government.

5-4-3 Maintenance and Improvement of Japan's Good Image

The Japanese corporations in South America believe that, if Japan's image improves as a result of ODA, this will help boost the image of Japanese corporations.

There are organizations such as the Bolivian Chamber of Industry that respect the unobtrusive stance of Japan, which doesn't stand out but provides important assistance; however, many people in general are not aware of Japanese support and even if Japan performs good assistance through ODA, ordinary citizens and even government officials are frequently not aware of it[53]. In Brazil, the existing soybean cultivation belt was created as a result of the Celades development costing US$1 billion that was implemented during the Tanaka administration, however, even if the local people know about Japan's cooperation, some government officials are unaware of it and, now that the JBIC bridge corporation has withdrawn from the region, there is no longer any evidence of Japanese involvement. In Argentina, Fuego Island has developed into a free zone and tourist center today, however, not many government officials realize that Japanese assistance provided the platform for this development. It is necessary to conduct public relations to advertise the results of ODA, and this needs to be not just a temporary thing but also an ongoing effort to ensure that the local side remains aware of Japan's contribution even after governments and government

[52] According to research by Mizuho Bank Research Institute, whereas the ratio of BRICs coverage in the media is 20% in the U.S. and U.K., this is only 7% in Japan.

[53] Concerning this point, south-south cooperation is said to entail problems because students only retain the impression of the country from which the lecturer came.

personnel change.

Moreover, in the case of South America, the Japanese descendant community and citizens of Japanese descent are good assets for building a positive image of Japan and Japanese corporations. Japanese descendants have high social credibility as well as a good reputation for literacy, talent and diligence, etc. This is a precious intangible asset for Japan that was built up through the hard work of the Japanese immigrants, and sustaining this asset is thought to be a very important thing for corporations. The good reputation of Japanese descendants supports the good image of Japan and Japanese corporations[54].

In order to sustain the intangible assets of the Japanese descendant community and Japanese descendants, it is considered important for the Government of Japan to provide proper ongoing support for this community. Unfortunately, there are some corporations that regard Japanese descendants as cheap labor with a certain degree of Japanese language ability, and if the Japanese descendant community including those who travel to Japan to work deteriorates, this will have a negative impact for Japan and its corporations. Rather, it is important to strengthen the ties that link Japan and South American countries through actively supporting citizens of Japanese descent.

For this purpose, private sector corporations believe that support for the Japanese descendant community should be treated separately from poverty reduction and national economic development. In recent years, overall support for the Japanese descendant community has declined and scholarships to send Japanese descendants to Japan to study have decreased; moreover, it is said that more Japanese descendants now consider English to be more useful than Japanese. However, as ties grow weaker with each generation, considering that it will be impossible to reestablish relations once they are broken, the significance of providing support to the Japanese descendant community needs to be reviewed.

There is also room to consider methods and incentives for utilizing experts and volunteers of Japanese descent in assistance fields because these people cost less money than mainland Japanese[55], they are well versed in local language and customs, and they can make a positive contribution to raising the image of Japan and the Japanese descendant community.

5-4-4 Collaboration between ODA and Japanese corporations

It was heard from government agencies and local corporations that Japanese assistance above all is real assistance. Other country donors try to convert the results of assistance into benefits for their own country's corporations, however, it is pointed out that Japanese assistance is not tied to the advancement or development of Japanese corporations[56].

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[54] In reality, Japanese descendants can speak Japanese, can understand Japanese culture to an extent and are regarded as an important presence for mediating with local corporations and employees. Numerous corporations pointed to the presence of Japanese descendants as an important reason for advancing into Brazil.

[55] The actual remuneration of experts of Japanese descent currently comprises only travel expenses, daily allowance and accommodation expenses, and it is said that experts of non-Japanese descent turned down employment when offered similar conditions. Even under such conditions, experts of Japanese descent are proud to play a part in Japanese development assistance and many of them engage in work with the desire to be useful for Japan.

[56] Moreover, it should be noted that some Japanese-affiliated corporations expressed doubts about Japanese development surveys and experts dispatches aiding the development of rival corporations, and questioned the wisdom of using Japanese taxpayers' money to put Japanese-affiliated corporations into a difficult position.

When the U.S. and European countries develop export industries in South America, they bring their own countries' corporations and utilize their capabilities. The American approach is sometimes criticized for being too politically heavy handed, however, Japan goes to the opposite extreme.

This situation indicates that Japan adopts the standpoint of the other country and conducts support that goes beyond Japanese interests, however, in a different sense, it may be considered that Japanese agencies and private corporations are not working well together. Currently, assuming the case where a JICA development study points to an industry with good potential and technical cooperation is required in order to exploit this, there is no collaboration whereby Japanese corporations are attracted in cooperation with JETRO.

Taking a different viewpoint, since the know-how possessed by private sector corporations with international competitiveness may be regarded as an important aid resource, t is important to make use of this.

Certainly, to carry out pure assistance like at present is a noble action and there are voices in local governments and the private sector that praise such policy, however, the private sector in general thinks assistance and private sector activities can be better linked by realizing a win-win situation for recipient countries and Japan[57].

Possible alternatives at this time may be to take corporations out to South America from Japan, or to utilize the Japanese corporations that are already established there. In the former case, for example, assuming a South American country that has abundant resources but where the development of efficiency production technology is lagging, taking out corporations that possess efficient production and energy saving technologies would be significant in terms of the utilization of resources and energy and prevention of global warming not only for the country concerned but also the whole world. Moreover, as an idea presented by a trading company in Chile, if the Japanese government could supply kitchen equipment, etc. as grant aid and cover the risk of non-payment by local governments, this company, which is well-versed in local agricultural products and logistics, could make a business out of school meals, thereby making a social contribution through improving the nutrition of people in poverty while at the same time making an appropriate profit.

If the advance of Japanese corporations creates local employment, realizes transfer of technology and contributes to economic development, it was pointed out this too is Japanese cooperation.

[57] Actually, for example, even in Bolivia, an NPO known as CEDES, which is the Bolivian representative organization of the World Business Council for Sustainable Development, conducts activities aimed at boosting procurement from local micro and small enterprises while promoting technical cooperation between member corporations. Therefore, there are some cases where private sector corporations contribute to social and economic development.

Part II

History and Current Situation of Regional Economic Integration

Part II
History and Current Situation of Regional Economic Integration

Chapter 6 Global Trends surrounding Economic Integration

6-1 Perspectives for Considering Cooperation in South America

The basic viewpoint derived from survey of analysis data concerning economic integration is that, when examining the approach to economic cooperation in the four priority countries in this study (Bolivia, Ecuador, Paraguay, Peru), it is necessary to consider not only the unique political and economic conditions of each target country, but also the overall South American political and economic situation that surrounds the target nations. This is because the political and economic conditions of each country are dependent on conditions in other countries. Particularly important is the strategy of the United States, which exerts a major influence in South America, and the response to this of South American countries, which varies from a policy of cooperation to a stance of defiant independence. In addition to this framework of the United States and South American countries, China is gradually increasing its presence, albeit in limited fields, in South America. The following items are considered to be highly important parameters influencing the economies of South America:

- The South American strategy and policy of the United States, which regards Latin America as its own backyard.
- The movements of Mexico, which is rapidly increasing its dependence on the United States
- The U.S. and South American strategies of Brazil – the largest nation in South America and a member of BRICS (Brazil, Russia, India, China)
- The South American strategies of the EU, Japan and China, which is conducting resource-seeking diplomacy
- The commitment to economic integration of countries belonging to the Andean Community of Nations and MERCOSUR respectively.

Another point that must not be overlooked is the fact that many priority nations in South America are confronted with poverty as well as regional and domestic economic disparities, and it will be essential to take a bold challenge to these issues.

6-2 History of Economic Integration

(1) From Economic Collaboration to Economic Integration

The history of bilateral and multilateral economic collaboration is certainly not new. In Europe, the European Coal and Steel Community was established in the 1950s, while in Asia, ASEAN was founded and five ASEAN projects of concrete economic collaboration were launched in the 1970s. In South America too, the Andean Community of Nations was established

in the latter part of the 1960s.

It was from the 1980s onwards that such economic collaboration developed into economic integration. Whereas economic collaboration frequently comprises relatively gentle economic cooperation between related countries, economic integration is essentially different. As is frequently described as tariff unions, economic integration entails the creation of common markets and, although member nations are independent in political terms, they form a united market. Moreover, in order to realize the formation of effective common markets, economic integration further evolves into the harmonization of economic policy, industrial policy, fiscal policy and financial policy between member states. However, there are wide discrepancies in the actual contents of economic integration. There are a number of steps that need to be taken, i.e. the setting of intra-regional common tariffs, the setting of external common tariffs, the removal of intra-regional non-tariff barriers, the removal of external non-tariff barriers, and moreover the harmonization of economic policies, industrial policies, fiscal polices and financial policies that make it possible to fully remove such tariff and non-tariff barriers. It is relatively easy to establish common tariffs, however, it is not so easy to abolish non-tariff barriers because numerous such barriers are adopted in order to soften the impact of tariff unions. In this respect, a paper recently published by the Inter-American Development Bank to introduce its activities [1] states that economic integration in South America is now in a state of transition from the "first generation," in which trade unions were the focus, to the "second generation" consisting of the removal of non-tariff barriers and investment barriers and protection of intellectual property, etc., although this process is still confronted with a number of hurdles.

(2) Background to the Acceleration of Economic Integration: The End of the Cold War

Changes in the global political framework following WWII

Economic integration intrinsically different from economic collaboration started appearing throughout the world from the second half of the 1980s against a background comprising changes in the postwar political framework and the rapid advance of information technology innovation. The postwar economic framework of the IMF and GATT was brought to an end following transition from the fixed exchange rate system to the floating exchange rate system in 1971 and the first oil shock in 1973, but it took another 15 years or so until the late 1980s before the postwar political framework, i.e. the East-West Cold War, was also brought to an end. In the wake of this, the United States and former Soviet Union advanced detante and various institutional transformations took place in former Eastern Block nations, for example, Perestroika and Glasnost in the former Soviet Union and the dissemination of those policies to other socialist countries.

The transformation in the relationship between the U.S. and the Soviet Union started from the start of the Gorbachev administration in March 1985. In November that year, both countries embarked on a 'fresh start' of seeking new bilateral ties. Against the background of the birth of the Gorbachev administration in the Soviet Union and the success of the "strong America" policy espoused by President Reagan in the United States, both countries advanced policy changes that resulted in the signing of a convention for the total banning of intermediate nuclear forces (INF), the withdrawal of the Soviet Army from Afghanistan and the consequent improvement of

U.S.-Soviet relations. The Soviet Union was freed from the political and economic losses and moral corruption caused by miltitary intervention and was able to devote energy to its economy-based policy of Perestroika.

Such changes had a major impact on nearby socialist states. Poland witnessed the birth of the first non-Communist administration in Eastern Europe in 1988, while Hungary held democratic elections under a new constitution renouncing the proletarian dictatorship in 1990. The institutional changes in the Soviet Union also had an effect on China. Although there was no change in the political systems of China, China-Soviet raprochment was realized and this enabled China to fully commit to economic development in an environment of peaceful relations with the Soviet Union. However, the biggest change of all was the unification of East and West Germany. After West Germany opened its borders with Hungary and Austria in May 1989, the number of East Germans escaping to West Germany through Hungary and Czechoslovakia increased and the border between East and West Germany including the Berlin Wall was finally liberated in November that year. Calls for democracy also became more vociferous in East Germany, and eventually the governments of both countries signed a treaty for the unification of both Germanys on August 31, 1990 and the country was unified on October 3 that year.

The advance of information technology and changing global production systems

Around the same time that the postwar political framework was undergoing upheaval, there were rapid developments in information technology that led to major changes in the global economy. In the thesis "The World Economy and Technological Change" [2] contributed to Foreign Affairs, Michael Blumenthal describes how big an impact information technology innovations have had on the world's production and logistics systems and consumption of resources and, as a result, how the industrial landscape has altered on the global level. There has been no change in the action of "product making," however, major changes have occurred in "methods of product making." Taking the case of manufacturing, in the past this referred to "production through manual work" but it now refers to "brain-facturing." Blumenthal's claim that "major changes have occurred in the importance of resources" does seem a little incongruous in the light of subsequent repeated competition for resources, however, no other thesis has so clearly demonstrated the extent of the impact that information technology innovation has had.

The end of the Cold War and advance of information technology innovation reduced market barriers and triggered the globalization of the world economy. The former Eastern Bloc market, which was previously too risky to venture into, is now regarded as an important market. The Chinese economy demonstrates this only too well. It was within such circumstances that moves to explore economic integration became more active. So far, socialist economies, which were previously separated from capitalist economies, have rejoined the global economy and helped create larger markets. As a result, advances have been made in the assimilation and integration of the Eastern and Western economies.

(3) Debate over the Merits of Economic Integration

The merits of economic integration lie in the fact that movements of goods, services and capital become more active via the market mechanism, thereby leading to higher economic

efficiency and higher economic benefits for the citizens of the countries concerned. Economic integration makes it possible to form giant markets, thereby enabling corporations to pursue merits of scale while at the same time making it easier and cheaper to gain access to innovative technologies. However, although there is no debate over these "potential" or "theoretical" merits of economic integration, there are both supportive (albeit not 100% supportive) and doubtful voices raised over the actual conditions brought about by economic globalization. In other words, there exists a conflict between the so-called globalization lobby and the anti-globalization lobby.

William Cline is one of the proponents of globalization. In his recent work "Trade Policy and Global Poverty" [3], in which he discusses the effects of global free trade on the economies of developing countries, he argues that global free trade will impart economic growth of 5.5% per year for 10-20 years, reduce global poverty by 20% and raise the standard of living for more than 500 million people who currently live in poverty. He argues that the liberalization of agricultural trade is essential for this purpose and adds that liberalization needs to be realized not only between advanced countries and developing countries but also between developing countries in order for these targets to be achieved. With respect to Latin America, Arminio Fraga [4] argues for the merits of economic integration. Upon analyzing changes in socioeconomic indicators in Latin American countries in the 1990s, he claims that economic conditions improved as a result of economic reforms including the promotion of free trade that took place based on the Washington Consensus described later. On the other hand, different analysis points to opposite conclusions. For example, in the paper "Globalization's Missing Middle" [5], Geoffrey Garnett argues that not only is poverty not being reduced but disparities are actually growing bigger and bigger. Also, as is mentioned later on, Jose Antonio Ocampo [6] arrives at some rather skeptical findings in his analysis.

There are two reasons why differing conclusions are derived with respect to the same subject. First, depending on how one approaches the goals of economic integration, a positive or supportive conclusion is reached if discussion focuses on macroeconomic indicators. However, when assessment of the actual state of economic integration is widened to include redistribution of income and reduction of poverty, negative or cautionary conclusions are reached. Accordingly, when discussing the effects of economic integration, it is necessary to first clarify the goals of economic integration. Second, this is a somewhat technical issue but, if the effect on poverty reduction is considered when discussing the effects of economic integration, as has been pointed out by Robert Hunter Wade [7], it is not possible to obtain accurate enough data to specifically demonstrate and analyze this. Data belonging to the World Bank is frequently used when gauging effect in terms of poverty reduction, however, Wade argues that this data is frequently biased and is not always suitable for use.

(4) Realizing the Effects of Uneven Economic Integration

There is little doubt over the "potential" merits of globalization and economic integration, however, the general consensus is that the degree to which such merits are realized is by no means even, fluctuating wildly between countries. In the processes of trade and investment liberalization and expansion that occur in line with globalization, there appears to be a large disparity between countries that have large benefits and countries that do not. In other words, there appear to be both

countries that benefit and countries that lose out within the same system. As examples that have greatly benefited, Geoffrey Garnett [5] points to India, China, Vietnam and Uganda, whereas as countries that have not benefited much, he raises African nations. He goes on to say, “Not only are benefits unequal for countries, they are unequal within countries too. The benefits are large for high income and low-income countries, while they are small for middle-income countries. Similarly, within the same country, the benefits for middle classes are small.”

The above arguments seem to indicate that while globalization and economic integration are essential requisites for economic development, they alone do not make economic growth or eradication of poverty possible. Put another way, in order to fully realize the benefits of economic integration, it is necessary to prepare the necessary groundwork and, once these preparations advance smoothly, economic integration can proceed smoothly. Conversely, if this groundwork does not take place smoothly, it is not possible to further evolve economic integration. Differences in such groundwork preparation are a factor in delaying the progress of economic integration. If economic integration produced a win-win situation for all participating countries, each country would align its approach towards integration, however, the fact is that differences in groundwork are leading to win-lose situations. Herein lies the reason why economic integration does not always follow a smooth path.

Concerning the background as to why economic integration in reality does not always create win-win situations upon taking into account differences in groundwork, Joseph S. Nye, Jr. [8] points out that, “The rules of globalization are not always decided in democratic fashion,” and that, “The contents of economic integration were not fair or equal to start with.” In order to counter such difficulties, he stresses that the global agencies responsible for tailoring economic integration need to adopt an “attitude that gives deep consideration to discipline regarding transparency, accountability and global governance.”

(5) Groundwork for Promoting Economic Integration

Generally speaking, economic integration reaches completion after passing through three processes. First, intra-regional tariffs are totally abolished and external tariffs are standardized in tariff unions. Second, non-tariff barriers are removed in a process that includes the liberalization of trade. Third, related countries conduct harmonization of economic, industrial, fiscal and financial policies to ensure economic integration in these two phases. The hurdles encountered become higher as more progress is made.

A major constraint and obstacle to the realization of economic integration at higher levels is the under-development of institutions within countries. Trade and investment liberalization alone does not guarantee economic development for a country. Liberalization is certainly one requisite, but it is not sufficient in itself. So what is required? Economic integration eventually boils down to “market liberation,” however, in order for a country to adequately respond to external competition, it is essential for it to conduct institutional and structural reforms. When such reforms are not adequately carried out, countries are unable to fully enjoy the benefits of economic integration. When the Latin American economy fell into crisis in the 1980s, economic reform became an essential requirement in order to recover, and the Washington Consensus consisting of 10 items proposed by John Williamson [9], [10] provided the framework for this.

Concerning just how indispensable this reform was for the realization of free trade, Arvind Panagariya, in his work "The Miracles of Globalization- Free Trade's Proponents Strike Back," [11] states that, "Free trade has its merits, however, these cannot be realized until other obstacles are removed."

Box 6.1 Washington Consensus

- Fiscal discipline
- A redirection of public expenditure priorities toward primary health care, primary education, and infrastructure
- Tax reform (gentle rate taxation to broaden the tax base)
- Exchange rate liberalization
- A competitive exchange rate
- Trade liberalization
- Liberalization of direct investment
- Privatization
- Deregulation (to abolish barriers to entry and exit)
- Improvement of property rights

Concerning the need for economic reform, the first step in economic integration is the creation of a common market, and it is easy to see that this will lead to the invasion of domestic markets and worsening of unemployment unless countries acquire industrial competitiveness. Therefore, the important thing is to promote "industrial structural adjustment" programs to secure industrial competitiveness while at the same time utilizing superior resources. However, as is described later on, such adjustment is unfortunately not being advanced in the priority countries targeted in the Study.

Economic reform is a prerequisite for ensuring the success of economic integration, however, the benefits of economic integration are conversely said to promote such economic reform. Indeed, it is often said that the reason why the United States lobbies South American countries to join the FTAA so much is to "utilize free access to the US market as leverage for institutional reform in South American nations." Concerning this point, Alejandro Foley [12] states the following: "It is possible that small or weak nations will accept institutional reform in exchange for access to the U.S. market, however, large countries such as Brazil hesitate before they can confirm that the merits of market liberation by the United States are really worth conducting institutional reform for." In doing so, he vividly expresses a conflict of interest between the United States, which badgers for economic reform, and the South American countries, which seek to gauge the merits of economic integration.

Judging from the progress of economic reform in South America, it is thought that economic reform has made actual progress in many countries. In trade terms, tariffs have been reduced and non-tariff barriers have largely been overcome, while in financial markets too, interest controls have been abolished and privatization has advanced. Lora [13] indexed and analyzed the level of

progress of these institutional reforms in the seven countries of Argentina, Brazil, Chile, Columbia, Mexico, Peru and Venezuela and concluded that institutional reform had made major progress in each country between 1985-1999. However, he also found discrepancies in the degree of progress, with Peru, Argentina, Brazil and Chile displaying a greater level of reform compared to Columbia, Mexico and Venezuela. The question is, what were the outcomes of economic integration in the midst of such reform, and this point is discussed later.

(6) Support for Countries Unable to Adequately Enjoy the Benefits of Economic Integration

Liberalization of agricultural imports and immigration policy

Carrying out the said reforms does not always ensure that the fruits of economic integration can be enjoyed. There are some countries that are unable to enjoy the merits of trade and investment liberalization nor experience higher economic growth. Needless to say, little progress is made in terms of the ultimate objective of reducing poverty. Such countries appear to be connected by some common elements. First, they are poor in natural resources and they only have low cost labor. Second, they are handicapped in geographical terms: for example, landlocked countries separated from markets are a prime case. Since such countries face higher transport costs, they incur a geographical handicap even if other conditions are the same. In South America, the landlocked nations of Bolivia and Paraguay, which do not possess ports (although Paraguay has river ports), are cases in point. And third, in reflection of the previous two factors, it is difficult for industrial structure to become sophisticated.

What kind of institutional design is required in order for such countries to benefit from the merits of economic integration? Joseph E. Stiglitz and Andrew Charlton, in their latest work "Fair Trade for All: How Trade Can Promote Development" [14], have the following to say: "Free trade has large merits for developing nations when viewed in the long term, however, in order for developing countries to enjoy the benefits of free trade, the major powers that are their partners in economic integration must display a degree of consideration. The first requirement is the opening of domestic markets to agricultural products, which are frequently the only resources that developing nations have. Many advanced nations are opposed to the liberalization of imports for the sake of protecting agriculture in their own countries, however, this policy needs to be reviewed. Second, it is necessary to liberalize imports of labor-intensive products. As for countries that still find it difficult to expand trade and investment even when such policies are adopted, it is necessary to consider the liberalization of immigration. In particular, such measures need to be considered with respect to geographically disadvantaged countries that have poor access the world's markets." Stiglitz and Charlton also make the following thought-provoking statement concerning the debate over whether economic integration is a good thing or a bad thing: "Rather than discussing the merits of economic integration and trade liberalization as an ideology, practical thought should be directed to ways for ensuring that developing countries are benefited." Nancy Birdsall, Dani Rodrik and Arvind Subramanian, in their paper entitled "How to Help Poor Countries" [15], say almost the same thing adding that, "Concerning the patent policies and intellectual property protection policies of the advanced nations, it is necessary to consider relaxing their application to the less developed nations."

Concerning the relaxation of immigration policy, there is opposition among many countries

that receive immigrants, however, Harris [16] claims that immigration has numerous benefits for receiving countries. He argues that the right to work is important and rather than focusing on permanent residence rights and exclusion, emphasis should be placed on ways to reduce crime. Jadgdish Bhagwati [17] presents a similar argument. Concerning the question of immigration policy, which is confronted with a number of difficult problems, Inter-American Dialogue describes concrete immigration measures (the conditional but active acceptance of immigrants) in Agenda for the Americas, 2005 [18].

The above points largely call for a rethink of trade policy among the advanced nations, and it is up to the advanced nations to decide whether this comes true or not. In this respect, I.M. Destler, in his latest work "American Trade Policies" [19], claims that as corporate activities become more globalized, the trade policies of singular nations are becoming far more flexible and liberalized than they were conventionally, and as a result there are less calls for protective trade and lower resistance to liberalization. This indicates that the merits of economic integration are slowly but surely growing larger. However, he also states that trade policy is coming to place more emphasis on bilateral agreements rather than multilateral agreements, which take huge amounts of time to conclude, hinting that multilateral economic integration does not necessarily proceed well in practice.

Attention on service exports

Another feature of economic integration that cannot be overlooked is the changing nature of industry in line with progress in information technology. In his paper entitled "Offshoring: The Next Industrial Revolution" that he contributed to Foreign Affairs [20], Alan S. Blinder points to the need to consider the outsourcing of services. Whereas attention has so far mainly focused on goods in the debate concerning liberalization of trade and investment in economic integration, attention is now also being directed towards services against the backdrop of advancing information technology. Although it is not possible to export services intended for individuals, it is becoming increasingly possible to export services aimed at business establishments. An example of the outsourcing of business services is overseas processing by accounting firms. Providing that information networks are established, such services can be supplied overseas depending on the level of education provided to human resources. The emergence of service exports utilizing information technology also hints at possibilities for overcoming the geographical handicap of landlocked countries, which are disadvantaged when it comes to exporting goods.

Chapter 7 Current Conditions of Economic Integration in South American Countries

7-1 History of Economic Integration in South America

Within the worldwide trend of economic integration, South America and nearby countries have promoted economic collaboration and integration under the following initiatives:

- Andean Community of Nations (CAN)
- MERCOSUR
- Free Trade Area of the Americas (FTAA)
- North America Free Trade Agreement (NAFTA)
- Caribbean Community and Common Market (CARICOM)
- Sistema de Integracion Centroamericana (SICA)
- Organization of American States (OAS)

Out of these, the major initiatives are described below.

Andean Community of Nations

(1) History

The Andean Community of Nations (CAN) was founded as an economic collaboration organization based on the Cartagena Agreement (Andean Pact) in 1969. Its member nations originally consisted of Columbia, Ecuador, Peru, Bolivia and Chile. Venezuela joined in 1973, while Chile withdrew in the same year. It was originally intended to promote economic collaboration, however, the Andean Community of Nations aiming for economic integration was set up in 1996 and remains to this day. Venezuela announced its withdrawal from the community, while Chile has decided to make a comeback to CAN as associate member in 2006. There is some disparity in the approach of each member nation to the community. Columbia and Ecuador are pro-U.S., whereas Ecuador is keen about the Andean Community of Nations although it does not adopt vigorous actions and at the same time is not anti-American. Venezuela and Bolivia are the prime sources of disturbance. Venezuela withdrew from the Andean Community of Nations in April 2006, citing the following reasons in official documents: “The discussion and signing of free trade agreements with the United States by Columbia and Peru is unacceptable because they run counter to the character of the Andean Community of Nations and attempt to alter its principles.” As to its real intentions, it appears that Venezuela withdrew from the Andean Community due to the participation of pro-American Columbia and Peru, and rather chose to collaborate with Brazil, the leading nation of Mercosur, which adopts an independent stance of the United States. Rather than economic considerations, it may be said that the political thinking of Venezuela’s President Chavez was the primary factor behind this. As for Bolivia, following the nationalization of its gas development industry, since it has adopted a stance of resource-based

nationalism and joint anti-American collaboration with Venezuela, it is also becoming a major cause of disturbance in maintenance of the CAN. As a result, there is a growing feeling that the Andean Community of Nations is nothing more than a lame duck organization. Against this background, there are some voices suggesting that rather than multilateral free trade agreements, bilateral free trade agreements will become the central theme in the case of Latin American states[58].

(2) Purpose of Establishment

The original objective was to establish a tariff bloc within 10 years, however, due to the temporary suspension of participation by Peru, overall integration work was effectively brought to a halt. A regional market was eventually formed when Peru returned to the community in January 2006. An external common tariff was started in 1995 by Venezuela, Columbia and Ecuador.

(3) Decision-making Organization

As may be gathered from its other name as the Andean Integration System (SAI in Spanish), the Andean Community of Nations was originally established with the aim of economic integration, and unlike Mercosur which is described later, its institutional framework is composed of a number of agencies that cross over national bounds. Its major agencies are as follows:

(i) The Andean Presidential Council, which is the supreme agency and provides guidelines for various types of regional integration
(ii) The Andean Council of Foreign Affairs Ministers, which assumes political leadership
(iii) The Andean Community Commission, which holds policymaking functions
(iv) The Andean Community General Secretariat, which is the executive branch of the community
(v) The Andean Community Court of Justice, which has the power to resolve judicial problems within the community
(vi) The Andean Parliament, which is the deliberative agency
(vii) The Andean Development Corporation and Latin American Reserve Fund, which provide finance for projects in the region

(4) History of Economic Integration

Trade Area

Intraregional Tariffs

Bolivia, Columbia, Ecuador and Venezuela abolished tariffs between them in January 1993. Peru joined in 1997, although it only remained a participating member until January 2006.

External Common Tariffs

In November 1994, external common tariffs were set at the four levels of 5%, 10%, 15% and

[58] According to an interview from a government official from Peru)

20%. However, Peru alone adopted its own independent tariff rates. In January 2002, all member states agreed to apply 0%, 5%, 10% and 20% (apart from Bolivia, which applied the 20% level; moreover, 0% can be applied for capital goods that are not produced domestically). Furthermore, a new scheme was introduced in 2002. Agreement was reached to apply common tariffs to 62% of target items, however, the members remained apart on the remaining 38% and have since continued to select their own tariff rates from the said four levels for these items. As is shown in Table 7-1, the average tariff rate is 9-13%, and the rate for agricultural products is around 3-5% higher than that for non-agricultural products. Moreover, concerning the quota system, Columbia, Ecuador and Venezuela have set quotas for numerous items (mostly agricultural imports).

Table 7-1 Tariff Rates (Average, %)

	All Items	Agricultural Products	Non-Agricultural Products	Quota System (all items)
Bolivia	9.3	10.0	9.2	-
Columbia	11.7	16.1	11.0	258
Ecuador	11.4	14.4	10.9	17
Peru	9.8	13.4	9.2	-
Venezuela	12.2	14.7	11.8	164

Source: Commissioned Survey report B

Nontrade Sectors

Liberalization has been realized in non-trade sectors just like in the trade area. These non-trade sectors include services, investment and intellectual property, and an outline description is given later on in section 7-3.

MERCOSUR

(1) History

The history of Mercosur dates back to the 1980s, when Brazil and Argentina signed an initiative to restore strategic and political friendship. At first, this program was intended to overcome historical differences between the two countries. Mercosur entailed the construction of a powerful system for the promotion of political and economic integration along EU lines, and it has been a political success.

Mercosur was established under the Treaty of Asunción, and it currently has five full-member nations – Brazil, Argentina, Paraguay, Uruguay and Venezuela. Associate members include Chile, Ecuador, Columbia, Peru and Bolivia. As was mentioned earlier, Venezuela joined in April 2006, however, some people claim that this was motivated more by political affinity rather than economic considerations.

Whereas the Andean Community of Nations has the reputation of a lameduck organization, Mercosur is also said to have internal wranglings[59]. Manifestations of this are increasing moves towards bilateral free trade agreements, the signing of a safeguard agreement between Brazil and

[59] According to an interview from the Japanese Embassy in Argentina

Argentina, and the actions of Uruguay and Paraguay, which are losing interest from the economic viewpoint.

(2) Purpose of Establishment

The purpose of Mercosur was defined as the formation of a common market in December 1994, referring specifically to the following:

(i) Free movement of goods, services and elements of production (labor, etc.);
(ii) Setting of common tariffs and common trade policy with respect to external parties;
(iii) Coordination of macroeconomic policy and sectoral policies; and
(iv) Standardization of legal systems in order to reinforce integration

(3) Decision-making Organization

The general framework was decided in the Ouro Preto Protocol in December 1994. The major agencies are as follows:

(i) The Common Market Council, which is the supreme agency
(ii) The Common Market Group, which is the executive branch
(iii) The Mercosur Trade Commission, which seeks to effectively apply the agreed common trade policy
(iv) The Mercosur Secretary, who carries out management and technical advice
(v) The Economic and Social Consultancy Forum, Joint Parliamentary Commission, which conducts consultative and advisory work

(4) History of Economic Integration

Trade Area

Intra-regional Tariffs

Going by the character of a tariff union, the region should be totally liberated, however, in reality there are exceptions. The most important sectors are automobiles and sugar, where no common system has so far been established.

External Common Tariffs

Common policy was approved and established under the aforementioned Ouro Preto Protocol, however, exceptional handling is currently applied with respect to four areas, i.e. exceptional items claimed by each country, capital goods, information technology and telecommunications equipment. As is shown in Table 7-2, the average tariff rate is 8-11%. In Brazil and Argentina, the tariff rate on agricultural products is slightly lower than for non-agricultural products, maybe in reflection of competitiveness. Conversely, Paraguay and Uruguay apply a tariff rate on agricultural products slightly higher than in other countries. In comparison with the Andean Community of Nations, tariffs are generally lower. Furthermore, hardly any countries adopt the quota system.

Table 7-2 Tariff Rates (Average, %)

	All Items	Agricultural Products	Non-Agricultural Products	Quota System (all items)
Argentina	10.6	9.9	10.7	-
Brazil	10.9	10.1	11.0	2
Paraguay	8.9	9.9	8.8	-
Uruguay	9.1	10.0	9.0	-
(Reference) Chile	5.9	6.0	5.9	-

Source: Commissioned Survey B

Nontariff Barriers

It was originally planned to abolish nontariff barriers by the end of 1994, however, following a long line of delays, this still hasn't been realized. There are some sectors in which it is impossible to reach an agreement on abolishment because restrictions are guaranteed under national constitutions. In other cases, delays have resulted from the fact that no binding date has been set for abolishment. Examples of this are the food and pharmaceutical sectors.
Examples of barriers that are currently a cause for debate are summarized below based on information given in the Commissioned Survey report.

- Label displays: demands for display contents that cross over the bounds of common sense
- Demands for the acquisition of importing licenses (import quota system under a different guise)
- Demands for product inspections before shipping
- Time consumed in customs clearance work
- High expense of customs clearance work
- Unstable product valuations (tariffs sometimes differ for the same products)
- Excessive inspections and tests conducted when importing
- Demands for hygiene certification in excess of the world standard
- Application of anti-dumping taxes
- Non-automatic granting of export licenses
- Discrimination against imports compared to domestically produced products
- Bureaucratic customs systems
- Demands for advance payment of value added tax and income tax
- Lack of transparency: technical measures to gauge product quality

Non-trade Sectors

Liberalization has been realized in non-trade sectors just like in the trade area. These non-trade sectors include services, investment and intellectual property, and an outline description is given later on in section 7-3.

(5) Assessment

Antoni Estavadeordal, Junichi Goto and Raur Saez, in "The New Regionalism in the Americas: The Case of Mercosur" [21], demonstrate the success of Mercosur so far, while at the same time pointing out weaknesses in terms of (i) inadequacy of the dispute resolving mechanism and (ii) the tendency of members to separately negotiate with third countries (utilizing non-tariff barriers). In order to successfully implement trade integration, it is necessary to set common systems and rules and secure the minimum degree of stability in exchange rates following adjustment for inflation, however, both these elements are missing in Mercosur. Accordingly, when countries find it difficult politically to implement economic integration, they attempt to protect their own economies at the sacrifice of neighboring countries (Felipe A.M. de la Balze) [22]. At the moment, Mercosur has avoided total collapse thanks to the personal intervention of the Argentine president, however, there is no doubt that it is in crisis.

It is also said that Mercosur has structural problems. Alejandro Foxely [12] is one of these voices. He points to problems in the liberalization of finance rather than trade, saying that financial liberalization can accelerate the exodus of capital, and that even though crisis could be prevented if harmonization was secured on the macro policy level, this area is lacking too. Operating problems such as these are underpinned by excessively large disparities between the member nations.

Comparison between Mercosur and the Andean Community of Nations

Mercosur and the Andean Community of Nations are the two major economic integration schemes in South America. The greatest difference between them is the looseness of Mercosur in contrast to the strength of the "constructed systems and mechanism" of the Andean Community of Nations.(The political instability of the community as typified by the previously mentioned withdrawal of Venezuela is obviously a separate dimension). In the case of the Andean Community of Nations, an organization that exceeds the bounds of the member countries propels economic integration, whereas in the case of Mercosur, the major countries such as Brazil and Argentina oppose restrictions being placed on their decision-making authority, and they certainly do not want to entrust trade and economic policies to a super-national system. The member nations only collaborate and cooperate enough for their interests to coincide within the framework of interests of whole membership. The following table gives a comparison of both organizations in order to accentuate this point. Compared to the Andean Community of Nations, Mercosur has the following characteristics:

- It contains a lot of exceptions,
- There is a lack of harmony, and
- Countries also resort to bilateral agreements.

In terms of consensus towards harmony, the Andean Community of Nations appears to be slightly ahead of Mercosur. A manifestation of this is the high number of anti-dumping complaints made between Brazil and Argentina, as described later. The same thing can be said about the high number of mediations in trade disputes.

Table 7-3 Comparison Between Mercosur and the Andean Community of Nations

Item	Mercosur	Andean Community of Nations
Intra-regional tariffs	- Exceptional handling in the sugar and automobile sectors	- Zero tariffs without exception from January 2006
External common tariffs	- Exceptional handling in telecommunications, capital goods and information instruments - There are “holes” regarding special tariffs, tariff preferences and trade restrictions.	- Peru has withdrawn, while the other countries have adopted common tariffs on 62% of items. - There is a “hole” regarding the agricultural sector.
Point of origin policy	- General principles are applied. - There are special demands in the chemicals, iron and steel, information instruments and telecommunication fields. - Flexibility is recognized with respect to Paraguay.	- General principles are applied to all tariff items.
Agriculture	- There is no special system.	- There is a common agricultural policy that includes a price band system.
Automobile sector	- The adoption of common policies continues to be pushed back, however, a new agreement is scheduled to be signed by June 2008.	- There is a complementary agreement between Columbia, Ecuador and Venezuela (expanded from 220,000 to 500,000 units over 10 years from 1999). - External common tariff in the case of light vehicles is 35% and either 10% (Columbia and Venezuela) or 15% (Ecuador) for other vehicles.
Special sector program	- There is no harmonization (priority is given to domestic laws).	- Progress is being made towards establishment of a common plant and animal quarantine system via the Andean agriculture and health system.
Trade-related technical obstacles	- There is no harmonization (priority is given to domestic laws).	- An important first step has been taken towards the establishment of technical regulations.
Trade protection	- Common safeguards are adopted (17 cases were exercised over 11 years between 1995-2005 and most of these involved Chile). - There are no common measures regarding dumping and countermeasures. - There were 347 anti-dumping cases over 11 years between 1995-2005 (including Chile). However, only 60 cases were directed against Mercosur countries (mostly between Brazil and Argentina). Many are directed against China and the	- There are regulations concerning dumping, subsidies and safeguards. - There were 17 safeguard cases over 11 years between 1995-2005. - There were 119 anti-dumping cases over 11 years between 1995-2005 (60 cases were by Peru and around 30 each by Venezuela and Columbia). Almost all were directed against external countries.

	U.S.	
Dispute settlement	- The number of disputes has been falling recently, however, the number of consultation cases over 11 years between 1995-2005 was 512 (mostly problems concerning plant and animal quarantine and import licenses). - Moves are being made towards institutionalization. - A permanent adjudication court started operation in 2004.	- Disputes are settled in a super-national court of adjudication.
Service sector	- Commitment between member nations is deeper than towards the WTO. Commitments in special sectors differ between each country.	- There are general regulations. - There are special agreements for the transport, tourism and telecommunications sectors.
Investment	- Countries have signed a protocol for common rules, but they haven't incorporated them into domestic legislation yet.	- There is common policy regarding foreign capital, trademarks, patents, license agreements and patent fees.
Intellectual property rights	- Criteria relating to trademarks and creativity have been harmonized.	- There is a system of common intellectual property rights.
Policy discord	- A number of indicators have been harmonized. - Agreement has been reached to set convergence targets for macroeconomic indicators, however, no concrete settings have been made yet.	- There are convergence targets for macroeconomic indicators such as inflation, fiscal deficit and public debt.
Special treatment	- A longer grace period has been granted to Paraguay and Uruguay concerning adherence to common obligations. - Flexibility has been applied to the point of origin policy regarding Paraguay.	- Special treatment was promised to Bolivia and Ecuador in the Cartagena Agreement.

Source: Commissioned Survey report B

Economic Collaboration between Countries in the South American Community

In addition to the two representative examples of economic integration above, there are numerous instances of economic collaboration between South American countries, prime examples of which are given below. The first interesting point here is that there are signs of confusion in regional economic integration in South America; for example, Venezuela has withdrawn from the Andean Community of Nations and joined Mercosur, while Peru and Columbia have entered into free trade agreements with the United States. Second, although South American countries have so far built an intricate network of relations with numerous other countries and regions, collaboration with Asian countries including Japan has not progressed very far and there is only a limited degree of exchange with the likes of China, India and South Korea.

Table 7-4 Economic Collaboration of South American Countries

Economic Collaboration	Outline	State of Progress, etc.
(Within South America)		
Latin American Economic Association	- Established in March 1981 with 12 member states: Argentina, Bolivia, Brazil, Chile, Columbia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.	- Tariff preference agreements
Between Mercosur and the Andean Community of Nations	- Agreement to form the framework for formation of a free trade area in April 1998 - The goal is to secure realization by January 2000 in a two-stage process. - The first stage is signing of a fixed preferential tariff agreement, and the second is transition to free trade (zero tariffs).	- No progress is being made due to circumstances. However, Brazil, Argentina, Columbia, Ecuador, Peru and Venezuela, etc. have separately signed complementary agreements with each organization. - A feature of the negotiations has been that infrastructure development has been targeted in addition to trade.
Between Mercosur and Peru	- An economic complementary agreement was signed in 2003, realizing free trade. Peru became the third associate member of Mercosur. - Regarding agricultural products, Peru established a safeguard mechanism in response to rapidly increasing imports from Argentina and Brazil.	
Between Mercosur and Chile	- A partial economic complementary agreement was signed in 1996.	- Petrochemicals, chemicals, pharmaceuticals and automobiles were targeted in 2002. - Liberalization was adopted for between 93-96% of products in 2006. - Commitment has been secured in service sector negotiations too.
(Outside of South America)		
Between Mercosur and EU	- A cooperation agreement eventually aiming for formation of a free trade area was signed in July 1999.	- Negotiations have been held numerously regarding exchange of liberalization lists and presentation of mutual free trade items, however, no agreement has so far been reached. - In addition to market access, opinions are also

		divided over the service sector, investment, intellectual property rights, government procurement and handling of point of origin policies.
Between Mercosur and India	- An agreement was signed in March 2005 concerning fixed preferential tariffs, point of origin principle, safeguards and dispute settlement mechanism.	- Tariff rates have already been brought down.
Tariff Union between Mercosur and South Africa	- A preferential tariff agreement covering approximately 1,000 items was signed at the end of 2004.	- Zero tariffs have been implemented with respect to 752 items by Mercosur and 531 items by South Africa
Between Mercosur and Mexico	- Within the framework of the Latin American Economic Federation Agreement, both regions signed an economic complementary agreement and committed to forming a free trade area in 2002. - Mercosur member states and Mexico will negotiate lists of items on a bilateral basis. - At the same time a complementary economic agreement will be signed for the automobile sector.	- Concerning the automobile sector, full liberalization was realized from May 2006 onwards. - Brazil, Argentina and Paraguay, etc. have already implemented liberalization with Mexico on an individual basis.
Between Mercosur and South Korea	- An information exchange mechanism has been established since 1997. - Agreement was reached on implementation of a F/S concerning the impact of a free trade agreement in October 2004.	
Between the Andean Community and the United States	- Since 1991, the United States has offered preferential tariffs to CAN members (Bolivia, Columbia, Ecuador, Venezuela) based on the Andean Trade Preference Act. The objective is to support the fight against narcotics, related crimes and terrorism.	- The agreement expired in December 2001, however, under the Andean Trade Promotion and Drug Eradication Act (ATPDEA), the term was extended and target areas expanded (Venezuela was excluded but Peru was newly included).
Between Peru and the US. and Columbia and the U.S.	- Bilateral free trade agreements were signed with Peru in December 2005 and Columbia in February 2006. - More than 80% of American products exported to Peru were subjected to zero tariffs, while the zero tariff handling of Peruvian exports to the U.S. already guaranteed under ATPDEA was made permanent. - Market access has been liberalized with respect to	- "For Peru, the free trade agreement with the United States is beneficial."[60]

[60] According to an interview from an official of the Peruvian government

	services and investment too.	
Between Chile and other nations and organizations	- Economic association agreement: EU - Complementary economic agreements: Bolivia, Venezuela, Columbia, Ecuador, Mercosur, Peru - Free trade agreements: Mexico, Canada, South Korea, European Free Trade Association, United States, Panama, China, Latin America, Costa Rica, Guatemala, El Salvador, Honduras, Nicaragua - Partial cooperation agreements: India	

Source: Commissioned Survey B

Free Trade Area of the Americas

The idea for FTAA dates back to 1991, but it was at the Miami Summit of 1994 that the main countries concerned agreed to push for its realization. Its concept called for a "free trade area covering from Alaska to Patagonia" and a scheme whereby all countries can simultaneously take part in a single round of multilateral negotiations. So far, in spite of the commitment of the United States, prospects appear uncertain. The original schedule to form the area by 2005 has still not been realized. In particular, Brazil is wary of American pressure to promote economic reforms and is concerned that it may be drawn into American interests too far. As was mentioned above, when one considers that American intentions are more concerned with promoting economic reform rather than realizing the benefits of economic integration, such wariness is not groundless. Accordingly, it is expected that blanket multilateral negotiations will be difficult. Rather, there is even speculation that the FTAA will become a series of bilateral discussions in the same way as Mercosur. Brazil is refusing to join this scheme so long as the United States refuses to change is agricultural protection policy, and this seems to typify the current poor state of cooperation between South America and the United States. This friction may contribute to deepening of the gap between the two sides.

Cooperation between South American Countries concerning Infrastructure Development[61]

South American countries have so far cooperated in constructing network infrastructure such as roads and so on, and the framework for this cooperation has been the Integration of Regional Infrastructure in South America (IIRSA). The main goal of IIRSA is to realize 10 integration and development hubs in South America. Cooperation extends from hard infrastructure to operational aspects and also includes harmonization of policies. Related parties include member nation governments, multinational financial institutions such as the Inter-American Development Bank, the Andean Development Corporation and the Financial Fund for the Development of the River Plate Basin (FONPLATA), etc., the private sector and civil society.

The organization of the IIRSA comprises the Executive Steering Committee, Executive

[61] Refer also Chapter 3 (3-2).

Technical Groups and the Technical Coordination Committee. The IIRSA project portfolio, as indicated below, comprises 40 groups, 335 projects and combined investment of US$ 37 billion. Target sectors include traditional infrastructure areas such as roads, railways, gas pipelines and bridges as well as the provision of postal services for the expansion of exports by small and medium enterprises. Out of the integration and development hubs, the MERCOSUR-Chile Hub (meaning the Mercosur hub including Chile) accounts for the most projects and largest investment, and this includes the gas pipeline project linking Argentina and Bolivia (US$ 1 billion project).

Table 7-5 Portfolio of IIRSA Projects

Development Hub	Project Groups	Projects	Investment (US$ billion)
Amazon Hub	6	44	2.0
Andean Hub	11	74	5.0
Guianese Shield Hub	4	32	0.37
Peru-Brazil-Bolivia Hub	3	18	11.6
Central Interoceanic Hub	5	44	3.3
Capricorn Hub	4	34	2.0
Southern Hub	2	21	1.1
MERCOSUR-Chile Hub	5	68	12.1
Paraguay-Parana Waterway Hub	—	—	—
Southern Andean Hub	—	—	—
Total	40	335	37.47

Note: Dashes (-) indicate areas where project plans have not yet been finalized.
Source: Commissioned Survey report B

Degree of Trade Liberalization in South America

Summing up the above, Table 7-6 gives an idea of the degree of trade liberalization in South America using tariff rates as the measure. The level of liberalization within the Andean Community and Mercosur is fairly high, however, liberalization rates between countries are only around 20% at highest, indicating that liberalization is only making slow progress. The exception is Chile, which has exceeded 90% and has already attained zero tariffs with respect to Mercosur (associate member) and the Andean Community. Judging from these facts, there is a disparity in the merits of economic integration between Mercosur, which accounts for a large economic scope (population of 2,320,000 people and GDP of US$ 997.5 billion) and the smaller Andean Community (population of 1,210,000 and GDP of US$ 374.6 billion). Assuming the case where the Andean Community and Mercosur amalgamated, there would be major benefits for both sides. This fact is amply proven by Chile, which is able to conduct free trade with both groups. The ratio of Chile's exports + imports to GDP (so-called degree of openness) is 61%, which is far higher than 35% in the Andean Community and 27% in Mercosur.

Table 7-6 Degree of Liberalization
(ratio of zero tariffs applied by county A to country B: ratio of all tariff items %)

A / B	Argentina	Brazil	Uruguay	Paraguay	Chile	Venezuela	Colombia	Ecuador	Bolivia	Peru
Argentina		100	100	100	95	9	11	22	92	
Brazil	100		100	100	98	11	27	22	92	
Uruguay	100	100		100	95				92	
Paraguay	100	100	100		94				92	
Chile	95	95	95	95		96	91	96		
Venezuela	12	21			97		100	100	100	100
Colombia	12	23			91	100		100	100	100
Ecuador	13	16			96	100	100		100	100
Bolivia	97	97	97	97		100	100	100		100
Peru						100	100	100	100	

Note: Figures rounded to the whole number
Source: Prepared based on the Commissioned Survey report B

Based on the above, Table 7-7 shows the results of calculating the actual size of the South American market assuming a number of bold assumptions. It can be seen that Uruguay, Paraguay, Bolivia and Chile have the greatest potential to receive the benefits of economic integration, although this is not the case in reality. The following reasons are considered for this: first, geographically distant countries still encounter trade handicaps even if they join economic integration associations. See later on (Prerequisite 2) for more discussion of this point. Second, there are major disparities in industrial structure. For example, even if a major market exists right next to a country, it cannot realize this geographical superiority unless it has the necessary supply capacity. Third, there is the existence of non-tariff barriers for various reasons. The main issue concerns whether or not potential can be translated into reality. The key factor lies in how fast industrial structural adjustment can be carried out in response to actual market expansion. Regarding this point, small countries such as Paraguay are finding that their domestic markets are being invaded by export pressure from the major countries before they are able to take advantage of market expansion, and such conditions are contributing to a negative outlook on economic integration. There is concern that economic integration serves only to make the strong countries stronger. However, since income elasticity is generally greater than price elasticity when it comes to expanding exports, the effects of economic integration should by no means be small providing that price competitiveness can be sustained to a certain extent. The point is how far export dynamism can be created in order to fully realize the benefits of regional integration. Concrete strategy regarding this point is detailed in later chapters.

(Prerequisites)

(1) Market size is expressed in terms of population and GDP.

(2) Zero tariff markets of other countries are regarded the same as own country markets and are thus added to the scale of own country markets. However, in cases where zero tariffs are not 100%, that percentage is multiplied by population or GDP in order to estimate the market scale.

(3) Geographical distances are not taken into account (for example, from the viewpoint of Brazil, even if Chile and Argentina are both zero tariff markets, the Chilean market is judged smaller than the Argentinean one because of the geographical distances involved. Here, however, the two markets are viewed in the same light).

Table 7-7 Actual Market Scale for South American Countries

Country	Population Criteria (million people)	GDP Criteria (US$ million)	Own Market Ratio (population)	Own Market Ratio (GDP)
Argentina	266	1,147	7.0	6.3
Brazil	274	1,173	1,5	1.5
Uruguay	240	1,114	58.5	15.1
Paraguay	238	1,113	38.4	155.5
Chile	315	1,215	19.3	10.6
Venezuela	180	675	6.8	5.1
Columbia	183	756	4.1	6.0
Ecuador	170	636	12.9	19.9
Bolivia	346	1,344	38.4	139.2
Peru	121	375	4.4	4.8

Source: Prepared based on Commissioned Survey B

7-2 Actual State of Trade Expansion under Economic Integration

(1) Slowing of Trade in the Andean Community

As is shown in Table 7-8, the level of trade in the main economic integration associations of South America as a ratio of world exports is static. Looking at exports and imports of each country in the Andean Community over the past 10 years or so, as is shown in Annex 2-1, each country's intra-regional exports grew in the first half of the 1990s, however, they have been stagnant ever since. Based on this fact alone, it cannot be said that economic integration has generated good results. This seems to show that the structure whereby economic integration can function as a common market in the true sense has not yet been developed. Concerning why this is, it is thought that each country in the community has not yet identified relatively superior sectors based on industrial structural adjustment. As is mentioned later, "export dynamism" is not being displayed.

Upon taking a rather detailed look at trade movements by country, the following points can be summarized:

- Regarding Columbian exports, exports to neighboring Ecuador and Peru are growing dramatically. Meanwhile, exports to Bolivia and Paraguay have remained small.
- Exports from Ecuador have increased a lot with respect to neighboring Columbia, but they remain static with respect to Peru.
- Exports from Peru have remained static with respect to both neighboring Ecuador and Columbia. On the other hand, there has been a steady increase in exports to neighboring Bolivia, albeit not so much in value terms.
- Exports from Bolivia showed a marked increase to neighboring Peru, but have since stagnated. Meanwhile, exports to Columbia have continued to grow.
- Exports from Paraguay have displayed hardly any growth with respect to all countries. Accordingly, it may be said that Paraguay is outside of the commercial scope of the Andean Community of Nations.

(2) Ongoing Trade Prosperity in Mercosur

Meanwhile,looking at export trends for Mercosur countries as shown in Annex 2-2, it can be seen that trade within the Mercosur block has increased dramatically since 1995. In particular, trade flows between Argentina and Brazil are growing very fast. Even the smaller countries of Paraguay and Uruguay are experiencing trade prosperity. Meanwhile, exports from Mercosur countries to the United States are sluggish. Moreover, exports from Mercosur countries to Andean Community countries are growing relatively smoothly, although the share is stagnant.

Table 7-8 Export Share of Economic Integration Blocks in World Exports(%)

	1970	1980	1990	1995	1997	1998	1999	2000	2001	2002
Andean Community	1.9	1.7	0.9	0.8	0.9	0.8	0.8	1.0	0.9	0.8
Mercosur	1.7	1.6	1.4	1.4	1.5	1.5	1.3	1,3	1.4	1.4

Source: Bank “World Development Indicators”2004

7-3 Expansion in Direct Investment under Economic Integration

Economic integration stimulates exchange of direct investment. Moreover, the scale of direct investment is a measure for indicating the future development potential of national economies resulting from economic integration. This is because direct investment indicates the degree of long-term commitment with respect to the countries invested in. If the effects of economic integration are recognized to be large, direct investment is stimulated and the level of commitment in a country’s economy grows.

Annex 2-3 shows analysis of direct investment trends in South America under economic integration. The features of this can be summarized as follows.

- All countries apart from Uruguay are receiving increasingly more direct investment, much of which comes from outside of South America.
- Within Mercosur, Chile is conspicuous as an investing and investment receiving country.
- Investment within the Andean Community of Nations does not stand out.
- Leaving aside Brazil, investment is directed more towards resource development-related sectors and tertiary industries rather than manufacturing, which offers higher job creation capacity. Brazil, with its large domestic market, receives a lot of investment into manufacturing.
- Generally speaking, expectations regarding the effects of economic integration are larger among investors than the countries concerned.
- Europe and the United States account for much of the investment into South America. Apart from resources development, the privatization of state enterprises in infrastructure sectors accelerated as a result of the Washington Consensus and stimulated investment from Europe and the U.S. The resulting privatization investment triggered slimlining, unemployment and political instability in the short term, however, in the long term it has the potential to accelerate economic growth and expand employment through increasing productivity.

Table 7-9 Direct Investment Trends in Each Country

Country	General Assessment	Investment from the Rest of the World	Investment from Mercosur	Investment from the Andean Community
Peru	- The positive effects of economic integration are limited to increased investment from Chile.	- Rapid increase in the 1990s - In terms of stock, around 10% in manufacturing, but highest in the infrastructure sector (30%).	- Investment has increased from Chile. -	- Investment from Columbia has become a little more conspicuous.
Ecuador	- Hardly any positive effects of economic integration can be recognized.	- Rapid increase in the 1990s, and this has continued into the 2000s. - Investment into the mining sector accounts for 90%.	- Only a small increase in investment from Argentina	- Hardly any impact
Columbia	- No conspicuous positive effects of economic integration can be recognized.	- Rapid increase in the 1990s - In terms of stock, around 20% in manufacturing, 50% in tertiary industries such as transport, telecommunications and finance, and 20% in mining.	- Only a minor positive effect on investment from Chile -	- Investment from Ecuador has become a little more conspicuous.
Bolivia	- The positive effects of economic integration can be recognized in some countries.	- Rapid increase in the 1990s - Approximately 50% in mining and 40% in service sectors	- Investment has increased from Argentina and Brazil.	- No conspicuous increase

Paraguay	- The positive effects of economic integration can be recognized in some countries. However, investment levels are low.	- Rapid increase at the end of the 1990s, albeit on a small scale. - Investment mainly directed towards transport and telecommunications, etc.	- Investment has increased from Argentina and Brazil.	- Hardly any
Venezuela	- No positive effects of economic integration can be recognized.	- Rapid increase in the 1990s - In terms of stock, more than 10% in manufacturing, 40% in oil and 15% in finance	- There was a temporary increase in investment from Argentina, but this was not sustained.	- No conspicuous increase
Argentina	- Positive effects of economic integration can only be recognized in Chile.	- Rapid increase in the 1990s - 40% in mining, 10% in energy, however, manufacturing also has a high share of 40% including 10% in chemicals.	- Investment from Chile has become more vigorous.	- Hardly any
Brazil	- Positive effects of economic integration can only be recognized in Argentina and Uruguay.	- Rapid increase in the 1990s, and this has continued into the 2000s. - In terms of stock, 35% in manufacturing (the highest in South America). 65% goes to tertiary industries comprising mainly transport, telecommunications, finance and commerce.	- Investment has increased from Argentina and Uruguay.	- Hardly any
Chile	- No conspicuous positive effects of economic integration can be recognized.	- Rapid increase in the 1990s, and this has continued into the 2000s. - Mining accounts for 50%, manufacturing 10%. Energy-related tertiary industries also account for a high share of 10-20%.	- Investment has increased from Argentina and Brazil, but amounts are small.	- Hardly any
Uruguay	- No positive effects of economic integration can be recognized.	- No conspicuous increase can be seen. The size of investment is also small.	- Hardly any	- Hardly any

Source: UNCTAD Website

(Auxiliary Table) Investment Structure
(Cumulative Direct Investment Between 1996-2004) (%)

Country	Data Period	Investment Sectors	Main Investing Countries
Peru	1996-2004	Service (76) Manufacturing (15) Resources (10)	UK (30) US (14) Netherlands (14) Spain (13)
Ecuador	1996-2005	Resources (81) Service (15) Manufacturing (4)	US (28) Canada (24) Italy (6) Spain (5)
Columbia	1996-2004	Service (59) Resources (21) Manufacturing (19)	US (23) Spain (18) Netherlands (10)
Bolivia	1996-2003	Resources (49) Service (43) Manufacturing (8)	US (35) Argentina (10) Brazil (10) Italy (10)
Paraguay	1996-2003	—	US (35) Argentina (11) Brazil (10) Netherlands (10)
Venezuela	1996-2005	Service (40) Manufacturing (59) Resources (1)	US (22) Spain (8) France (5)
Argentina	1996-2004	Resources (41) Service (29) Manufacturing (21) Other (9)	Spain (44) US (18) France (8) Netherlands (5)
Brazil	1996-2005	Service (68) Manufacturing (28) Resources (4)	US (22) Spain (14) Netherlands (14)
Chile	1996-2004	Service (63) Resources (26) Manufacturing (11)	Spain (30) US (23) Canada (13)

Source: Commissioned Survey report B (taken from the Economic Commission for Latin America and the Caribbean: ECLAC)

Concerning direct investment trends in Brazil and Peru, for which sector-separate investment data can be obtained, the following table shows which countries have invested in what sectors.

Table 7-10 Investment by Mercosur Countries into Brazil over the Past 10 Years
(Stock Base)

Unit: US$ million

Investment Destination	Investing Country	Industrial Sector
Brazil	Argentina (757)	Mining (oil), food, chemicals, metals, wholesaling, finance, business services
	Chile (228)	Food, timber products
	Uruguay (2,106)	Chemicals, rubber and plastic products, wholesaling, finance, business services
Peru	Chile (609)	Finance, trade, manufacturing
	Columbia (192)	Electric power, gas, water supply
	Uruguay (151)	Finance

Source: Prepared from the UNCTAD Website

7-4 Changes in Industrial Competitiveness under Economic Integration

The size of direct investment is also an approximate measure for understanding the state of industrial competitiveness in each country. This is because investors invest in countries that appear to be competitive. Industrial competitiveness is by no means limited to export competitiveness. It also signifies competitiveness in terms of deploying businesses domestically, i.e. domestic competitiveness. The service sector is a good example of this. The following table shows which sectors are considered to be competitive in each country.

Table 7-11 Industrial Competitiveness of Each Country

Country	Competitive Sectors	Remarks
Peru	Mining, power, gas and water supply, telecommunications, finance	Economic infrastructure
Ecuador	Mining	
Columbia	Mining, oil, power, gas and water supply, telecommunications, finance	Economic infrastructure, chemicals in manufacturing
Bolivia	Oil	
Paraguay	Foods and drinks, finance	
Venezuela	Mining, finance, machine appliances	
Argentina	Oil, chemicals, food, power, gas and water supply, finance	
Brazil	Transport machinery, chemicals, foods, electric machines, metals, power, gas and water supply, commerce, transport, finance	All industrial sectors in general
Chile	Mining, food, power, gas and water supply, transport and telecommunications, finance	Only food in the manufacturing sector
Uruguay	Unknown	

Source: Prepared from the UNCTAD Website

7-5 Deployment of the South American Economy under Economic Integration

(1) Harsh Assessment of the Outcome of Economic Integration

After almost 10 years of economic integration efforts, has poverty been reduced in the countries of South America? Unfortunately, the answer is “No.” Accordingly, there is a growing feeling of anti-globalization among South American nations, which believe that not only has economic integration not always been beneficial in reducing poverty but that it has actually widened disparities. The primary objective of economic integration is not to tackle poverty but rather is directed towards boosting economic efficiency through trade and investment liberalization, and as a result aiding economic growth and expanding employment. However, in view of the high ratio of poverty that confronts South America, poverty reduction should be regarded as a primary rather than a secondary objective of economic integration. For this reason, there are moves to reform current economic integration schemes to contents that are more focused on reducing poverty. Because economic integration is founded on the positive policies of economic liberalization and open market access, it is essential to investigate the reasons why it

has not always been successful in South America. Otherwise, the discussion will degenerate into a simple two-way debate of globalization versus anti-globalization.

Two factors can be raised as reasons for the poor results of economic integration in South America. First, export dynamism, which is normally realized through economic integration, has not been attained, and second, even when export dynamism has taken place, either it hasn't been translated into job creation, especially job creation among poverty classes, or income redistribution functions have not worked, meaning that the benefits of dynamism have not translated into poverty reduction. How do economists analyze this point? Jose Antonio Ocampo, in his essay "Latin America's Growth and Equity Frustrations During Structural Reforms" [6], takes an overall view of the Latin American economy over the past 20 years as described in (2) and (3), and although he recognizes the improvement of macroeconomic indicators and realization of dynamic exports throughout Latin America as a whole, he gives a harsh assessment of regional disparities and income redistribution functions within the said dynamism.

(2) Macroeconomic Performance

As a result of the debt crisis of the 1980s, the per capita GDP of Latin American countries decreased by 0.9% per year over the decade of the 1990s in a period known as the "lost decade." Considering that per capita GDP had increased by 2.7% per year from 1950 to 1980, this was a major shock. The economic growth of 1950 to 1980 was underpinned by the forceful protection of domestic markets and active government intervention in economy and industry. In spite of the rapid economic growth and industrialization, these protective policies above all were considered to be the cause of inefficiency, macroeconomic imbalance and the debt crisis. Accordingly, with external pressure also playing a part, the governments of the South American countries launched a program of reform from the late 1980s through to the stat of the 1990s with the aims of reducing state intervention to a minimum and opening markets. Liberalization of trade and investment advanced and tax reforms were carried out in the fiscal sector. However, the privatization of state-owned enterprises and reforms of the labor market were only limited. Looking at the reforms conducted in each country, two major patterns emerged. The first took place in Argentina, Bolivia, Chile and Peru, where reforms were advanced over a short time; and the second took place in Brazil and Columbia, where the pace of reform was more circumspect. Thanks to these reforms and other factors, the economy gently reverted to positive growth between 1990-1997. Per capita GDP growth of 2% per year was restored. Concerning these circumstances, Arminio Fraga, in "Latin America since the 1990s: Rising from the Sickbed?" [4], gives the following analysis: "Certainly, concerning the redistribution of income, hardly any improvement could be seen, however, judging from macroeconomic indicators and social indicators, there was clear improvement in the South American economy during the 1990s."

However, South America experienced a further "lost five years" between 1998-2002. Per capita GDP over this time decreased by 0.3% per year. Against this background, doubts started to arise about whether or not economic reform really was a good thing or not and there were moves to reassess the reforms. Even though it is impossible to make a general assessment due to the differing contents and tempo of economic reform in each country, looking at the results of investigating and analyzing economic trends over the past five years, it may be said that, "The

development strategy of economic reform was successful in a number of sectors, but it failed in others." In particular, this strategy was effective in terms of stimulating healthy exports, triggering direct investment and raising the productivity of major corporations. Moreover, in many countries, inflation was brought under control and effects were seen in fiscal and macroeconomic terms. However, reforms concerning privatization and liberalization of labor markets ended up only half finished, productivity only increased slowly and the rate of economic growth was far inferior to that of emerging Asian nations such as Vietnam and China. As a result, the effects of reform displayed a conspicuous dual structure, income distribution became distorted and the effect in terms of reduction of poverty was not very great. For example, whereas the poverty rate was 40.5% in 1980, this increased to 48.3% in 1990 and was only brought down to 43.5% following reforms in 1997. Moreover, in spite of the subsequent economic growth, poverty still remained almost the same at 43.4% in 2002.

In consideration of these points, Ocampo concludes that, "The results of market-oriented economic reform have been exaggerated and its inherent risks have been overlooked" [6]. However, rather than only stressing the poor aspects being caused by economic reforms, Ocampo retains a positive view and proposes the following measures claiming that a second generation of economic reforms is needed to follow the first. First, concerning macroeconomic policy, in addition to controlling inflation and reducing fiscal deficit, it is necessary to raise high and stable economic growth and expansion of employment as policy goals. Second, in order to realize a dynamic economy, it is necessary to have appropriate currency exchange policy, domestic financial policy and technical policy. And third, it is necessary to incorporate social policy into economic policy.

Table 7-12 Average Annual Growth in Per Capita GDP (%)

	1970s	1980s	1990s	Change between 1970-80s	Change between 1980-90s
Argentina	1.5	-2.9	3.2	-4.4	6.1
Brazil	5.9	-0.4	1.3	-6.3	1.7
Chile	1.1	2.1	4.9	1.0	2.8
Columbia	3.3	1.3	0.8	-2.0	-0.5
Mexico	4.3	-0.3	1.8	-4.6	2.1
Peru	0.6	-2.9	2.1	-3.5	5.0
Venezuela	-0.4	-1.7	-0.1	-1.3	1.6
Average	2.3	-0.7	2.0	-3.0	2.7

Source: Arminio Fraga,"Latin America since the 1990s: Rising from the Sickbed"

Table 7-13 Social Indicators (%)

	Illiteracy			Life expectancy			Infant mortality			Primary school admission rate		
	1980	1990	2000	1980	1990	2000	1980	1990	2000	1985	1990	2000
Argentina	5.6	4.3	3.2	69.6	71.6	73.9	38.0	28.0	20.0	-	-	107.0
Brazil	24.0	18.0	13.1	62.6	65.6	68.1	70.0	50.0	32.0	81.2	86.4	97.0
Chile	8.6	6.0	4.2	69.3	73.7	75.6	31.7	16.0	10.1	-	87.7	88.8
Columbia	16.0	11.6	8.4	65.7	68.3	71.4	40.0	29.0	20.0	65.5	68.7	88.5
Mexico	18.7	12.7	8.8	66.8	70.8	73.1	56.0	37.0	25.0	99.6	100.3	103.4
Peru	20.6	14.5	10.1	60.4	65.8	69.3	81.0	58.0	31.0	95.9	-	-
Venezuela	16.1	11.1	7.5	68.3	71.2	73.3	34.0	23.0	20.0	83.7	88.1	88.0
Average	15.6	11.2	7.9	66.1	69.6	72.1	50.1	34.4	22.6	85.2	86.2	95.4

Source: Arminio Fraga, “Latin America since the 1990s: Rising from the Sickbed”

(3) Assessment of “Export Dynamism”

Assessment of “export dynamism” is just as important as the assessment of poverty reduction. Since export dynamism is the prime short-term target of economic integration, assessment of this is worthy of a lot of attention. Concerning this point, as can be gathered from the following table, the growing sophistication of the export structure over the whole of South America is dramatic. However, when broken down into individual areas, a different picture emerges. Sophistication is fairly clear in Mexico and Central America, and Ocampo [6] refers to this as the “Northern pattern.” Meanwhile, the “Southern pattern” comprising Mercosur, the Andean Community and Chile, while also showing signs of dynamism, is not as prominent as the north. Ocampo calls this difference the “North-South divide.” He summarizes this north-south pattern in the following way and argues that both regions have specialized along these lines.

- Northern pattern: manufacturing products containing a high ratio of imported raw materials, exports to the U.S. market, diversification of agricultural exports, linkage with direct investment in multinational corporations, incorporation into the international division of production
- Southern part: extra-regional export of manufacturing products based on commodities and natural resources, diversification of intra-regional exports, investment into services, natural resources and production for regional integration processes

Table 7-14 Changes in the Export Structure of Latin American Countries

	Primary products		Resource –based manufactures		Low-level technology manufactures		Medium-level technology manufactures		High-level technology manufactures		Non-classifiable items	
	1990	2000	1990	2000	1990	2000	1990	2000	1990	2000	1990	2000
(Northern pattern)												
Mexico	29.4	11.7	9.4	5.8	10.6	14.7	31.8	38.5	14.9	25.3	3.9	3.9
Central America	57.9	27.7	11.1	9.2	21.0	39.7	5.4	6.6	3.4	14.5	- 2	2.2
(Southern pattern)												
Mercosur	36.5	34.7	23.6	24.1	14.8	11.0	20.7	21.2	3.2	6.6	1.1	2.4
Andean Community	58.1	59.5	30.0	24.5	5.6	6.3	4.4	6.4	- 3	0.9	- 5	2.4
Chile	41.9	40.3	49.4	48.6	- 4	- 0	3.5	5.7	0.3	0.7	2.4	1.7
(Latin America)	393	27.3	22.6	17.0	11.5	14.0	18.7	24.6	5.7	14.0	2.2	3.1

Another point of interest is the slow development of export dynamism in the Andean Community of Nations, and this feature is especially pronounced in Bolivia, Peru and Venezuela.

Table 7-15 Export Structure of the Andean Community of Nations (%)

	Primary product exports		Manufacturing exports		High tech exports	
	1990	2000	1990	2000	1990	2000
Bolivia	95	71	5	29	-	-
Columbia	74	66	25	34	-	7
Ecuador	98	90	2	10	-	6
Peru	82	89	18	29	-	3
Venezuela	90	91	10	9	4	3

Source: Corporacion Andina de Fomento, “Trade and Investment in the Americas” May 2004

(4) Factors Behind the Absence of Export Dynamism

What are the factors behind the failure of the Andean Community of Nations to realize (either adequately or not at all) export dynamism, which can usually be anticipated when promoting economic integration? First, industries that are capable of supporting the sophistication of exports have failed to develop. The top exports in the region are crude oil, petroleum products and agricultural products, however, there are hardly any exports of technology-intensive products, which are displaying rapid expansion in global markets. Concerning the background for this, as was mentioned earlier, the Andean Community has been unable to identify its relatively superior industrial sectors because of the absence of industrial structural adjustment.

Table 7-16 Major Exports of Andean Community of Nations (%)

	1980	1990	1995	1996	1997	1998	1999	2000
Crude oil	47.1	37.3	30.1	37.3	34.0	27.7	48.4	42.6
Petroleum products	20.3	19.3	16.0	14.9	13.5	11.5	1.3	16.2
Coffee	8.8	5.3	5.8	4.3	5.8	5.8	3.8	2.3
Bananas	1.0	2.6	3.2	3.2	3.8	4.0	3.5	2.3
Gold (ore)	-	-	2.2	2.1	1.7	3.4	3.0	1.7
Coal	-	2.0	1.8	1.8	1.8	2.7	2.2	2.2
Shells	-	1.1	1.7	1.4	1.9	2.2	1.7	-
Cut flowers	-	-	-	1.3	1.4	1.8	1.7	1.4
Smelted copper	1.4	1.4	1.9	1.6	1.7	1.6	1.4	1.3
Aluminum	1.1	2.3	1.8	--	-	1.3	1.3	1.1
Meat	-	1.2	1.8	1.8	2.2	-	-	1.5
Average share of major products	84.1	74.0	66.3	69.7	67.8	62.0	68.3	72.5

Source: Corporacion Andina de Fomento, “Trade and Investment in the Americas” May 2004

Second, no neighboring countries carry potential for major growth in the future. This typifies the reputation the region has a “losers’ club.” For example, even if the region does not have international competitiveness in world terms, if a large market existed in an adjacent country, the income effect would operate and thereby trigger the growth and sophistication of exports, however, such conditions are not operative. The Brazilian market is nearby, however, apart from Venezuela, this is an inaccessible market for countries of the Andean Community due to obstruction by the Andes Mountains and the Amazon River in spite of close geographical proximity. Third, the relatively large market of Mercosur has been slow to liberalize trade, meaning that exports to this region are extremely small. As can be seen in Table 7-17, even the largest exporting nation of Peru is only able to point to around US$ 300 million of manufactured goods exports. The fourth factor is that, even though the parties responsible for the sophistication of exports are international corporations, incoming investment to the manufacturing sector in the Andean Community is extremely low. The above points contrast starkly with the relationship that Mexico and Central American countries enjoy with the United States.

Table 7-17 Exports of Manufactured Goods (2004, $ million)

	Mercosur	Andean Community	Chile	South America Total	Mexico	Rest of World	World Total
Argentina	3.514	746	1,067	5,328	793	3.376	9,497
Brazil	7,976	3,576	1,888	13,440	3,580	35,754	52,774
Paraguay	85	18	5	108	3	42	153
Uruguay	386	15	32	433	46	204	684
Bolivia	21	32	13	66	9	347	422
Columbia	126	2,334	179	2.638	348	3,812	6,799
Ecuador	18	284	13	314	7	216	537
Peru	295	638	137	1,070	62	5,503	6,634
Venezuela	105	1.290	43	1,438	384	3,696	5,518
Chile	1,145	946	0	2,090	607	12,267	14,964

Source: Commissioned Survey report B

(5) Future Prospects

According to the Inter-American Dialogue Report [23], the economies of South America in 2004-2005 displayed a recovery from the difficult period of 2002-2003, however, there are doubts over how long this will last. Above all, political systems are fragile. Maybe the biggest problem is that the citizens of each country are disparate and do not share the same desire to make their countries strong, and this is damping national strength. Even so, conditions have changed greatly since the 1980s, and these changes have largely come about from the fact that three powerful convictions have been realized under support from politicians and academics from the 1990s onwards. The first of these convictions, according to the Inter-American Dialogue Policy Report "The Troubled Americas" [24], is that democracy and democratic elections are the only acceptable way to secure political power, and this has become a reality in the region. Second is the conviction that free international trade and investment based on market principles above all are the sources of economic vitalization. And third is the conviction that it is necessary to build a constructive partnership with the United States in order for the Latin American countries to attain economic growth. These three convictions continue to receive support even under difficult domestic conditions, however, it is also a fact that the people of Latin America no longer have the confidence they used to possess. In addition to economic and political disorder, there is a feeling among the people that the United States lacks strong commitment to Latin America and at best only views the region as its own backyard, and this is turning into a deep sense of disappointment. The fact remains that the future of Latin America depends on the approach taken by the United States.

7-6 Towards Creative Economic Reform

The first requirement for economic strengthening that makes it possible to reduce poverty is political stability. So what are the essential conditions required for political stability? First is the

existence of political parties that cherish powerful democracy; second is the existence of political leadership; third is a firm stance towards drugs and crime; and fourth is a strong economy. A strong economy is necessary to ensure political stability, however, as a prerequisite for building a strong economy, the aforementioned Inter-American Dialogue "The Troubled America" primarily points to the importance of "agreement on the necessity of economic reform."

The economies of South America are beset with numerous problems, however, this does not mean that the citizens want to withdraw from the market economy. Having said that, many citizens have reservations over the scope and tempo at which economic reform is being realized. The fact is that, in spite of economic reform, per capita income is not increasing, average citizens are becoming poorer, job opportunities remain limited, national finances are deteriorating and business conditions are repeatedly fluctuating. Against this background, there is a growing feeling among people that, "Economic management in South America is unfair, meaning that the benefits of economic reform only reach limited classes, while most people are left out of the loop and become poorer." In this respect, the Inter-American Dialogue "Carnegie Endowment for International Peace" states the following: "In order to raise the standard of living in South American countries, it is necessary to conduct economic reform more directly and effectively. Economic reform is not a mistake, but it is too narrow and lacks creativity," and it goes on to make the following proposals:

- Building of the social safety net: emergency public works programs, home support to enable children to continue attending school
- Reduction of subsidies to wealthy universities to release additional funds for preschool and elementary school programs
- Elimination of tax evasion and prevention of tax loopholes for high income earners
- Reduction of troublesome procedures for small enterprises and improvement of access to credit, information and specialist services
- Revision of outdated labor laws that do not protect workers and dampen job creation willingness and mobility
- Measures to deal with racial and minority disparities
- Expansion of farmland ownership opportunities through market and community reform

The important area in building the above social safety net is the enhancement of education. This is because education more than anything else supports democratic politics. Concerning education, major improvement has been witnessed in some indicators such as elementary school attendance and so on, however, according to "Quantity without Quality-A Report Card on Education in Latin America" compiled by Partnership for Educational Revitalization in the America [25], there is a massive amount of room for the qualitative improvement of education. In particular, there are countless problems concerning academic ability, equality of opportunities and standardization of education.

7-7 Essential U.S. Commitment towards South America

(1) American Commitment towards South America

Jeff J. Schott, in his work [26], conducts analysis on the degree of compliance to free trade of South American economies based on indicators such as price stability, fiscal discipline and market-oriented reform, etc. and he reaches the following conclusions. “The most difficult trade negotiation partner for the United States is Brazil (which is also the least prepared country). The successful formation of the Free Trade Area of the Americas is dependant on the endurance of economic growth, which is an essential requirement for sustainable reform. This is also an important factor for the countries of Latin America to accept free trade. The problems facing the countries of South America are growing income differentials, high unemployment, weak business leaders and government officials, and spillover from regional disputes in the Andean region (Columbia, Ecuador and Venezuela). However, the greatest problem is the weak commitment of the U.S. to formation of the Free Trade Area of the Americas and the regional political situation.” Schott also expresses concern over the “dearth of initiative in the United States.” It is generally accepted that US commitment is one of the keys to ensuring the success of economic integration in South America, however, because American commitment is wavering, cooperative relations between the U.S. and South American countries are not in tune. Concerning this point, Peter Hakim, in “Is Washington Losing America” [27], voices pessimistic sentiment by saying, “U.S. relations with Latin America are unlikely to improve in the immediate future, the reason being that U.S. concern does not lie in Latin America.” Carla A. Hills, in “Free Trade in the Americas” [28], states the following: “U.S. interest in Latin America has been cyclical: long periods of apathy have followed times of strong interest. For example, in spite of announcing Pan Americanism, the Good Neighbor Policy and the Alliance for Progress, the U.S. disregarded these policies after a few years.” According to Peter Hakim [29], relations between the U.S. and South America were extremely good in the 10 years before President Bush, however, conventional goodwill and cooperative relations have dissipated since 2000. In the paper “A Break in the Cloud” [23], Inter-American Dialogue says that, “Few Latin American governments today view the United States as a reliable partner.” Having said that, rather than poor cooperation with the United States, some people believe the Washington Consensus is a bigger contributing factor to the poor economic performance of Latin American countries.

(2) South American Trade Policy of the United States

The following paragraphs describe changes in U.S. policy regarding free trade with South America. Latin America experienced a debt crisis in 1982, marking the start of the “lost decade.” Due to excessive economic intervention by governments, the economic growth of every country slowed down, markets became constricted and social instability occurred. Among these circumstances, awareness grew among South American countries that, in order for economic growth to occur and the standard of living to improve, market freedom and democratic rule were needed more than dictatorships. In 1990, President Bush announced the Enterprise for the Americas Initiative, in which the U.S. proposed that the countries of South America should conduct economic reform and trade liberalization under U.S. initiative in return for debt relief.

As the first step of this initiative, the North American Free Trade Agreement was signed in 1982, resulting in the adoption of zero tariffs on all manufactured products, the removal of all trade barriers between the U.S. and Mexico concerning farm products, the widespread liberalization of services including financial services, and the stipulation of rules concerning the protection of high-level intellectual property and investment. As the second step, it was decided at the Miami Summit of 2005 to conduct negotiations on the North American Free Trade Agreement until 2005. The United States encouraged the governments of Latin America to promote privatization, strengthening of macroeconomic policy, liberalization of regulations and opening of markets. Up until the first half of the 1990s, privatization advanced, inflation came down, overseas investment prospered, democratic governments appeared in rapid succession, and the phrase "Latin tigers" was bandied about. Everything was going well up until this point. However, in the third stage from the second half of the 1990s, starting from a growing sense of opposition to trade liberalization mainly among blue-collar workers in the United States, U.S. interest in Latin America started to wane and a shadow was cast over NAFTA negotiations. In the fourth stage of 2002, the trade policy of the Bush administration ran aground as a result of economic recession and the 9/11 terrorist attacks. As the fifth stage of post-2002, at the WTO Doha meeting that was staged in the wake of 9/11, elimination of poverty was raised as a target necessary also for the defeat of terrorism, and it was decided to bring the less developed nations into the global trade system through the Doha Round of negotiations by January 2005. This also happened to be the goal of the Free Trade Agreement of the Americas.

7-8 Increasingly Important Trends of Brazil and Mexico

When considering the future of economic integration in South America and approach to economic cooperation regarding the four target countries, the trends of related nations cannot be overlooked. In particular, the movements of Brazil and Mexico are especially important. This is because both countries have a major impact on economic integration in South America, and their U.S. policies also have an effect. In addition, the movements of Chile and Venezuela are important, although not as much.

The most important country for the United States is Mexico, which is its second largest trading partner after Canada. Mexico is now regarded as the first priority of American foreign policy. Meanwhile, Mexico is strongly aware of maintaining an economic relationship with the United States that is neither too close nor too far removed. Mexico's survival relies on its strengthening relations and extending dependence with the United States. Accordingly, the Andean Community of Nations is able to realize cooperative relations with the United States, albeit indirectly, through building its links with Mexico.

On the other hand, Brazil has a stronger sense of independence than Mexico. Although it is not antagonistic towards the United States, unlike Mexico it seeks a path of independence rather than dependence in its relations with Washington. Chile is an associate member of Mercosur and is also a member of APEC, so it adopts a multi-directional approach. If Brazil signs a trade agreement with the United States, relations between the two will be significantly deepened. Venezuela, on the other hand, is strongly anti-American and is attempting to rally the rest of South

America in that direction, and it is thus is a worrying presence in the region. The main thrust of Venezuela's argument is that the Washington Consensus, rather than imparting merits to the economies of South America, has created a society of disparities. Venezuela calls for efforts to realize economic integration that makes it possible to reduce poverty.

7-9 China's Deepening Relations with South America

China is another country that will have a major impact on future economic integration in South America. China's approach to the region has become more active in recent years, and this trend is underpinned by two factors. First, there is the securing of access to South American natural resources, which are essential to China in order to enable its medium to long-term economic growth. It is reported that China is considering making direct investment into securing resources in unison with investment into infrastructure. However, no such investment has taken place as yet. Second is the Taiwan issue. There are 26 countries in the world that recognize the existence of Taiwan as a state, and 12 of these are situated in Latin America. China wants to reduce this figure and is aiming to strengthen economic ties with Latin America with this in mind. Looking at these policies, there are some people who think that China is trying to build a hegemony in South America, however, Peter Hakim [29] says, "China is well aware that South America is a highly important region for the United States and, being confronted with the local neighbors of North Korea and Taiwan, it is does not want to earn the displeasure of Washington by interfering in South America too much."

However, the resource strategy of China is not to be underestimated. In particular, Japan cannot overlook the actions of China. In the medium to long-term, it is likely that China will sustain high-degree growth, in which case the securing of natural resources will be the primary issue for policymakers. Needless to say, China will turn its attention to South America, which is a veritable goldmine of natural resources. It is possible that China will also compete with Japan for resources in this region. Looking at the recent resource-gaining strategy of China, it is not simply purchasing resources, but it is also intensifying involvement in other fields, for example, power plant construction projects, etc., with a view to securing further development rights. For Japan, which is poor in natural resources, it is necessary to compile a "resource map" of South American resources and develop a strategy of resource development in joint work with the countries of South America. Moreover, needless to say, resources here refer not only to mineral resources but also to agricultural and forestry resources, fisheries resources and water resources.

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Part III

Trends in Development Aid (South America Overall and Poorest Nations in South America)

Part III
Trends in Development Aid
(South America Overall and Poorest Nations in South America)

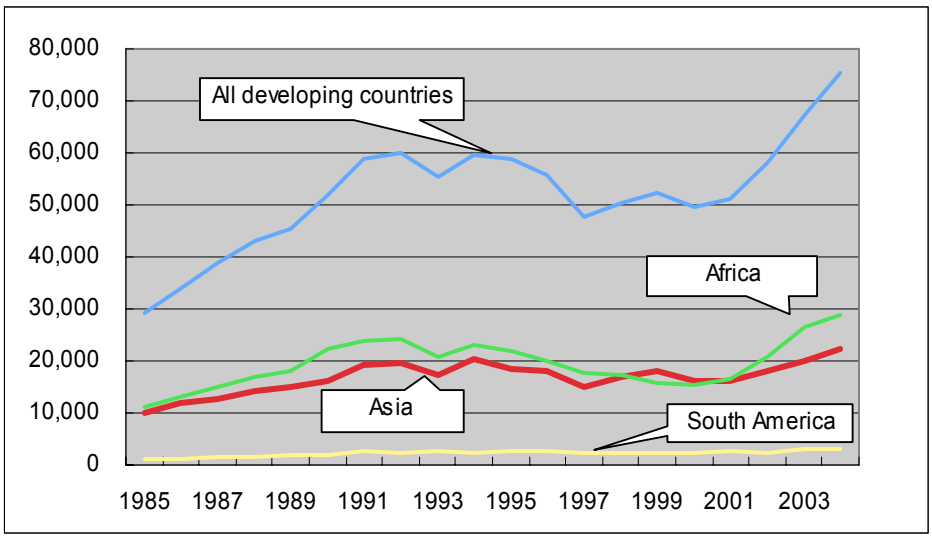
Chapter 8 Trends in Aid to South America

This chapter will present an overview of the overall trends in aid to South America and Japan's aid trends.

8-1 Overall Trends

(1) Trends in ODA by Region

From 1985 to 2004, ODA from the main DAC donating countries and international organizations to South America averaged about $2.237 billion annually. In 2004, this accounted for a mere 4 percent of the total amount of ODA. The amount of ODA during the same period to Africa averaged $19.5 billion and to Asia averaged $16.813 billion per year. Because ODA to developing countries has increased after 2001, the amount of ODA to Africa and Asia has been on the rise, however, there has been little change in aid to South America in the last twenty years.



Source: Figures from DAC International Development Statistics

Fig. 8-1 Aid by Region[62] (Net amount provided by international organizations and main DAC donating countries. Units: million dollars)

(2) Trends in Aid to Ten South American Countries

Table 8-1 shows the aid given to ten South American countries[63] from 1994 to 2004. Throughout this period, Bolivia received the most aid during this period, accounting for about thirty percent of overall ODA to South America.

[62] Thirteen South American countries: Argentina, Bolivia, Chile, Colombia, Ecuador, the Falkland Islands, Guiana, Paraguay, Peru, Surinam, Uruguay and Venezuela

[63] The countries above excluding the Falkland Islands, Guiana and Surinam.

This aid to Bolivia is mainly the result of its gathering international interest as one of the first countries involved in the Comprehensive Development Framework (CDF) and Poverty Reduction Strategy Paper (PRSP) development projects supported by the World Bank and International Monetary Fund (IMF). Until 2003, Peru received the second most aid after Bolivia with about 20 percent of that given to South America, but in 2004 Colombia overtook Peru to become second. Although the amount of aid given to Chile and Paraguay has shown a slightly declining trend, the aid given to Ecuador, Argentina, Venezuela and Uruguay has not changed very much. The order of aid received in 2004 was Bolivia (32%), Colombia (21%), Peru (19%), Brazil (12%), Ecuador (5%), Argentina (4%), Chile (2%), Venezuela (2%), Uruguay (1%) and Paraguay (1%).

Table 8-1 Aid Given to Ten South American Countries (Units: million dollars)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Argentina	146.08	143.49	124.62	87.21	79.82	95.45	68.79	147.97	51.54	100.3	90.6
	8%	6%	5%	4%	4%	5%	4%	6%	2%	3%	4%
Bolivia	568.53	718.52	831.28	700.04	628.54	568.78	474.43	734.7	680.4	928.99	765.71
	29%	31%	35%	34%	29%	29%	26%	30%	29%	31%	32%
Brazil	252.72	276.47	289.75	288.32	333.77	185.92	320.88	347.89	328.61	294.4	283.5
	13%	12%	12%	14%	16%	9%	18%	14%	14%	10%	12%
Chile	151.16	157.42	196.3	128.33	105.99	69.51	48.72	57	-8.51	74.76	48.07
	8%	7%	8%	6%	5%	4%	3%	2%	0%	2%	2%
Colombia	77.37	170.83	188.44	195.04	168.02	301.65	186.26	379.8	439.77	800.9	519.45
	4%	7%	8%	9%	8%	15%	10%	16%	19%	27%	21%
Ecuador	211.58	226.28	245.35	151.5	178.68	146.04	145.95	172.7	215.37	176.1	159.27
	11%	10%	10%	7%	8%	7%	8%	7%	9%	6%	7%
Paraguay	93.25	136.05	84.34	102.58	76.01	77.59	81.3	60.8	55.88	49.75	20.06
	5%	6%	4%	5%	4%	4%	4%	3%	2%	2%	1%
Peru	336.25	372.46	328.71	393.46	501.6	449.98	398.7	451.4	493.68	497.03	462.54
	17%	16%	14%	19%	23%	23%	22%	19%	21%	16%	19%
Uruguay	74.32	67.74	34.81	33.61	24.77	21.74	16.68	14.65	9.94	14.06	21.64
	4%	3%	1%	2%	1%	1%	1%	1%	0%	0%	1%
Venezuela	26.99	43.84	38.09	8.59	42.08	43.92	75.85	44.41	56.67	81.52	47.95
	1%	2%	2%	0%	2%	2%	4%	2%	2%	3%	2%
Total for ten countries	1938.25	2313.1	2361.69	2088.68	2139.28	1960.58	1817.56	2411.32	2323.35	3017.81	2418.79

Note: Net aid base provided by international organizations and main DAC donating countries.
Source: Figures from DAC International Development Statistics

(3) Trends in Support for South America by Donor Country

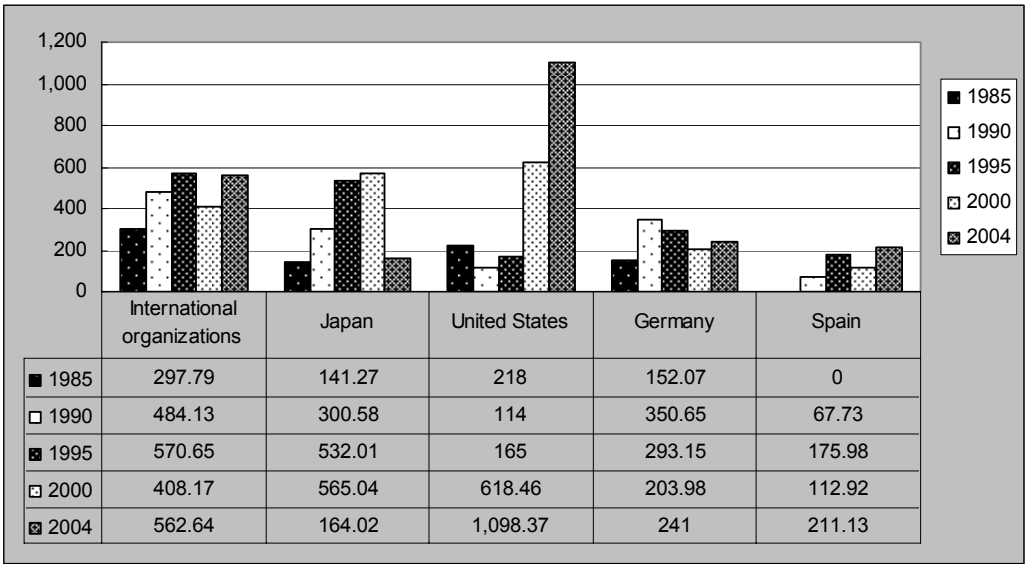
Figure 8-2 shows a comparison of aid given to South America by the major donor nations and international organizations[64] at five points in time: 1985, 1990, 1995, 2000 and 2004. This figure shows that there was not a big difference in the amount of aid given by the largest donor, the United States, and the second largest donor, Japan, as of 2000, but because the United States increased its aid after that year, the amount of aid provided to South America by the United States in 2004 was significantly greater than that of the other donor nations. In additional to its regular ODA budget, the United States has been reinforcing its aid to South America by creating the Millennium Challenge Account (MCA) to provide more aid. In addition, the United States has also been giving preferential tariff treatment to South American countries based on the Andean Trade Promotion and Drug Eradication Act (ATPDEA).

As of September 2006, the South American country that is eligible to receive MCA support is

[64] This is an aggregate for all international organizations that are included in the DAC statistics, including the World Bank, Inter-American Development Bank, UN related organizations, etc.

Paraguay, and the countries that can receive aid through the ATPDEA are the four Andean countries of Bolivia, Peru, Ecuador and Colombia.

Although not to as great an extent as the United States, Germany, Spain and international organizations also increased their aid to South America from 2000 to 2004. The only country that has decrease its aid was Japan, and as of 2004 Japan was overtaken by Germany and Spain in net aid.



	International organizations	Japan	United States	Germany	Spain
1985	297.79	141.27	218	152.07	0
1990	484.13	300.58	114	350.65	67.73
1995	570.65	532.01	165	293.15	175.98
2000	408.17	565.04	618.46	203.98	112.92
2004	562.64	164.02	1,098.37	241	211.13

Source: Figures from DAC International Development Statistics

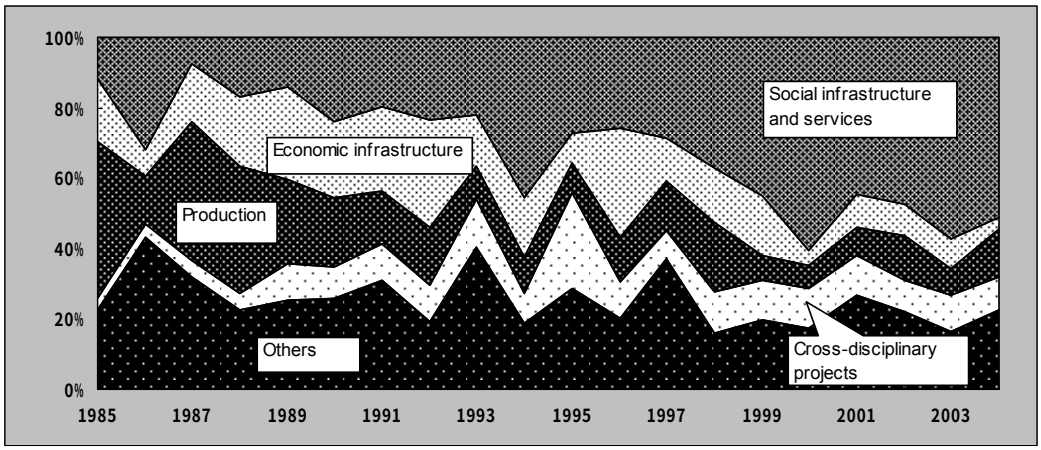
Fig. 8-2 Aid to South America[65] by Donor Nation

(Net amount provided by international organizations and main DAC donating countries. Units: million dollars)

(4) Aid by Usage

Figure 8-3 shows how the percentage of aid was used in different sectors. The ODA percentage has been decreasing for the economic infrastructure sector, including transportation, storage and energy. This sector accounted for about 18 percent of ODA in 1985 and at one time (1996) exceeded 30 percent, but it has been under ten percent for the past few years. Conversely, the percentage of ODA for "soft" sectors such as social infrastructure and services has been increasing. These fields include education, health and medicine, governance and civil society. ODA for social infrastructure and services accounted for 12 percent of the total in 1985, but it has steadily increased and in 1999 it accounted for more than 45 percent of total ODA. Although the percentage of aid for the production sector is lower than it was twenty years ago, in recent years it has been steady at slightly over ten percent.

[65] Thirteen South American countries: Argentina, Bolivia, Chile, Colombia, Ecuador, the Falkland Islands, Guiana, Paraguay, Peru, Surinam, Uruguay and Venezuela



Source: Figures from DAC International Development Statistics

Fig. 8-3 Aid to South American Countries[66] by Sector
(Commitment amount base by international organizations and main DAC donating countries.)

(5) Aid for the Economic Development Sector

Table 8-2 shows the aid for the economic development sector[67] for the years 1985, 1990, 1995, 2000 and 2004. The percentage of aid to South America that the economic development field accounts for has been decreasing annually: 62 percent in 1985, 40 percent in 1990, 15 percent in 1995, and 11 percent in 2000. However, in 2004 it was at 15 percent or the same level it was ten years earlier.

In examining the aid provided to the economic development sector by different areas, the transportation and storage field accounted for 20 to 30 percent of the total in 2000, but this had decreased significantly to 5 percent in 2004. The percentage of the total accounted for by the energy field also decreased from 23 percent in 1985 to 2 percent in 2004. In place of these fields, the percentage of aid to agriculture, forestry and fisheries is increasing. Aid for agriculture, forestry and fisheries was low from 1985 to 1990 when the percentage given to transportation and storage was high. Aid started to increase after that period, however, so that by 2004 over 70 percent of the aid to the economic development sector was being devoted to agriculture, forestry and fisheries. The background to this increase involves the adoption of the United Nations Millennium Project to reduce poverty at the UN Millennium Summit held in September 2000. Because the reduction of poverty has been made an international goal and because it has been included in the international Millennium Development Goals, it is believed that the various donor nations are providing more aid to agriculture, forestry and fisheries because they believe support to the production sector will help improve the lives of the poor. In addition to the above, another recent feature in the economic development sector is that the percentage of aid for the trade policies and regulations field has been gradually increasing since 2000.

[66] Same as above.
[67] The economic development sector is a total for the following: Transportation and storage; energy; industry; mining; agriculture, forestry and fisheries; business and other services; trade policies and regulations; and tourism.

Table 8-2 Aid for the Economic Development Sector

Units: Million dollars

	1985	1990	1995	2000	2004
Transportation and storage	23.885 5%	188.224 26%	89.105 22%	127.996 31%	30.864 5%
Energy	119.603 23%	149.508 20%	80.683 19%	13.29 3%	10.34 2%
Industry	60.294 11%	77.991 11%	28.661 7%	24.921 6%	37.435 6%
Mining	1.465 0%	29.799 4%	12.649 3%	10.189 2%	9.613 2%
Agriculture, fisheries and mining	321.401 61%	250.37 34%	186.903 45%	209.221 51%	460.479 76%
Business and other services	1.465 0%	29.799 4%	12.649 3%	10.189 2%	9.613 2%
Trade policies and regulations	0.875 0%	7.295 1%	2.184 1%	13.285 3%	44.607 7%
Tourism	0.102 0%	0 0%	1.11 0%	2.602 1%	3.718 1%
Total for economic development field	529.09	732.986	413.944	411.693	606.669
Total aid to South America	860.14	1853.426	2733.05	3845.325	3969.465
Aid to the economic development sector as a percentage of the total aid to South America	62%	40%	15%	11%	15%

Note: Commitment amount base by international organizations and main DAC donating countries.
Source: Figures from DAC International Development Statistics

8-2 Japan

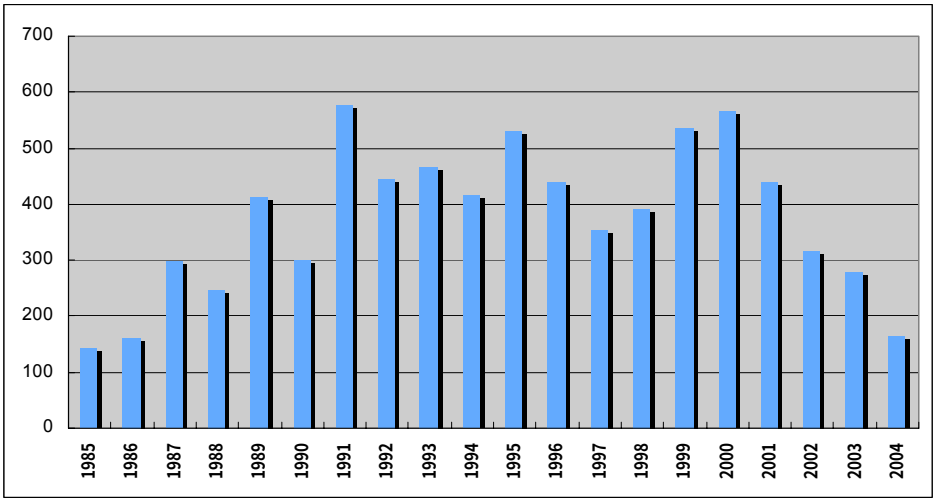
8-2-1 Aid to South America

(1) Overall Trends

Japan's aid to South America has been based on a number of factors. First, about 60 percent of Japanese immigrants around the world live in South America so that there is a strong historical connection. Latin America is also rich in mineral and agricultural resources, so that many of the countries have a relatively high income level. However, the difference in income levels between countries and within countries is very large, with areas of high poverty located in rural and mountainous areas.

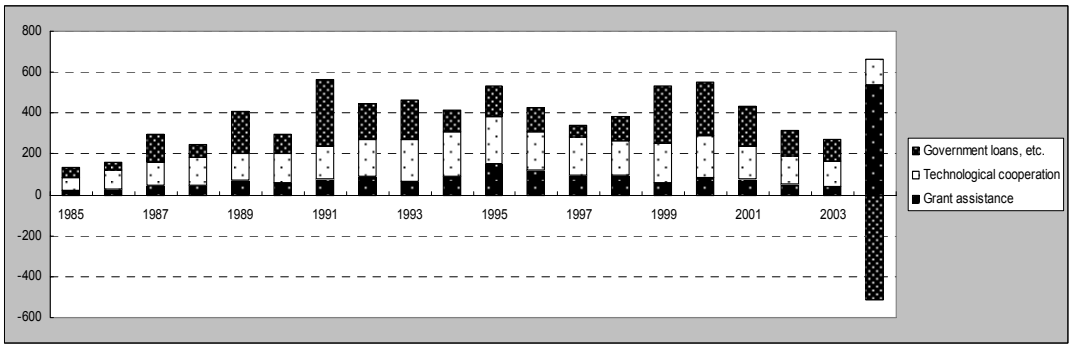
In reviewing Japan's bilateral aid to South America for the past twenty years, in 1985 aid was at $141 million and it increased and reached its peak in 1991 at $576 million. Although the amount of aid fluctuated after that, it gradually decreased from 2000 to $1.64 million in 2004 or about the same level it was at twenty years previously (Fig. 8-4). This is but a mere 3 percent of the total $5.954 billion of Japan's bilateral ODA.

Figure 8-5 shows the make up of Japan's aid by type over the last twenty years. Because Bolivia was given debt relief, yen loans went into the red, so that, excluding 2004 when grant assistance was greatly increased, one of the features of Japan's aid to South America has been a good balance between yen loans, technological cooperation, and grant assistance. (See Figure 8-5.)



Source: Figures from DAC International Development Statistics

Fig. 8-4 Japan's Aid to South America[68]
(Net disbursement base; units: million dollars)



Source: Figures from Ministry of Foreign Affairs, Data Book by Country

Fig. 8-5 Japan's Aid to South America[69] by Type of Aid
(Net disbursement base; units: million dollars)

(2) JICA and JBIC Aid Policies for South America

For the period 2006 to 2009, JICA's[70] policy for South America will be based on four common tasks: 1) Reduction of poverty and correcting the income gap; 2) increased employment through the sustainable growth of the economy; 3) solving global (regional) scale problems that ignore national borders; and 4) cooperation for the construction of peace. In addition, the fields in which aid will be focused are as follows: 1) Health, medicine and hygiene; 2) agriculture and rural village development; 3) education; 4) environmental protection; 5) administrative organization and developing systems (governance); 6) developing economic and

[68] Thirteen South American countries: Argentina, Bolivia, Chile, Colombia, Ecuador, the Falkland Islands, Guiana, Paraguay, Peru, Surinam, Uruguay and Venezuela
[69] The countries above excluding the Falkland Islands, Guiana and Surinam.
[70] JICA internal document, "Implementation Policy for Latin American Projects (Proposal)"

social infrastructure and industrial development; 7) creating peace and supporting the social weak; and 8) disaster prevention. By country, aid will be increased to Bolivia and Ecuador, decreased to Brazil, Argentina, Chile, Venezuela and Uruguay, and will remain the same to Colombia, Paraguay and Peru.

With regard to the JBIC[71], aid to South America will emphasize economic differences between regions and differences in income. In order to correct these, aid for the following will be emphasized: 1) Developing economic and social infrastructure; 2) training manpower; 3) recovering employment opportunities and security; and 4) reducing poverty. In addition, the promotion of regional integration is considered a key to the future economic and social development of this region, so that aid for regional integration initiatives will also be emphasized. In their policy, the JBIC has selected seventeen countries for emphasis in their aid, but only Peru has been selected as such from South America. Because of financial and economic conditions, there are only four South American countries that are eligible for aid from the JBIC as of September 2006: Brazil, Peru, Paraguay and Colombia. Furthermore, Peru, Brazil and Colombia are emphasized because of their mineral and agricultural resources, and Paraguay is emphasized because of its Japanese expatriate society.

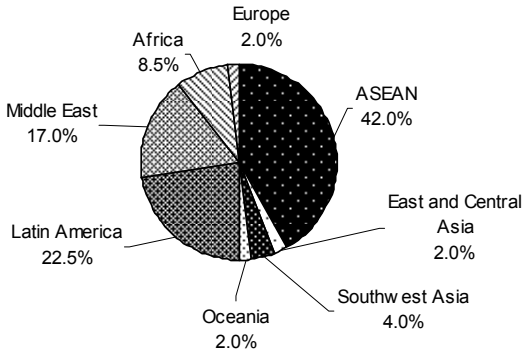
8-2-2 South-South Cooperation and Regional Cooperation

(1) South-South Cooperation

Because of its historical background, Latin America has a common cultural and linguistic background. Based on this fact, Japan has been aggressively supporting what is known as "South-South cooperation" in which developing countries improve their relations through technological and economic cooperation, so that they can develop independently. Since the Partnership Program (PP) was introduced in 1994, twelve countries[72] have signed partnership agreements with Japan. Of these, four are Latin America countries (Chile, Brazil, Argentina and Mexico).

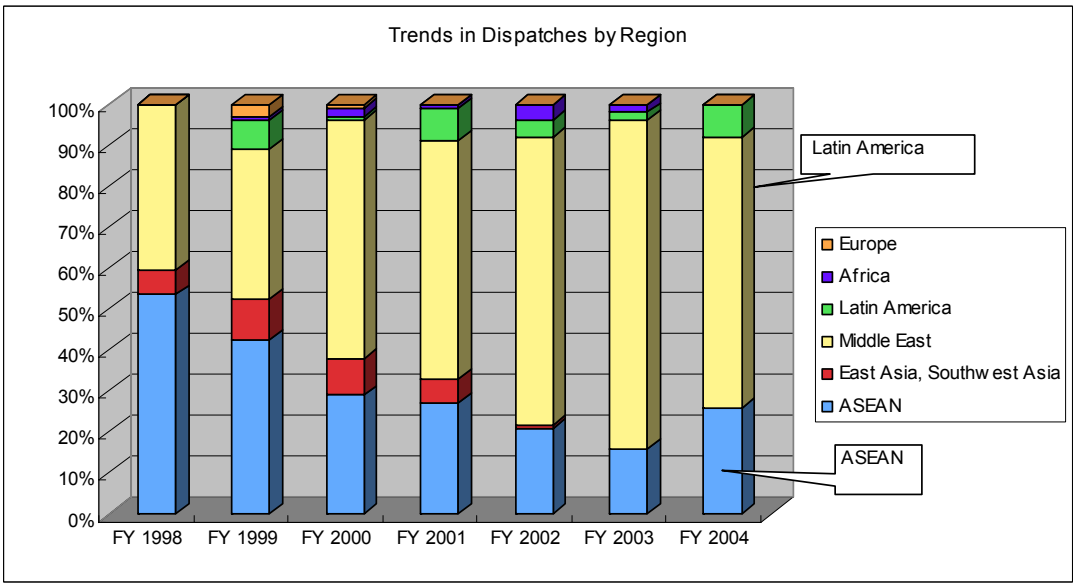
South-South cooperation is mainly based on two types of aid: Third-country training (group training and individual training) and third-country specialists. The regions where these are most commonly used are the ASEAN countries and Latin America. For example, in fiscal 2003, ASEAN countries accounted for 42 percent of third-country group training and Latin American countries for 22.5 percent (Fig. 8-6). With regard to the dispatching of third-country specialists, the countries that dispatched the most were those in Latin America. In 2003, Latin American countries accounted for 80 percent of the third-country specialists who were dispatched (Fig. 8-7). In addition, many of the third-country specialists were of Japanese ancestry. According to the records of Japanese-ancestry third-country specialists who were dispatched from Brazil, while only four were dispatched in 1998, this number has gradually increased, so that by 2005 it had reached 30. Although the initial fields of specialization were agricultural, they have gradually diversified to include medicine and communications network development.

[71] JBIC, "Implementation Policy for Overseas Economic Cooperation Projects (Fiscal Years 2005 to 2007)"
[72] As of January 2005



Source: JICA, "Guidelines by Task: South-South Cooperation," January 2005, pp. 30-31

Fig. 8-6 Third-Country Group Training by Region (2003)



Source: Figures from JICA data

Fig. 8-7 Third-Country Training by Region

(2) South-South Cooperation Aid in the Economic Development Field

Table 8-3 shows the third-country specialist dispatch record in the economic development field for South America (from 1994 to 2004). This shows that Argentina has been providing technology related to beef to Paraguay, statistical technology related to economic surveys to Peru and freshwater fish farming technology Bolivia. Chile has been providing sea farming technology to Peru, and mineral environmental protection, mine development and plant quarantine technology to Bolivia. Brazil has been providing Paraguay and Venezuela with machinery and machinery efficiency improvement technology and wholesale market improvement technology, Peru with animal and animal product inspection technology. In addition, transfer of technology has not been limited to that from medium-developed countries to less-developed countries, but has involved transfer between less-developed countries, such as the

transfer of telecommunications technology and beef cattle raising technology from Paraguay to Bolivia, and transfer of other technology from Peru to Ecuador and from Bolivia to Peru.

(3) Regional Cooperation

Regional cooperation that includes the cooperation of two or more countries to solve common problems such as environmental problems and epidemics that ignore national borders are also being emphasized in South America. Specifically, one JICA regional planning member was assigned to Paraguay from 2001 to 2002, and in 2003 one member was assigned to Argentina to discover and formulate Mercosur regional cooperation proposals. At the "First Mercosur Regional Technology Cooperation Officer and Secretary Meeting" held on March 15, 2005, specific measures for the future were discussed. Among the Mercosur regional cooperation projects, the following are related to the economic development field:

- Packaging technology improvement plan for the distribution of products within Mercosur (development study)
- Mercosur tourism promotion seminar (special regional training)
- Mercosur tourism promotion project (technological project)
- Manpower training project for the improvement of domestic livestock hygiene in southern South America through regional cooperation (technological project)

In addition to the above, a regional planning survey member is assigned to Ecuador to support common tasks within the Andes region and to discover and formulate proposals for projects.

Table 8-3 Third-Country Specialist Dispatch Record in the Economic Development Field[73] within South America (1994 to 2004)

Fiscal year	Accepting country	Dispatching country	Instructing items	Receiving country organization	Affiliation of the specialist
2003	Paraguay	Argentina	Meat quality assessment	Paraguay Agricultural Testing Farm	
2004	Paraguay		Packaging technology		
2003	Venezuela		Small and medium business management control	Aragua State Government Economy and Technology Development and Export Council	
2003	Peru		Economic survey implementing structure	INEI (National Statistics and Information Agency)	
2003	Peru		Industrial survey implementing methods	INEI (National Statistics and Information Agency)	
2003	Peru		Organization of manpower resources	INEI (National Statistics and Information Agency)	
2004	Peru		Industries registry methods	National Institute of Statistics and	
1996	Bolivia		Rainbow trout farming	Ministry of Economic Development, Agriculture and Dairy Agency, Office of the Vice Minister for Forestry and Fisheries Development	Neuken Ecology Application Center, Breeding Production Department
2001	Bolivia		Forming fish farming plans	Bolivia Fisheries Development and Research Center	Neuken Applied Ecology Center (CEAN)
2000	Peru	Chile	Sea farming technology	Ministry of Fisheries, Ilo Regional Bureau	Norte Catholica University
2001	Peru		Sea farming	Ministry of Fisheries, Ilo Regional Office (DIREPE-ILO, MIPE)	Catholica Norte University
2004	Peru		Basin management	INRENA	
1997	Bolivia		Digital communications	Pedro Domingo Mulillo Vocational Training School	International Telecommunications Training Center
2000	Bolivia		Mine environmental protection and pollution prevention	Ministry of Economic Development, Mining and Metallurgy Agency, General Mining Bureau	Ministry of Mining, Mining Geology Bureau (SERNAGEOMIN)
2000	Bolivia		Mine protection and environment related laboratory technology	Ministry of Economic Development, Mining and Metallurgy Agency, General Mining Bureau	Ministry of Mining, Mining Geology Bureau (SERNAGEOMIN)
2000	Bolivia		Plant quarantine technology field (monitoring plant hygiene)	Ministry of Agriculture, Dairy and Rural Village Development, Agriculture and Dairy General Bureau	Ministry of Agriculture, Agriculture and Dairy Service Organization (SAG)
2000	Bolivia		Plant quarantine technology field (plant quarantine)	Ministry of Agriculture, Dairy and Rural Village Development, Agriculture and Dairy General Bureau	Ministry of Agriculture, Agriculture and Dairy Service Organization (SAG)
2000	Bolivia		Animal and plant quarantine administration and system field (organization and organizational structure)	Ministry of Agriculture, Dairy and Rural Village Development, Agriculture and Dairy General Bureau	Ministry of Agriculture, Agriculture and Dairy Service Organization (SAG)
2000	Bolivia		Animal quarantine technology (protection of domesticated animals)	Ministry of Agriculture, Dairy and Rural Village Development, Agriculture and Dairy General Bureau	Ministry of Agriculture, Agriculture and Dairy Service Organization (SAG)
2001	Bolivia		Mine development	Mining and Metallurgy Vice Minister Office	Geology and Mining Public Corporation
2001	Bolivia		Mine protection and environment	Mining and Metallurgy Vice Minister Office	
2001	Bolivia		Veterinary product import authorization system	National Agriculture and Dairy Hygiene Organization (SENASAG)	Agriculture and Dairy Service (SAG)
2001	Bolivia		Plant quarantine technology	National Agriculture and Dairy Hygiene Organization (SENASAG)	Agriculture and Dairy Service (SAG)
2001	Bolivia		Establishment of plant epidemiology monitoring system	National Agriculture and Dairy Hygiene Organization (SENASAG)	Agriculture and Dairy Service (SAG)
2001	Bolivia		Animal quarantine technology	National Agriculture and Dairy Hygiene Organization (SENASAG)	Agriculture and Dairy Service (SAG)
2003	Bolivia		Legal Department Chief in Livestock Service in Chile(SAG)	SENASAG	
2003	Bolivia		National Advisor for Fruit Fly Project	SENASAG	
2004	Ecuador	Paraguay	Machine control using Visual C++		
1997	Bolivia		Telecommunications (Digital exchanges, ISDN)	Pedro Domingo Mulillo Vocational Training School	Telecommunications Public Corporation, Telecommunications School
1997	Bolivia		Telecommunications (Digital transmission)	Pedro Domingo Mulillo Vocational Training School	Telecommunications Public Corporation, Telecommunications School
2000	Bolivia		Distribution function improvement instruction for produce	Santa Cruz Sustainable Development	Ministry of Agriculture and Dairy,
2001	Bolivia		Improving the raising of beef cattle	National Domestic Animal Improvement Center (CNMGB)	Asuncion National University
1999	Argentina	Brazil	Tree grafting technology to improve the productivity of vegetable farming	Colientez Planning Agency, International Cooperation Bureau, Vegetable Production Technology Center (CETEPRO)	Paulista University, Department of Agriculture
2003	Ecuador		Electronic equipment development	Vocational Ability Development Organization	
2003	Paraguay		Optical fiber technology	SNPP (Japan-Paraguay Vocational Ability Center)	
2003	Paraguay		Automatic power factor improvement technology	SNPP (Japan-Paraguay Vocational Ability Center)	
2003	Paraguay		Improvement of public wholesale markets (support for external consigment)	Asuncion City Hall	
2004	Paraguay		Improvement of the management of the Asuncion central wholesale market	Asuncion City Hall	
2003	Venezuela		Mechatronics technology	INCE (National Vocational Training School)	
2003	Peru		Animal and farm product inspections to ports and airports	National Agriculture Hygiene Agency	
2004	Ecuador	Peru	Numeric Control Programming for Machine Tools Training	Servicio Ecuadoriano de Capacitacion(SECAP)	
2001	Peru	Bolivia	Lake Titicaca rainbow trout fish farming technology (water quality control for rainbow trout farming)	National Development Agency (INADE)	Bolivia Fisheries Survey and Development Center
2001	Peru		Lake Titicaca rainbow trout fish farming technology (feed analysis and quality control)	National Development Agency (INADE)	Bolivia Fisheries Survey and Development Center
2000	Bolivia	Paraguay	Instruction for the improvement of produce distribution functions	Santa Cruz Sustainable Development Bureau	Paraguay Agriculture and Dairy Ministry

Source: JICA data

[73] Transportation and storage; energy; industry; mining; agriculture, forestry and fisheries; business and services; trade policies and regulations; IT and other economic development related items were selected and listed by the survey team.


0 100 200 km
0 100 200 mi
Riberalta
Cobija
BRAZIL
PERU
Amazon Basin
Río Beni
Río Mamoré
Trinidad
Lago Titicaca
ANDES
★LA PAZ
Cochabamba
Nevado Sajama
Oruro
Santa Cruz
Altiplano
Río Lauca
Sucre
Puerto Aguirre
Potosí
ATACAMA DESERT
SOUTH PACIFIC OCEAN
Tarija
PARAGUAY
Río Paraguay
CHILE
ARGENTINA
66
60
12
18

Chapter 9 Bolivia

9-1 Economic Overview

9-1-1 Resources and Geographical Conditions

Bolivia has a national land area of approximately 1,100,000 km2, roughly 3.3 times the size of Japan. Although it has the fourth largest area in South America, its population is small at approximately 9 million. It is a landlocked nation enclosed by five countries: Brazil in the northeast, Paraguay in the southeast, Argentina in the south, Peru and Chile in the west. In geographical terms, it is divided into three main regions, i.e. the Andes plateaus in the west, the Andes lowlands comprising the eastern slopes, and the eastern lowlands that stretch over the northeastern half of the country. Due to the undulating nature of the land, the country also has extremely diverse climate and resources.

The Andes highlands cover one-third of the national land area and are composed of the parallel-running East Andes and West Andes and the Altiplano plateau running from north to south. Both mountain ranges reach altitudes of 5,000-6,000 m and have cold climates. In the East Andes especially, there are abundant reserves of zinc, gold and tin, etc. Altiplano is a plateau belt ranging in altitude of 3,500-4,000 m, and the climate here is both cold and arid. This belt, which is home to 40% of the population, contains the major urban centers such as the administrative capital La Paz[74], Oruro and Potosi, which prospered on the back of mine development. Traditional farming based on kinua and potatoes is carried out with livestock grazing, while concentration of micro and small enterprises mainly in the light manufacturing sectors of food processing and textiles can be seen in El Alto in the Lima metropolitan area.

The Andes lowlands are mainly at an altitude of between 1,500-2,500 m and belong to the subtropics with high temperature and humidity, although the climate is generally mild. In the north, coca is cultivated, and foods such as wheat, sweet corn, fruits and vegetables are grown and supplied to the Altiplano. Major cities are Cochabamba, Sucre and Tarija.

The eastern lowlands, which cover 60% of the national land area, are at an altitude of 500 m or less. Although this area belongs to the tropic, there is great variation in climate conditions, ranging from the tropical rainforest belt around the headwaters of the Amazon River to the steppe region of Chaco in the southeast, where there is hardly any rainfall during the winter. The area around the capital Santa Cruz has an intermediate climate between these two extremes. This area has recorded dramatic growth over the past 30 years as a large-scale center of agricultural production and export (soybeans and sugar, etc.), and Santa Cruz is now the driving force behind Bolivia's exports. Moreover, natural gas is produced in the Chaco region, and this too is an important source of exports for the country.

9-1-2 Industrial Structure

The Bolivian economy fell into crisis as a result of the hyperinflation of the mid 1980s, however, thanks to the new liberal economic policy that was adopted after that, inflation was

[74] The constitutional capital is Sucre in Chuquisaca Province.

brought under control and stable economic growth of more than 4% was achieved in the 1990s. After a period of economic stagnation at the end of the 1990s, the GDP has continued to grow but only at a slow pace. Future issues of economic development are connected to the country's dependence on primary products such as agricultural products and natural resources, and the dual structure of industry comprising the modern export sector typified by large-scale agricultural processing and natural gas and the traditional agricultural sector that is struggling with low productivity.

Looking at the sector-separate composition of GDP over the past 10 years, the agriculture sector (including forestry, stockbreeding and fisheries) has occupied a steady 15% of GDP. Looking at the breakdown of this, production of agricultural products for industrial uses is increasing, while coca production, which accounted for 0.8% of GDP in 1996, fell rapidly to 0.1% by 2005 On the other hand, the petroleum and natural gas sector has been extending its share against a background of prosperous overseas investment and inflation of international prices, and this grew from 5% in 1996 to 7% in 2005. The ratio of manufacturing is a steady 17% of GDP, however, the weight of foodstuffs including the export sector of agricultural processing has been growing. Consumer goods including foods, beverages, tobacco, textiles, clothing and leather products accounts for the majority of manufacturing.

Table 9-1 Sector-Separate Composition of GDP in Bolivia

Production amount — Unit: Million Bolivianos

Year	1996	1997	1998	1999	2000	2001	2002	2003 (p)	2004 (p)	2005 (p)
Agriculture, forestry, stockbreeding, fisheries	2,998,549	3,135,126	2,996,265	3,071,385	3,178,127	3,288,118	3,302,826	3,586,450	3,603,509	3,786,743
Petroleum, natural gas	792,604	904,594	1,021,115	977,522	1,091,373	1,090,835	1,142,298	1,230,951	1,528,446	1,759,265
Metal, non-metal minerals	1,094,631	1,097,072	1,091,917	1,039,130	1,054,638	1,022,241	1,023,172	1,030,400	946,627	1,055,998
Manufacturing	3,376,399	3,444,617	3,530,213	3,633,489	3,698,532	3,797,922	3,807,441	3,957,855	4,180,034	4,314,282
Foods	1,140,285	1,166,075	1,194,724	1,257,129	1,359,170	1,457,386	1,431,811	1,494,770	1,554,170	1,576,914
Beverages, tobacco	441,213	455,836	504,244	487,556	478,921	476,961	486,862	524,241	580,303	627,708
Textiles, clothing, leather products	357,168	378,128	381,132	397,570	405,518	408,414	398,756	406,635	419,073	430,879
Timber and timber products	203,892	215,960	218,240	231,121	243,866	251,974	253,598	259,145	267,205	274,359
Electricity, gas and water supply	401,704	420,615	431,205	451,592	459,719	462,796	473,119	487,566	501,078	514,271
Construction	690,954	725,467	984,720	818,987	784,857	730,023	848,101	652,030	664,039	673,648
Commerce	1,709,922	1,794,308	1,822,788	1,820,033	1,891,201	1,902,346	1,943,265	1,996,640	2,077,606	2,137,460
telecommunications	2,008,715	2,194,451	2,349,061	2,330,768	2,384,974	2,457,014	2,563,308	2,666,390	2,774,826	2,864,303
leasing	2,201,889	2,479,724	2,790,734	3,161,497	3,140,493	3,146,257	3,047,412	2,987,398	2,935,865	2,954,594
Administrative services	1,793,454	1,877,546	1,947,842	1,991,269	2,024,002	2,075,008	2,140,786	2,214,429	2,234,713	2,247,793
GNP (including others)	19,700,704	20,676,718	21,716,623	21,809,329	22,356,265	22,732,700	23,297,736	23,983,025	24,924,345	25,935,070

indicates provisional values.

Composition Ratio — Unit: %

Year	1996	1997	1998	1999	2000	2001	2002	2003 (p)	2004 (p)	2005 (p)
Agriculture, forestry, stockbreeding, fisheries	15.2	15.2	13.8	14.1	14.2	14.5	14.2	15.0	14.5	14.6
Petroleum, natural gas	4.0	4.4	4.7	4.5	4.9	4.8	4.9	5.1	6.1	6.8
Metal, non-metal minerals	5.6	5.3	5.0	4.8	4.7	4.5	4.4	4.3	3.8	4.1
Manufacturing	17.1	16.7	16.3	16.7	16.5	16.7	16.3	16.5	16.8	16.6
Foods	5.8	5.6	5.5	5.8	6.1	6.4	6.1	6.2	6.2	6.1
Beverages, tobacco	2.2	2.2	2.3	2.2	2.1	2.1	2.1	2.2	2.3	2.4
Textiles, clothing, leather products	1.8	1.8	1.8	1.8	1.8	1.8	1.7	1.7	1.7	1.7
Timber and timber products	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Electricity, gas and water supply	2.0	2.0	2.0	2.1	2.1	2.0	2.0	2.0	2.0	2.0
Construction	3.5	3.5	4.5	3.8	3.5	3.2	3.6	2.7	2.7	2.6
Commerce	8.7	8.7	8.4	8.3	8.5	8.4	8.3	8.3	8.3	8.2
Transport, warehousing, telecommunications	10.2	10.6	10.8	10.7	10.7	10.8	11.0	11.1	11.1	11.0
Financial services, real estate, leasing	11.2	12.0	12.9	14.5	14.0	13.8	13.1	12.5	11.8	11.4
Administrative services	9.1	9.1	9.0	9.1	9.1	9.1	9.2	9.2	9.0	8.7
GNP (including others)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Growth Rate — Unit: %

Year	1996	1997	1998	1999	2000	2001	2002	2003 (p)	2004 (p)	2005 (p)
Agriculture, forestry, stockbreeding, fisheries	6.7	4.6	-4.4	2.5	3.5	3.5	0.4	8.6	0.5	5.1
Petroleum, natural gas	2.2	14.1	12.9	-4.3	11.6	0.0	4.7	7.8	24.2	15.1
Metal, non-metal minerals	-4.8	0.2	-0.5	-4.8	1.5	-3.1	0.1	0.7	-8.1	11.6
Manufacturing	4.9	2.0	2.5	2.9	1.8	2.7	0.3	4.0	5.6	3.2
Foods	6.0	2.3	2.5	5.2	8.1	7.2	-1.8	4.4	4.0	1.5
Beverages, tobacco	7.3	3.3	10.6	-3.3	-1.8	-0.4	2.1	7.7	10.7	8.2
Textiles, clothing, leather products	3.2	5.9	0.8	4.3	2.0	0.7	-2.4	2.0	3.1	2.8
Timber and timber products	1.9	5.9	1.1	5.9	5.5	3.3	0.6	2.2	3.1	2.7
Electricity, gas and water supply	3.4	4.7	2.5	4.7	1.8	0.7	2.2	3.1	2.8	2.6
Construction	9.0	5.0	35.7	-16.8	-4.2	-7.0	16.2	-23.1	1.8	1.4
Commerce	5.4	4.9	1.6	-0.2	3.9	0.6	2.2	2.7	4.1	2.9
Transport, warehousing, telecommunications	6.9	9.2	7.0	-0.8	2.3	3.0	4.3	4.0	4.1	3.2
Financial services, real estate, leasing	8.5	12.6	12.5	13.3	-0.7	0.2	-3.1	-2.0	-1.7	0.6
Administrative services	1.5	4.7	3.7	2.2	1.6	2.5	3.2	3.4	0.9	0.6
GNP (including others)	4.4	5.0	5.0	0.4	2.5	1.7	2.5	2.9	3.9	4.1

Source: Instituto Nacional de Estadística (INE)

9-1-3 Trade Structure

(1) Structure of Exports

Bolivia's exports were static at around US$1.2-1.3 billion during the 1990s, however, they have recorded rapid growth after 2003 due to expansion in the hydrocarbon sector. Export sectors are very different from the GDP breakdown described above: whereas the petroleum, natural gas and mining sector accounts for just 10% of GDP, it accounted for two-thirds of all exports in 2005. Following the opening of a natural gas pipeline with Brazil in 1999, exports of natural gas increased until this is not Bolivia's largest export item. Mineral resources based around as tin, silver and gold are steady exports, and demand from China has been growing rapidly in recent years. In line with expansion of the hydrocarbons sector, the share of non-traditional product

exports fell from 45% in 1996 to around 30% in 2005, although the value of these exports has demonstrated steady growth. In particular, soybeans (beans, bean cake and soy oil) are the second largest export item behind natural gas. Soybeans are mostly exported to CAN nations (especially, Venezuela, Columbia and Peru), and inflation in international prices has led to the growth of exports in each country's market. Other major export fields and export destinations are timber products, adornments, fruits, textiles, sugar and leather, etc., each accounting for between 1-3% of total export value.

Looking at export destinations, due to expansion in exports of natural gas, Brazil overtook the United States to become the top destination in 2001, and it accounted for one-third of total export value in 2004. Out of exports to Brazil, natural gas accounts for more than 80%, petroleum for 15% and minerals for almost all the remainder. Exports to the United States – the second largest export destination – are petroleum, gold, adornments and, thanks to the benefit of the Andean Trade Promotion and Drug Eradication Act (ATPDEA), textiles and clothing, etc.

Trade relations with CAN countries are becoming more important for Bolivia; in particular, Venezuela, Columbia and Peru are the most important export destinations behind Brazil and the United States. The ratio of exports to these countries was around 18% in the mid 1990s, however, it has increased to approximately 30% in recent years. Market access to these countries that is protected by intra-regional tariffs and external common tariffs has been particularly beneficial for the expansion of non-traditional product exports such as soybeans, raw cotton and sugar. However, if the free trade agreement that was signed between CAN and Mercosur in 2004 progresses in future, it is forecast that Bolivia will be exposed to competition with farm products from Brazil and Argentina.

Japan currently lies behind the above countries as an export destination, and it mainly imports zinc, silver, sesame and sugar from Bolivia.

(2) Composition of Imports

Imports in 2005 amounted to US$2.3 billion, recording growth for the second year running. Raw materials and intermediate goods account for 54% of all imports, while capital goods are 24%. In line with the increase in investment based on privatization and construction of the gas pipeline with Brazil in the latter part of the 1990s, imports of capital goods increased rapidly, however, these subsequently fell off rapidly due to economic recession and the opaque political situation. The recent increase in imports has been caused mainly by rapid growth in raw materials and intermediate goods; in particular, fuel, lubricants and industrial intermediate goods are growing a lot. Meanwhile, consumer goods account for around 20% of all imports, and this ratio hasn't changed much over the past 10 years.

In terms of import training partners, ties with the two Mercosur nations of Brazil and Argentina are strong, and imports from these two countries currently account for roughly half of all imports. Imports from Brazil are mainly machines, automobiles and iron and steel, while imports from Argentina are largely petroleum, chemical industrial products and machines. In the same way as with exports, the relative importance of the United States is declining, however, it is still the third biggest import partner with imports of mainly machines and electric instruments. The ratio of imports from the CAN region increased from around 8% in the mid 1990s to 13% in

2004. Imports from mainly Peru and Columbia are active, with iron and steel and plastic products coming from Peru and electric instruments and so on coming from Columbia.

Table 9-2 Composition of Bolivia's Exports

Value of Exports (FOB) Unit: US$ million

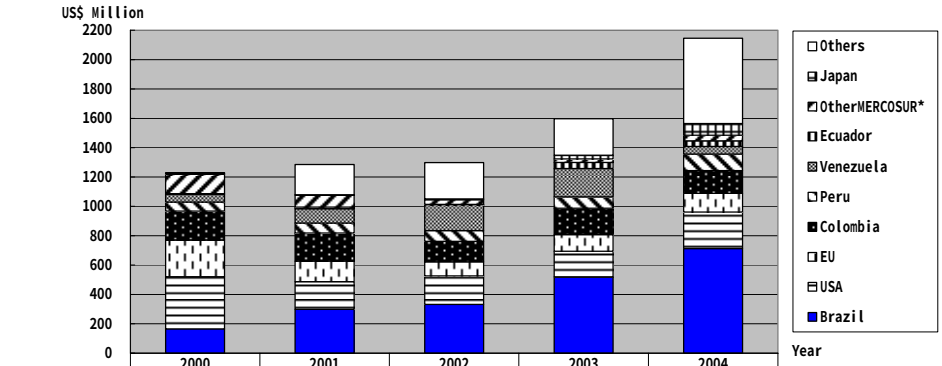
Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005(p)
Traditional products	619.3	606.6	531.8	472.1	603.7	643.6	693.3	874.6	1308.1	1886.2
Mining products	**478.0**	**499.6**	**435.2**	**397.0**	**424.9**	**340.0**	**346.9**	**369.3**	**457.2**	**544.3**
Tin	83.5	81.6	66.1	69.4	76.5	56.1	58.2	74.6	147.1	125.8
Zinc	151.7	200.0	158.2	154.3	170.6	118.9	112.1	124.2	151.7	200.1
Gold	119.6	110.5	112.7	89.1	88.0	92.2	89.7	72.1	34.3	78.7
Silver	64.0	59.3	73.1	68.1	74.0	53.9	68.5	75.9	91.2	92.4
Hydrocarbons	**141.3**	**107.0**	**96.7**	**75.1**	**178.8**	**303.6**	**346.4**	**505.3**	**850.9**	**1341.9**
Natural gas	94.5	69.9	55.5	35.5	121.4	239.3	266.2	389.6	619.7	983.9
Other	46.8	37.1	41.2	39.6	57.3	64.2	80.2	115.7	231.2	357.9
Non-traditional products	595.2	647.3	576.3	570.1	642.6	582.7	626.6	715.3	886.5	865.8
Soybeans	200.6	242.5	231.7	222.8	299.2	275.0	318.6	369.8	425.6	373.5
Castana	28.6	31.1	30.9	30.9	34.1	27.7	27.4	37.7	53.4	74.4
Timber	82.6	87.6	67.5	51.0	57.7	41.0	41.1	42.8	56.1	67.6
Adornments	39.8	20.0	3.4	15.4	31.8	28.0	41.5	41.5	44.5	49.3
Leather	12.2	14.8	11.3	12.4	22.8	23.0	24.5	21.8	23.6	21.7
Sugar	27.9	22.1	23.6	9.2	7.2	10.0	15.8	23.7	31.0	18.3
Re-exports	79.2	16.5	214.7	360.6	226.1	123.7	52.4	84.2	68.1	55.9
Total exports (including others)	1295.3	1272.1	1324.7	1405.4	1475.0	1352.9	1374.9	1676.6	2265.2	2810.4

Composition Ratio Unit: %

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005(p)
Traditional products	47.8	47.7	40.1	33.6	40.9	47.6	50.4	52.2	57.7	67.1
Mining products	**36.9**	**39.3**	**32.8**	**28.2**	**28.8**	**25.1**	**25.2**	**22.0**	**20.2**	**19.4**
Tin	6.4	6.4	5.0	4.9	5.2	4.1	4.2	4.5	6.5	4.5
Zinc	11.7	15.7	11.9	11.0	11.6	8.8	8.2	7.4	6.7	7.1
Gold	9.2	8.7	8.5	6.3	6.0	6.8	6.5	4.3	1.5	2.8
Silver	4.9	4.7	5.5	4.8	5.0	4.0	5.0	4.5	4.0	3.3
Hydrocarbons	**10.9**	**8.4**	**7.3**	**5.3**	**12.1**	**22.4**	**25.2**	**30.1**	**37.6**	**47.7**
Natural gas	7.3	5.5	4.2	2.5	8.2	17.7	19.4	23.2	27.4	35.0
Other	3.6	2.9	3.1	2.8	3.9	4.7	5.8	6.9	10.2	12.7
Non-traditional products	45.9	50.9	43.5	40.6	43.6	43.1	45.6	42.7	39.1	30.8
Soybeans	15.5	19.1	17.5	15.9	20.3	20.3	23.2	22.1	18.8	13.3
Castana	2.2	2.4	2.3	2.2	2.3	2.1	2.0	2.2	2.4	2.6
Timber	6.4	6.9	5.1	3.6	3.9	3.0	3.0	2.6	2.5	2.4
Adornments	3.1	1.6	0.3	1.1	2.2	2.1	3.0	2.5	2.0	1.8
Leather	0.9	1.2	0.9	0.9	1.5	1.7	1.8	1.3	1.0	0.8
Sugar	2.2	1.7	1.8	0.7	0.5	0.7	1.1	1.4	1.4	0.7
Re-exports	6.1	1.3	16.2	25.7	15.3	9.1	3.8	5.0	3.0	2.0
Total exports (including others)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: (p) indicates provisional values.

Source: Instituto Nacional de Estadística (INE)

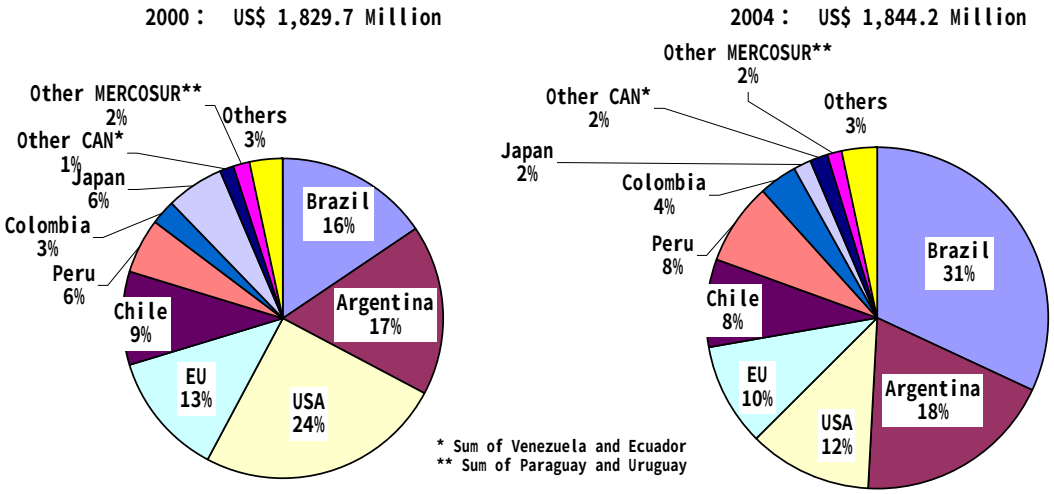


	2000	2001	2002	2003	2004
Others	6.2	205.3	247.6	250.0	581.7
Japan	3.5	2.8	5.9	23.8	80.3
OtherMERCOSUR*	132.7	81.6	31.6	24.3	37.8
Ecuador	6.0	10.2	3.1	40.9	37.8
Venezuela	51.7	98.2	175.0	194.5	52.1
Peru	61.4	67.5	73.9	76.6	112.2
Colombia	196.0	191.9	139.5	180.3	154.9
EU	251.7	139.7	96.4	113.4	127.4
USA	353.9	187.9	193.1	174.3	248.4
Brazil	166.5	299.6	332.7	519.8	713.5

*MERCOSUR countries excluding Brazil

Source: IMF, Direction of Trade Statistics Yearbook 2005

Figure 9-1 Main Export Destinations of Bolivia



Source: IMF, Direction of Trade Statistics Yearbook 2005

Figure 9-2 Main Import Sources of Bolivia

9-1-4 Acceptance of Direct Investment from Overseas

In response to the privatization policy and large-scale natural gas projects promoted in the 1990s, there was a major inrush of overseas investment to Bolivia at this time, and this exceeded US$1 billion in 1999. However, privatization investment reached a ceiling after that; the country was beset by economic and fiscal deterioration and social unrest such as anti-government demonstrations; and criticism that natural gas revenues were not contributing to poverty reduction led to calls for revision of the hydrocarbons law. Against this background and amidst fears of deterioration in the investment environment, direct investment rapidly decreased. Incoming investment in 2003 was approximately US$570 million.

In terms of sector, the natural gas and petroleum sector accounted for 44% of investment in 2003, and this was followed by the construction sector with 16%, manufacturing sector with 11%, and retailing and wholesaling sector with 10%. Investing countries in order are the United States, Argentina, Brazil, Spain and Italy[75].

[75] Order of total investment from 1997 to 2002 (source: UNCTAD, World Investment Directory)

9-2 Industrial Promotion Policies and Systems

9-2-1 Current Industrial Policy and its Background

(1) Political Background

The IMF-led structural adjustment policy (1993-1997) and economic liberalization policy of the 1990s had an macro effect on economic growth in Bolivia. However, because these policies did not lead to any growth in the economic sector formed by low-income classes, and due to disillusionment with political corruption and the traditional political elite, social unrest peaked following the economic crisis that started in 1999.

Following the administration of Hugo Saurez, Gonzalo Lozada narrowly won the race to become president by holding off the MSM, however, due to public criticism of preferential measures for foreign petroleum companies, opposition from the MSM in the national diet, rioting on the streets and an anti-government movement, he was forced to resign in October 2003. Vice President Mesa was appointed as the new president, however, when the hydrocarbons law that was approved in the national diet in May 2005 met with the dissatisfaction of citizens and energy corporations, violent strikes and demonstrations broke out and he too was forced to resign in June the same year. After that, Mr. Rodriguez, Director of the Supreme Court, managed a provisional government (election management) and, in the presidential election that was held in December 2005, Evo Morales, the leftwing representative of the MSM and a man of native descent, won by a landslide and was elected the new president.

(2) Political Flow and Basic Policies of the New Administration

As can be gathered from above, politics in Bolivia is dominated by populism set against a background of criticism for IMF-led structural adjustment and trade liberalization (neo liberalism), and the political influence of people in poverty and native peoples, who make up the majority of the population, constitutes a powerful force.

The Morales administration has only just announced its policies and the details are unclear, however, its policy on industrial development is surveyed here based on the Bolivia State Development Plan that was announced in the government explanation meeting in May and the MAS Government Plan 2002-2010 that was compiled in the runup to the election last year. The political stance of the new administration is based on, (i) harsh criticism of neo liberalism, structural adjustment and international agencies, and (ii) active government involvement in national economic development, and it is aiming to reduce poverty through bolstering the participation of poor people in economic activities while reflecting the opinions of the majority of the people. The ideals contained in the national development plan are as follows:

- Realization of “quality lifestyle” as the central theme of the national development plan
- For this goal, breakaway from colonial rule and neo liberalism
- Integration of formation of communal spirit crossing over racial differences

The three pillars of the national development plan are as follows:

- Production development and creation of employment
- Stabilization of macro economy and public finance
- Funding of programs

Moreover, the following four strategies are included in the national development plan:

- State strategy for Bolivian productivity
- Strategy for respect of the Bolivian state
- Bolivia sovereign nation strategy
- Bolivia democratic state strategy

(3) Important Points of the Industrial Vision as seen in the 2004 National Dialogue

Bolivia conducts "national dialogue" in order to ascertain the will of the people. This dialog was started in 1997 and was mostly recently held in 2004, when approximately 70,000 people took part in municipalities throughout the country. The dialog in 2004 was conducted with the goal of "forming a national vision." As a result, with the emphasis placed on production development, the objective is to form a comprehensive production strategy (EPI) in order to overcome defects in the poverty reduction strategy (EBRP). Moreover, although the collated results concerning priority industrial sectors show some regional bias and have not been fully narrowed down, the priority sectors in order are given as (i) agriculture (41%), (ii) stockbreeding (19%), (iii) tourism (14%), (iv) manufacturing (12%), (v) forestry (5%) and (vi) fisheries (3%), etc. In regional terms, emphasis is placed on agriculture in valley areas, while primary product processing industry is viewed as important in lowland areas. As for priority markets, 1,075 respondents said the domestic market was the most important, while 45 pointed to export markets and 568 pointed to both domestic and foreign markets, thereby indicating that the majority of people are oriented towards the domestic market. To sum up, it is thought that the industrial policy of the new government will be compiled based on the national dialog and the political keynote of the administration.

(4) Guidelines of Industrial Policy as seen in the National Development Plan

The first pillar of the national development plan, i.e. production development and creation of employment, proposes to realize improvement in the quality of citizen lifestyles through increasing the productivity of micro, small and medium enterprises, which dominate the corporate world, using revenues from hydrocarbon resources, mineral resources and electric power consumption as state finances. In other words, it is intended to attain equal social development comprising the fair spread of benefits from public goods and services, enhancement of social security and equality of education opportunities through lifting up the overall level of society in an environment of public participation in production activities and social fairness.

Moreover, in the first of the four strategies, i.e. the state strategy for Bolivian productivity, stable growth of the macro economy is required in order to realize quality lifestyles, and technical innovation, equality and environmental conservation are considered to be the keys to this. Moreover, as targets for attainment by 2010, improvement in the quality of employment (education and training), increase in household incomes (promotion of business starts, creation of employment opportunities, improvement of productivity, etc.), reduction of inequality (support for disadvantaged people), and a food sovereignty plan (food security and independence) are raised. In addition, the following are raised as strategies related to industry:

- Promotion of the state ownership of resources and establishment of a development

inducement bank and technology bank

- Using resources to fund economic development
- Promoting industry, tourism, agriculture, house construction, transport, finance and services as sources for promoting employment and increasing income
- Promoting development of telecommunications, roads, railways, electric power, waterworks and gas as industrial and social infrastructure
- Developing irrigation, science and technology, flora and fauna conservation and information telecommunications are production services

9-2-2 Current Framework of Measures and Issues

(1) Financial System

The bank system of Bolivia was historically incomplete and suffered from inadequate supervision. The government embarked on improving the banking sector in 1993 and, after the financial system was placed under the control of the council on financial regulations (Confip) in 1998, a new mutual fund system, non-government micro finance agency and legislation concerning savings and loan associations, etc. were established in order to improve access to finance in rural areas. Moreover, the Financial Supervision Agency came to supervise financial services targeting nine domestic banks, three foreign banks and 45 non-banks (as a result of bank reform, the number of domestic banks was reduced from 14 to nine). The Spanish bank Banco Santander Central Hispano gained the majority of shares in the largest bank in the country – Banco Santa Cruz – in 1997. The three foreign-affiliated banks have branch offices in the country's major cities and mainly conduct corporate lending.

(2) Education and Training

There has been a decline in illiteracy in rural areas in recent years, however, illiteracy is still high among women in these areas. According to a survey in 2001, school attendance rates were improved following education reforms that stated in 1996, and the attendance rate among children aged 6-14 is 91.4%. However, in rural areas, the school attendance rate drops to 86.3% and many children continue to work in order to support the household economy. Moreover, the average schooling time of children in rural areas is 4.2 years (2001), which is higher than 3.5 years in 1998, although lower than 9.4 years in urban areas.

(3) Infrastructure Development

1) Transport Infrastructure

Roads and Ports

The transport infrastructure of Bolivia is generally fragile. In lowlands, flooding regularly occurs, while in mountain areas, landslides and other disasters often impede the physical distribution of agricultural products, etc. Accordingly, physical distribution costs are high and competitiveness is hindered. The ocean ports that Peru is currently able to use are, on the Pacific Ocean side, Antofagasta in Chile, where it has priority rights of use, and Ilo and Matarani Ports in Peru, and on the Atlantic Ocean side, Buenos Aires Port in Argentina, which has been growing in importance as a cereals exporting port in recent years. Concerning access to these

ports, there are land routes to the Pacific Coast, and river routes to the Atlantic side from Puerto Suare Port.

The combined extension of roads in Bolivia is approximately 70,000 km, and there are three arterial highways. Paved roads are only found in and around major cities and the paved ratio is 33% (2005). Two new national highways are currently under construction, i.e. the route between Santa Cruz and Puerto Suare on the border with Brazil, and the northern route between La Paz and Guajara Mirim, also on the border with Brazil, over the Andes. These roads are scheduled for completion in 2010.

Railways

There are two main rail routes: the eastern lowlands network is connected to railways in Brazil and Argentina, while the western highlands network is linked to railways in Chile. The government is aiming to restore rail routes that were previously discontinued, however, there are doubts about profitability and highway construction appears to be a better alternative.

Air Transport

Due to the unsuitability of topographical conditions for infrastructure construction, airlines are an important means of transport. Regarding domestic services, LAB connects the main cities with air routes. The country's international airports are in La Paz, Santa Cruz and Cochabamba, however, since La Paz Airport is unable to handle flights by large aircraft, Santa Cruz is becoming more important as an international hub.

2) Telecommunications Infrastructure

Ever since a new law was promulgated in 1995 and the state telecommunications company Entel was privatized (purchased by Stet Co. of Italy, now named Telecom Italia), the telecommunications sector has been growing. In return for investment of US$610 million, Entel was granted exclusive rights to the long-distance telephone and international telephone services for six years as part of the privatization deal. Moreover, whereas regional industrial associations conventionally operated telephone services in main domestic cities, exclusive rights similar to Entel were recognized in rural areas and cities until November 2001. After this, the market was opened to free competition, and six long-distance telephone and international telephone companies entered the market to compete against the 16 existing regional telephone service associations utilizing the Entel facilities. In response to this, AXS Co. (a partner with the American energy company AEX), is competing with Entel using its own telephone network. In 2003, in the first year following liberalization of the sector, Entel had an 81.5% share of the market. Ever since privatization in 1996, the telecommunications and telephone sector has displayed steady improvement and, with the addition of technical progress, there has been an increase in mobile phones, greater use of the Internet and e-mails and improvement in prices. The number of Internet users as of 2003 is 327,000. However, the PC dissemination rate in Bolivia is the lowest among Latin American countries at 2% (the regional average is 3.6%). The number of TV stations is increasing and there are now 42 private stations (2005), however, radio is still the main form of media in the poor rural areas, and there are 825 registered radio stations. There are seven domestic newspapers.

(4) Research and Development

Because details on the new administration's industrial policy are unclear, the details on research and development policy are unknown, however, it is likely that research and development will revolve around the national strongpoint of natural resources. In particular, research and development are required with respect to the development of new products and new export commodities related to agricultural resources and petroleum and gas resources.

(5) Export Promotion

In order to realize the new government's target of sustainable economic growth of 6-7% in Bolivia, which has a population of 9,500,000 and poverty rate of 67.3% 2003), it will take more than just the domestic products purchasing plan (Compro boliviano), It will be difficult to promote economic development unless a concerted effort is made to promote exports of petroleum, gas, nonferrous metal resources, agricultural products, and processed agricultural products, which can be easily merchandized as international commodities. The new administration's policy includes a strategy of giving priority to satisfying domestic demand first, however, as well as developing infrastructure to satisfy domestic demand, it will be necessary to promote export promotion too. In other words, it will be necessary to forcefully promote LNG export plans to the United States and Mexico and gas exports to Brazil and Argentina via international pipelines.

(6) Energy Development

The energy sector (petroleum, natural gas and electric power generation) of Bolivia is the central pillar of the country's economy and is the most important issue in economic policy. In particular, for the Morales administration, the nationalization of natural gas is indispensable for social and economic development, and revenue from this will be the most important source of finance for funding national development.

Natural gas reserves in Bolivia amount to 48.7 trillion feet – more than five times the amount needed to sustain current domestic demand and exports for 20 years – and there is possibility that even more reserves will be found in future. The previous government promoted the supply of natural gas to neighboring countries and distant markets based on the comprehensive gas plan, however, due to opposition to exports ahead of domestic supply by extreme groups calling for gas to be first directed to domestic needs, LNG plans targeting North America and Mexico were suspended in 2003, and work on construction of a gas pipeline to Argentina in the north was called off. However, the supply of natural gas to Argentina, which had continued for 27 years prior to that, was provisionally resumed in 2004. Even so, the new government's gas policy has still not been revealed in detail, and attention will be directed on the contents of this (city gas, automobile CNG, petrochemical industry based on gas and so on).

9-2-3 Policy Systems and Administration Required of the Government

- Concerning industrial policies focusing on the poverty classes, it is likely that relief measures will be provided for low-level micro and small enterprises, and it is possible that this could be an inefficient promotion policy in terms of driving economic

development. In reality, many medium and large corporations have concerns about this biased industrial policy of the government, and it may be necessary to rethink policies that neglect modern corporations, which should play the central role in economic development when viewed from the conventional macro economic standpoint.

- The new Bolivian government has proclaimed the nationalization of natural gas resources, however, the government itself is seeking understanding for this extreme measure from overseas corporations. If such extremist measures are allowed to become the norm, overseas corporations will no longer want to put direct investment into Bolivia and the government will be exposed to international criticism. Certainly, natural gas is a precious resource that holds the key to the future of the Bolivian economy, and revenues from the exploitation of this should be first directed towards the further development of natural gas in a show of desire by the government to build national wealth.

9-2-4 Relationship between Trade and Industrial Promotion

(1) Regional Collaboration

Since Bolivia is a landlocked country, intra-regional collaboration with countries that can promote overseas investment and commerce is an increasingly important aspect of economic relations. Bolivia is a full member of CAN and an associate member of Mercosur. Moreover, its geographical situation dictates that it have strong economic relations with surrounding Brazil, Argentina, Peru, Chile and Paraguay especially. From the 1990s onwards, intra-regional trade with surrounding countries and direct overseas investment increased and relations with surrounding countries became more important. In particular, following the discovery of a major natural gas field in 1997, ties with the neighboring major natural gas markets of Brazil and Argentina became even more important. However, LNG projects with the United States and Mexico became burdened with long transportation distances and high costs because of national resentment against the Chilean route, and Bolivia ended up using the northern route through Peru, which is a competitor in the field of gas exports.

(2) Bilateral Relations and Trade

Chile

Bolivia lost its access to the Pacific Ocean following its defeat in the Pacific war from 1879-1883. Based on an agreement, Bolivia has priority utilization rights at Antofagasta Port and Arica Port in Chile (as well as Ilo and Matarani Ports in Peru) as access to the Pacific seaboard, however, the fact that it has no ocean ports of its own means that it must pay higher costs. From the 1970s onwards, Bolivia has been calling on Chile to enter renewed negotiations on the territorial treaty that was signed in 1906 and defines the borders of both countries. However, in spite of expressions of support for this by surrounding countries, Chile is steadfastly refusing to comply. Relations between the two countries are delicate and complicated and have become more intransigent in recent years, however, the Chilean president attended the inauguration ceremony of the Bolivian president and is striving to repair diplomatic relations, which had been shelved since 1978.

United States

Diplomatic relations with the United States remain the most important issue of foreign affairs policy even if trade relations have slowed down. Moreover, the United States is Bolivia's largest trade partner and biggest investing country. Central themes in diplomacy between the two countries are reduction of coca production, distribution of narcotics, military aid and development aid. The new ruling party (MAS) that came to power in January 2006 is opposed to reducing cultivation of coca, and this is set to become a thorny issue with the American government from now on.

9-2-5 Main Industries and Policies

(1) Agriculture

Bolivian agriculture is still dominated by subsistence farming. In particular, the majority of farmers in highland areas and the central valleys are poor peasant farmers, who account for 60% of all farmers in the country.

Lack of investment, lack of technology, lack of transportation infrastructure and poor irrigation facilities, etc have brought about this situation. The agriculture sector lies at the heart of poverty reduction, which the new government has raised as its central political agenda. In recent years, Brazilian and Argentinean investment in cultivation of commercial crops has increased in Santa Cruz Province in the east, and soybeans, sugar cane and oil crops (maize and sunflowers), etc. are being produced and exported to CAN countries. These exports benefit from the fact that Mercosur exports to CAN countries are exempt from tariffs.

The mountain farmers of Bolivia have traditionally cultivated coca as a luxury grocery and pharmaceutical that fetches a high market price, has high growth and is easy to transport. Because production rapidly increased mainly in the Chapel Valley area from the 1970s to the start of the 1980s, restrictions were enforced except for certain legalized areas, however, these were not effective. As a result of pressure from the United States, the cultivated area of coca was reduced from 48,600 ha in 1995 to 19,900 ha in 2001, however, it rebounded again to 27,000 ha in 2004. The government offers guidance encouraging farmers to switch to other crops, but to little avail, so the Mesa administration implemented a subsidization scheme for other crops and also compiled the New 5-Year Drug Strategy under support from the United States, EU and United Nations, etc. The new government appears to be aiming to revise the coca cultivation law (that imposes harsh penalties on coca growers and dealers) of 1998 to a law that only controls the manufacture of cocaine.

(2) Energy Industry

Hydrocarbon Industry Development Policy

In March 2005, re-nationalization of the hydrocarbon industry was proposed, and in May the same year, the new hydrocarbons law and hydrocarbons industry development policy were presented for deliberation in the national diet. The new law basically entails the large-scale increase in taxation on petroleum companies, imposing an additional flat rate tax of 32% on production from all existing petroleum corporations. Foreign-affiliated corporations have launched protests against the government, however, the taxes are now being collected.

Meanwhile, there are groups in Bolivia that seek the full nationalization of the said industry, and the policy of the new administration is attracting attention. The Morales government maintains that full nationalization is inappropriate, but has clarified that the government holds the authority to determine petroleum and gas sale prices (domestic sales and long-term export contracts).

Petroleum Production and Petroleum Industries

The hydrocarbons industry was nationalized and the state petroleum corporation YPFB was established in 1953. However, due to national fiscal difficulties, additional investment to the industry ceased during the 1990s, and the new hydrocarbons law passed the national diet in 1996, resulting in part of YPFB stocks being sold to the private sector. After that, overseas investment in the petroleum and gas sector increased rapidly until 2002, however, because of the unpopularity of natural gas exports among citizens, the prospects for exports became shrouded in uncertainty and foreign investment dropped off dramatically in 2003-2004.

As of the end of 2005, Bolivia has estimated petroleum reserves of 856 million barrels, and all produced petroleum is consumed domestically except for a minor portion used for adjustment between exports and kerosene imports. However, because it is likely that more condensate will be produced in line with the development of natural gas from now on, surplus crude oil will be made available for export. Ever since YPFB was privatized, it has conducted auctions of development zones, however, because of the difficulty of developing a new market for petroleum gas, investors are losing their willingness to invest in petroleum development.

Natural Gas

The new government's declaration that it wants to nationalize the country's natural gas resources has caused a stir inside and outside the country, however, the government is seeking understanding that this policy is essential for the socioeconomic development of the country. Bolivia's reserves of natural gas stand at 48.7 trillion feet as of 2005, and there is a strong possibility that these will increase more in the future. However, the domestic demand for natural gas is very low and, export market development has been slow and the social environment surrounding petroleum and gas development is opaque. The Rio Grande – Campinas gas pipeline to Brazil (US$2 billion, 30 million m3 per day) was completed in 1999, however, the demand for Bolivian natural gas in Brazil has subsequently dropped off due to gas subsidization problems, delays in power plant construction, currency depreciation and new gas production in Brazil and high transportation costs. According to the contract signed between the countries, the minimum purchase amount is 24,000,000 m3 per day, however, the average purchase amount up to 2005 was 22,100,000 per day. Meanwhile, gas supply to Argentina has remained steady at 7,700,000 m3 per day on average through existing pipelines, however, plans for a new pipeline have been suspended (similar to the LNG plans for the United States and Mexico) due to opposition at home.

Bearing in mind the above points, in order to achieve the policy goal of using revenues from nationalized natural gas production as funding for national development, the government needs to overcome the dilemma of delaying export revenue as a result of giving priority to limited domestic demand.

(3) Mining

Metal mining and smelting have historically been pillars of the Bolivian economy. However,

depreciation in the price of tin in the mid 1980s later spread to zinc, silver, lead and antimony too and triggered the closure of mines and contraction of investment. The Bolivian metal corporation (Comibol – a national holding company) shifted its surviving facilities to private corporations, associations and community enterprises, thereby promoting joint venture operations with the private sector and reducing its presence. Comibol commenced gold mine development in the mid 1990s, however, due to lack of funds and falling international prices, it downscaled its plans. The privatization of Vinto (a tin and antimony smelting corporation) in 1999 marked the end of the era of nationalized mining, which had started with the nationalization programs of the 1950s. any employees of state-owned mining corporations found employment in small-scale mining by low-productivity mining associations, and production fell to around one-third.

(4) Manufacturing

The manufacturing sector in Bolivia is underdeveloped and is dominated by semi-processed products for export such as processed soybeans and smelted metals, etc. and products intended for the domestic market. Development of manufacturing is hindered by fragile infrastructure, high interest rates on loans and competition with black market products, etc. Consumer products such as foods, beverages, tobacco, detergent, textiles, leather products and shoes, etc. account for half of manufacturing activities, while traditional handicrafts, jewelry, processed soybeans, smelted metals, timber products and refined petroleum products, etc. account for the other half. Bolivia has opportunities to exports such products to CAN member countries and the countries of Mercosur, of which it is an associate member. However, since the United States is unwilling to renew ATPDEA at the end of this year, Bolivia will lose the advantages that this guaranteed for textile exports to that country.

(5) Tourism

Bolivia has tourism resources such as ancient ruins, cities from the age of colonial rule, highland trekking and natural wildlife parks, etc. However, due to inaccessibility of the country, poor infrastructure, a dearth of international standard hotels and competition from surrounding countries, the tourism industry is not performing well. Moreover, closures of arterial roads and airports as a result of frequent demonstrations after 2000 have further exasperated this situation. Revenue from tourism displayed steady growth from the 1990s onwards and reached a peak of US$180 million in 1999, however, it has been in decline ever since. The number of overseas tourists visiting the country in 2004 was 406,000.

9-2-6 Micro, Small and Medium Enterprises and Policies

As is the case in other CAN countries, medium-size corporations only account for a very small ratio of the corporate structure in Bolivia. In other words, small and medium enterprises that are in the process of evolving from small enterprises to major corporations (as seen in Japan) are few and far between. Almost all micro and small enterprises belong to traditional sectors supplying goods and services to local markets, whereas innovative corporations (venture corporations) that have the potential to grow hardly exist at all. In other words, the large majority of micro enterprises comprise cottage industries and part-time businesses linked to the poverty

classes. When classified in terms of large corporations, small and medium enterprises, and micro enterprises, the GDP share and employment share of each are as shown below. The large number of people employed by micro enterprises indicates that problems of micro enterprises are more of a social issue than an economic one.

Table 9-3 GDP Share and Employees of Corporations

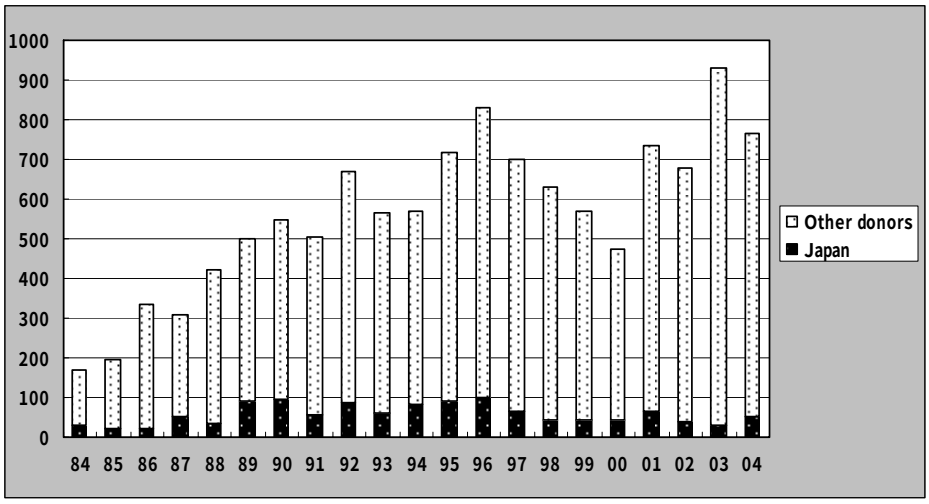
Scale	GDP Share (%)	Employees (%)
Large corporations	65%	7%
Small and medium enterprises	10%	10%
Micro enterprises	25%	83%

The new government, regarding micro and small enterprises that account for the majority of corporations as the most direct and effective targets for support in poverty reduction, is aiming to implement measures for promoting the productivity of these organizations. Similar thinking can be seen in other CAN countries, however, because such enterprises only target traditional and limited markets, unless drastic reforms to direct corporate efforts outwards are implemented, it is forecast that this policy will have little prospect of success.

9-3 Aid Trends

9-3-1 Overall Trend

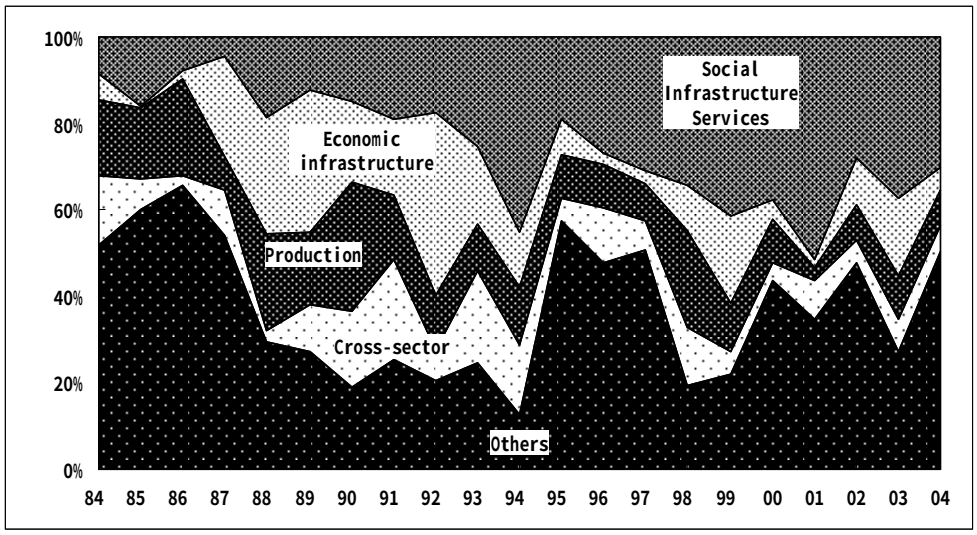
Bilateral aid and multilateral aid to Bolivia were more than US$100 million in 1984, however, this gradually increased to approximately US$800 million in 1996. The amount dropped off slightly from 1996 to 2000, however, in recent years it has varied between US$700-900 million. Since Bolivia is the least developed country in South America and was targeted under the Heavily Indebted Poor Countries (HIPC) initiative of 1997 and the Expanded HIPC initiative of 2001, donor nations regard it as a priority country for aid, and it is the largest recipient of ODA out of 10 countries in South America. The largest bilateral aid donors to Bolivia are, in order, the United States (US$137 million), Germany (US$75 million), and Spain (US$54 million). Japan is the fourth largest donor together with the United Kingdom at US$50 million. In terms of multilateral aid, the World Bank IDA (US$117 million) is the largest donor followed by the IDB (US$82 million), while no other donors provide more than US$3 million.



Source: Prepared from DAC International Development Statistics (IDS), Net disbursement

Figure 9-3 Past Aid to Bolivia (US$ million)

Looking at sector-separate trends of aid over the past 20 years, a certain level of aid was provided to the transport and storage sector and other areas of economic infrastructure until 1992, however, after that aid was greatly shifted to the social infrastructure services sector and debt relief in response to the country's fiscal deficit. Moreover, following compilation of the PRSP in 2001, the ratio of aid going to basic education, water supply and public sanitation within the social infrastructure services sector has increased a lot. Aid in the production sector is largely directed towards agriculture, while aid for cross-sectoral issues is largely directed towards environmental conservation. Even so, aid going to these areas accounts for less than 10% of the total aid amount.



Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 9-4 Past Aid by Sector in Bolivia (1984-2004)

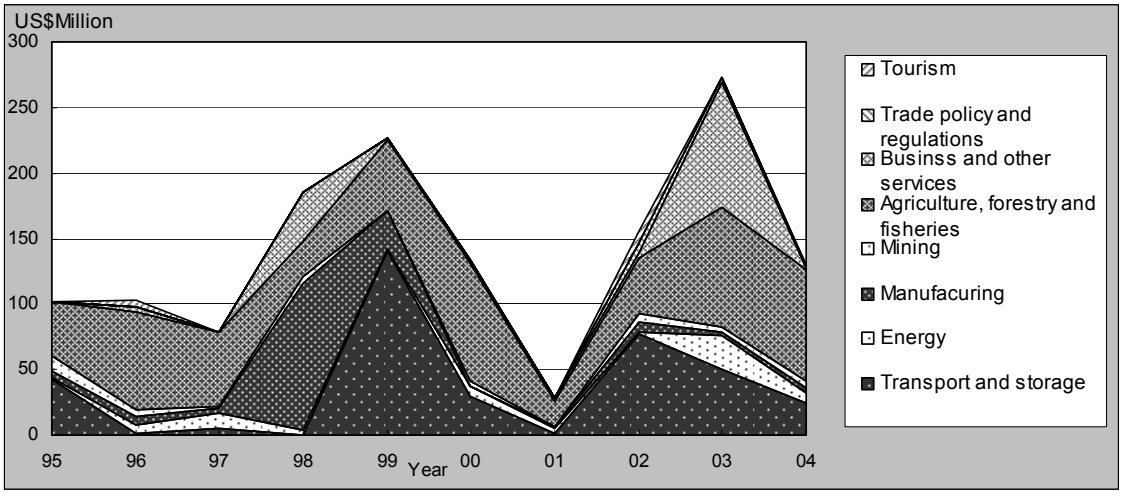
Furthermore, in the economic development field[76], aid is mostly directed towards agriculture, forestry and fisheries, and the average amount of aid to this field over the past 10 years has been approximately US$142 million. Until now, donors had not conducted so much support with respect to the economic development field, however, based on the national dialog of 2004, following the setting of development (priority) business sectors in a maximum of six sectors in each municipality as well as the establishment of prefectural development funds according to these priority sectors, the importance of economic development has been confirmed and donors are now considering making major increases to their aid in this field.

	95	96	97	98	99	00	01	02	03	04
Economic development (US$ Million)	102.2	102.7	79.1	185.1	226.5	133.8	28.4	156.3	273.2	130.5

Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS),

Figure 9-5 Past Aid by Sector for the Economic Development Field in Bolivia (1995-2004, US$ million)

[76] Summated assuming the economic development sectors of: transport and storage, energy, manufacturing, mining, agriculture, forestry, fisheries, business and other services, trade policy and regulations, and tourism



Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 9-6 Past Aid for the Economic Development Field in Bolivia (1995-2004, US$ million)

9-3-2 Projects in the Economic Development Field (Japan and Major Donors)

(1) Japan

Japan regards (i) social development, (ii) support for increased production and (iii) institutions and governance as the priorities of its support to Bolivia. Concerning (ii) support for increased production, improvement of agricultural productivity and promotion of socioeconomic activities through road network construction were the main activities before, however, following the national dialog of 2004, instead of specializing only on increase of productivity in the agricultural sector, JICA has switched to policy of local economic vitalization via comprehensive production chain and regional development including transfer of technology in Japanese business techniques. Specifically speaking, JICA aims to realize local vitalization via development of production chains through implementing pilot area economic development, pilot production chain development, transfer and dissemination of Japanese-style business improvement and diagnosis techniques, and strengthening of occupational training. Moreover, based on the idea that road network construction forms the foundation for local economic activities, it plans to continue implementing cooperation including support for the development of road administration capacity.

JBIC has so far released Bolivia from 53 billion 379 million yen of debts. Since Bolivia is a heavily indebted nation, there is little prospect of its receiving financial cooperation in the immediate future.

Major Japanese projects implemented in the economic development field since 1995

[Development studies[77]] Potosi Mining Sector Environmental Pollution Assessment Study, Study

[77] Concerning development studies, major projects in the economic development field implemented between 1995 and 2004

for the Regional Electrification Project Utilizing Renewable Energy, Santa Cruz Province Agricultural Logistics System Improvement Project, Oruro-Cachabamba Railway Improvement Project, La Paz Province Achacachi Agricultural Development Project, Study for the Regional Electrification Project Utilizing Renewable Energy, Oruro-Uyuni Regional Resources Development Study, Yani-Perecheco Regional Resources Development Study, Basic Study for Mining Project Formation (Study for the Regional Electrification Project Utilizing Renewable Energy) (Regional Electrification Project/Micro Hydropower)
[Grant Aid] Santa Cruz Province Northern Bridge Construction Project, El Alto International Airport Modernization Project, Santa Cruz Northwestern Regional Road Construction Project, Japan-Bolivia Friendship Bridge Repair Project
[Technical Cooperation Projects] Table Beef Improvement Project, Potosi Mine Environmental Conservation Research Center, Technical Dissemination and Improvement Project for Small-scale Livestock Farmers

(2) Major Donors

The following paragraphs describe the trends of aid by major donors in the economic development field, and summarize the points that require particular attention when considering support in this sector.

USAID [78] The priority sectors until 2003 were (i) economic development, (ii) employment promotion and (iii) poverty reduction; moreover, the targets of aid were limited to rural areas. However, in line with migration from the countryside to the cities, ever since USAID has given priority to employment problems in cities and the concept of "production chains" in its economic development support, it has ceased to distinguish aid between rural areas and cities. In its Bolivian strategy for 2005-2009, USAID has raised the following as priority areas: (i) income improvement of people in poverty, (ii) improvement in living quality through health promotion, (iii) protection of natural resources aimed at sustainable economic development, (iv) eradication of illegal coca, (v) economic stability, and (vi) democratization. Concerning (i) income improvement of people in poverty, support is being provided in the four priority areas of, a. micro finance, b. agricultural development support (enhancement of agricultural technology and access to markets), c. strengthening of trade and competitiveness, and d. improvement in sustainable economy of areas facing food shortages. Moreover, since Bolivia can export to the United States without any tariffs under the Andean Trade Promotion and Drug Eradication Act (ATPDEA)[79], albeit for a limited period only, concerning b. agricultural development support, direct support is provided to private sector corporations through linking buyers in the United States with producers in Bolivia.

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[78] USAID/Bolivia Country Strategic Plan, 205-2009, February 22, 2005, and results of local hearings
[79] Legislation provided on condition that coca cultivation is eradicated. This will expire at the end of this year and is not scheduled to be renewed.

Important points to consider

- USAID sometimes dispatched American consultants as the need dictates, however, it basically utilizes local consultants. Bolivian local consultants are very capable.
- In the area of agricultural development support, recipient farmers were made to bear 15% of the support cost. This is also important from the viewpoint of encouraging farmers' autonomy. Moreover, since it takes time for support to produce results in this sector, rather than emphasizing direct support to farm households, pinpoint support is provided by tracing back to market needs based on giving emphasis to the production chain.
- USAID previously limited support to rural areas, however, following migration to the cities and the emergence of urban unemployment, it is no longer important to distinguish between the countryside and cities.

KfW[80] In the five-year plan from 2001 to 2006, support is provided to the three priority sectors of (i) water hygiene, (ii) agricultural development and (iii) decentralization and democratization. KfW aid to Bolivia is approximately US$40,000,000 per year, of which US$10,000,000 is directed to aid in the economic development field. In the economic development field, KfW has provided micro finance support to micro enterprises for 15-20 years with NAFIBO as its counterpart. Regional priority areas are Chaco and north Potosi (the areas with the greatest poverty and highest ratio of native peoples), and it provides funding and technical cooperation to the local governments in these areas. For example, in the School Breakfast Project, schools provide breakfasts to children using local foodstuffs in an effort to raise school attendance rates, advertise local farm produce and boost productivity.

Important points to consider

- In consideration of the unstable political situation and sustainable development potential of support projects, KfW plans on conducting aid in the economic development field with local governments (rather than central government ministries and agencies) as the counterparts.

AECI[81] Priority sectors are, (i) social and institutional capacity building, (ii) enhancement of human capacity, (iii) improvement of economic capacity, (iv) enhancement of environmental conservation capability, (v) freedom and improvement of capacity in the area of culture, (vi) women's independence and empowerment, and (vii) prevention of disputes and building of peace. Under (iii) improvement of economic capacity, the following is carried out: a. in line with direct support for strengthening the competitiveness of micro enterprises, financial support via micro finance, and support for corporate management in order to link micro enterprises with internal and external markets from the viewpoint of production chains, b. support for economic infrastructure, c. support for institutional reforms of employment, etc. related to economic development, and d. support for improvement of the investment environment.

[80] Documento estrategico de aspectos centrals, Cooperacion Alemana al Desarrollo 2003 and results of local hearings
[81] Documento de Estrategia Pais 2005-2008, Cooperacion Espanola and results of local hearings

EU[82] In the country-based strategy for 2002-2006, priority is placed on the three points of (i) improvement of access to drainage and pure water, (ii) economic growth (nurturing of industries to replace coca cultivation), and (iii) regional integration (road development on the scale of US$80,000,000 per year). Under (ii) economic growth, in addition to supporting the promotion of EU and Bolivian trade and investment, support is provided for the establishment of regulations and legislation and organizational capacity building based on the WTO framework. Under (iii) regional integration, a road construction project linking Brazil Bolivia and Chile is being implemented. Moreover, in addition to bilateral aid, the EU provides multilateral aid to CAN. Specifically, this aid targets customs clearance systems, strengthening of competitiveness, statistics and trade promotion, etc.

Important points to consider

- Impediments to the implementation of aid in Bolivia are political and social instability, weakness of administrative organizations, low education levels, and the shortage of skilled human resources. When providing aid, it is necessary to build programs that take these impediments into account.

World Bank[83] Priority areas are (i) macro economic stability, (ii) correction of disparities through provision of social infrastructure (education and public sanitation) to poverty classes, and (iii) prevention of corruption and administrative strengthening (institutional reform). Looking at past loan aid, 40% has been directed to the transport sector, 18% to public health and nutrition, 17% to public sector management, 15% to the agricultural sector, and 10% to private sector development. Concerning economic development support currently under implementation, a project (Decentralized Infrastructure for Rural Transformation, Bolivia) aimed at decentralization for improvement of local infrastructure services is underway. Moreover, a fund has been established with the agriculture ministry as counterpart, and this provides grants of around US$1,000 to micro, small and medium enterprises with a view to boosting the competitiveness of enterprises.

Important points to consider

- The World Bank conducted support for civil society in the past, however, the benefits of this failed to reach citizens. Based on the lessons learned from this experience, the World Bank shifted aid for domestic problems to employment and social security and, considering that the national administration has changed five times in just a few years, it has changed its priority to private sector development.
- Care is required concerning the excessive expectations of the Bolivian government. The local side needs to realize that time is required in order for the results of aid to emerge.
- It is important to utilize NGOs and implement aid that centers on the beneficiaries.

[82] Bolivia Country Strategy Paper, EU, 2002 and results of local hearings
[83] Country Assistance Strategy for the Republic of Bolivia, January 8, 2004

Table 9-4　Priority Aid Sectors of Donors in Bolivia and Features of Aid in the Economic Development Field

Agency	Priority Sector	Aid Priorities in the Economic Development Field	Projects and Programs in the Economic Development Field
JICA	①Social development ②**Support for increased production** ③Institutions and governance	• Production chain and regional development • Transport network development	• Pilot area economic development（support for agriculture and stockbreeding technology center, rice seed dissemination, coffee cultivation support, etc.) • Pilot production chain development (technial guidance on production chain development and small and medium enterprise diagnosis through PRSP support and small and medium enterprise support promotion by planning coordinators, etc. • Transfer and dissemination of Japanese-style business improvement and diagnosis techniques • Strengthening of occupational training • Efficient transport administration (road administration, transport operators registration system, etc.) • Development of arterial transport networks (bridge construction)
USAID	①Income improvement of people in poverty ②Improvement in living quality through health promotion ③Protection of natural resources aimed at sustainable economic development **④Eradication of illegal coca** **⑤Economic stability** ⑤Democratization	• Micro finance • Agricultural development support (enhancement of agricultural technology and access to markets) • Strengthening of trade and competitiveness • Improvement in sustainable economy of areas facing food shortages	• Expansion of small-scale financial institutions • Support for management of credit unions and building of electronic transfer system • Support for building production chains linking farmers to markets (organic onions, organic coffee, organic chocolate, etc.) • Craftsmen development • Business environment improvement and training for raising the management skills of small and medium enterprises • Support for higher agricultural productivity, market development and irrigation/roads construction for small farmers.
KfW	①Water hygiene **②Agricultural development** ③Decentralization and democratization	• Micro finance support to micro enterprises • Poorest areas (Chaco and north Potosi) • Improvement in agricultural productivity through large-scale irrigation development	• Special fund for NAFIBO • School Breakfast Project
AECI	①Social and institutional capacity building ②Enhancement of human capacity **③Improvement of economic capacity** ④Enhancement of environmental conservation capability ⑤Freedom and improvement of capacity in the area of culture ⑥Women's independence and empowerment ⑦Prevention of disputes and building of peace	• Strengthening the competitiveness of micro enterprises • Support for economic infrastructure • Support for institutional reforms of employment, etc. related to economic development • Support for improvement of the investment environment	• Financial support via micro finance, and support for corporate management in order to link micro enterprises with internal and external markets from the viewpoint of production chains
EU	①Improvement of access to drainage and pure water **②Economic growth (nurturing of industries to replace coca cultivation)** **③ Regional integration**	• Promotion of economic cooperation between Bolivia and the EU • Transport infrastructure development	• Identification and introduction of business chances • Support for the establishment of regulations and legislation and organizational capacity building based on the WTO framework • Trans-Ocean Project (Brazil-Bolivia-Chile)
WB	①Macro economic stability **②Correction of disparities** ③Administrative strengthening	• Improvement in productivity of micro, small and medium enterprises • Maintenance of sound finance	• Establishment of a fund with the agriculture ministry as counterpart, and this provides grants of around US$1,000 to micro, small and medium enterprises with a view to boosting the competitiveness of enterprises

Source: Prepared by the Study Team based on the country-separate strategies and plans of JICA and donors and the results of local hearings


GALAPAGOS ISLANDS
0 50 km
0 50 mi
Equator
San Lorenzo
COLOMBIA
Esmeraldas
Ibarra
Río Putumayo
Santo Domingo de los Colorados
Equator
QUITO
Nueva Loja
Cotopaxi
Río Napo
Manta
Quevedo
Portoviejo
Ambato
PACIFIC OCEAN
Chimborazo
Riobamba
Guayaquil
La Libertad
Golfo de Guayaquil
Cuenca
Machala
Puerto Bolívar
Loja
PERU
Río Marañón
0 50 100 km
0 50 100 mi
ANDES

Chapter 10 Ecuador

10-1 Economic Overview

10-1-1 Resources and Geographical Conditions

Ecuador, located just under the Equator in the northwestern part of the South American continent, has a land area of approximately 280,000 km2, corresponding to roughly 70% of the area of Japan. It shares borders with Columbia and Peru and also possesses the Galapagos Islands situated some 1,500 km off the coast in the Pacific Ocean. The Andes run through the center of the country, which is divided into the Pacific coastal belt, the Andean plateaus and mountains, and the forest belt in the east.

The coastal belt in the west is covered in tropical forests from the north to the center, whereas the southern part near the border with Peru is an arid desert zone. The coastal city of Guayaquil in the central-southern part has a trading port and is the commercial center, and it is also the largest city in the country with a population of around 2,000,000. Approximately half of the national population lives in this area. Roughly 45% of the population live in the plateau and mountain zone at altitudes of 2,000-3,000 m, and the climate in this area is generally moderate. The capital of Quito, situated at altitude of 2,850 m, is the second largest city after Guayaquil. The forest belt in the east of the country is tropical jungle that continues from the Amazon, and only around 5% of the population lives in this area.

In view of these topographical and climate features, Ecuador has one of the most diverse biota in the world; moreover, numerous agricultural products are cultivated on the fertile land that is based along the coast and in the eastern forest belt. Ecuador also has abundant fisheries resources in its inland rivers and lakes and in the ocean off the coast. It also has rich underground resources: petroleum that is drilled largely in the Amazon region in the east is refined in Esmeraldas Province on the northern coast, while natural gas is produced in the Amazon region and off the coast of Guayaquil.

On the other hand, Ecuador is confronted with the threat of frequent natural disasters. In 1998, heavy rains caused by the El Nino phenomenon caused catastrophic damage to roads, infrastructure and crops; and an earthquake caused major damage to the capital Quito and ruptured oil pipelines in the same year. Moreover, occasional volcanic eruptions cause airports and hydroelectric power stations to close down as well as causing damage to crops, basic infrastructure and production activities.

10-1-2 Industrial Structure

The economy of Ecuador has been driven by petroleum exports and agricultural production ever since the 1970s, when production and exports of petroleum started in earnest. Currently, in terms of GDP share, the petroleum and mining sector accounts for 22%, while agriculture, stockbreeding and fisheries for 10%. In agriculture, stockbreeding and fisheries, the major products are bananas, coffee, cacao, livestock and shrimps, etc. In particular, Ecuador is well known as the world's top exporter of bananas. In manufacturing, processed foods and beverages based on agricultural and fisheries products account for roughly 50% of the share, and this

increases to approximately 75% when textiles, leather products and timber products are also taken into account. This dependence on primary products creates an economic structure that is easily influenced by international prices and weather conditions. In fact, as a result of depressed petroleum prices at the end of the 1990s, the El Nino phenomenon and the outbreak of white spot disease in shrimps in 1998, production sectors were greatly affected and this led to the further deterioration of public finances, runaway inflation and a general economic crisis. In 2000, the government adopted the dollar as its currency and secured assistance from international monetary institutions such as the IMF, and as a result inflation was brought under control. The economy has recovered from 2000 onwards and has sustained growth thanks to the high price of oil; however, the economic structure is still prone to external shocks. Because industries with employment absorption capacity do not develop, there is no improvement in the unemployment rate. It is necessary to conduct reform of the industrial structure in order to enhance economic competitiveness.

Moreover, economic activities in Ecuador are mainly confined to Guayas Province, which contains the largest city of Guayaquil, and Pichancha Province, which is home to the capital Quito. These two areas account for approximately 30% and 20% of the GDP excluding petroleum, respectively. Other important economic areas are Manabi Province (agriculture and fisheries), Azuai Province (ceramics, furniture, tires, etc.) and Esmeraldas Province (oil refining and timber), etc.

Table 10-1 Sector-Separate Composition of GDP in Ecuador

Production Value — Unit: US$ million

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture, stockbreeding and forestry	1,201	1,309	1,244	1,405	1,466	1,524	1,620	1,690	1,726	1,796
Fisheries	255	292	310	289	227	231	229	262	263	305
Mining and petroleum gas drilling	3,245	3,184	3,133	3,177	3,430	3,466	3,380	3,583	4,501	4,541
Manufacturing (excluding petroleum refining)	2,208	2,330	2,458	2,329	2,170	2,276	2,333	2,440	2,519	2,745
Petroleum refining	-876	-884	-893	-1,132	-1,360	-1,372	-1,372	-1,443	-1,627	-1,761
Electricity and water supply	116	124	134	165	169	170	184	186	179	172
Construction	1,238	1,271	1,268	952	1,127	1,349	1,619	1,608	1,673	1,723
Wholesaling and retailing	2,558	2,673	2,693	2,392	2,483	2,603	2,649	2,741	2,824	2,983
Transport and warehousing	1,181	1,269	1,322	1,321	1,413	1,420	1,421	1,447	1,470	1,523
Financial services	689	674	560	295	301	281	289	291	309	362
Other services	2,145	2,249	2,412	2,336	2,421	2,521	2,627	2,737	2,900	3,116
Indirect financial services	-673	-670	-567	-380	-385	-322	-440	-422	-411	-447
Public services and social security	742	763	809	764	835	844	864	889	916	929
Domestic services	25	26	27	28	28	29	30	31	32	31
Total industrial added value	**14,053**	**14,609**	**14,910**	**13,941**	**14,326**	**15,020**	**15,433**	**16,040**	**17,275**	**18,019**
Other elements	1,515	1,590	1,632	1,558	1,608	1,764	2,064	2,082	2,283	2,467
GDP	**15,568**	**16,199**	**16,541**	**15,499**	**15,934**	**16,784**	**17,497**	**18,122**	**19,558**	**20,486**

Note: 2000 as reference

Composition Ratio — Unit: %

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture, stockbreeding and forestry	7.7	8.1	7.5	9.1	9.2	9.1	9.3	9.3	8.8	8.8
Fisheries	1.6	1.8	1.9	1.9	1.4	1.4	1.3	1.4	1.3	1.5
Mining and petroleum gas drilling	20.8	19.7	18.9	20.5	21.5	20.7	19.3	19.8	23.0	22.2
Manufacturing (excluding petroleum refining)	14.2	14.4	14.9	15.0	13.6	13.6	13.3	13.5	12.9	13.4
Petroleum refining	-5.6	-5.5	-5.4	-7.3	-8.5	-8.2	-7.8	-8.0	-8.3	-8.6
Electricity and water supply	0.7	0.8	0.8	1.1	1.1	1.0	1.1	1.0	0.9	0.8
Construction	8.0	7.8	7.7	6.1	7.1	8.0	9.3	8.9	8.6	8.4
Wholesaling and retailing	16.4	16.5	16.3	15.4	15.6	15.5	15.1	15.1	14.4	14.6
Transport and warehousing	7.6	7.8	8.0	8.5	8.9	8.5	8.1	8.0	7.5	7.4
Financial services	4.4	4.2	3.4	1.9	1.9	1.7	1.7	1.6	1.6	1.8
Other services	13.8	13.9	14.6	15.1	15.2	15.0	15.0	15.1	14.8	15.2
Indirect financial services	-4.3	-4.1	-3.4	-2.5	-2.4	-1.9	-2.5	-2.3	-2.1	-2.2
Public services and social security	4.8	4.7	4.9	4.9	5.2	5.0	4.9	4.9	4.7	4.5
Domestic services	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Total industrial added value	**90.3**	**90.2**	**90.1**	**89.9**	**89.9**	**89.5**	**88.2**	**88.5**	**88.3**	**88.0**
Other elements	9.7	9.8	9.9	10.1	10.1	10.5	11.8	11.5	11.7	12.0
GDP	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Growth Rate — Unit: %

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture, stockbreeding and forestry	8.3	9.1	-5.0	13.0	4.3	3.9	6.3	4.4	2.1	4.1
Fisheries	4.7	14.6	6.1	-6.7	-21.6	1.7	-0.6	14.2	0.5	16.0
Mining and petroleum gas drilling	0.8	-1.9	-1.6	1.4	8.0	1.1	-2.5	6.0	25.6	0.9
Manufacturing (excluding petroleum refining)	5.0	5.5	5.5	-5.2	-6.8	4.9	2.5	4.6	3.2	9.0
Petroleum refining	19.8	1.0	0.9	26.8	20.1	0.9	0.0	5.2	12.7	8.2
Electricity and water supply	11.9	6.8	8.5	23.0	2.6	0.6	8.2	1.2	-3.9	-3.9
Construction	1.3	2.7	-0.2	-24.9	18.3	19.7	20.0	-0.7	4.0	3.0
Wholesaling and retailing	5.4	4.5	0.7	-11.2	3.8	4.8	1.8	3.5	3.0	5.6
Transport and warehousing	1.3	7.4	4.2	0.0	7.0	0.5	0.1	1.8	1.6	3.6
Financial services	11.2	-2.2	-16.9	-47.3	2.2	-6.7	2.9	0.4	6.2	17.2
Other services	4.5	4.9	7.2	-3.2	3.7	4.1	4.2	4.2	5.9	7.5
Indirect financial services	18.5	-0.5	-15.3	-33.0	1.3	-16.4	36.6	-3.9	-2.8	8.8
Public services and social security	-0.9	2.8	6.0	-5.6	9.3	1.1	2.3	2.9	3.1	1.4
Domestic services	1.8	4.4	3.0	3.4	2.4	2.8	2.1	4.5	3.7	-4.5
Total industrial added value	**2.3**	**4.0**	**2.1**	**-6.5**	**2.8**	**4.8**	**2.7**	**3.9**	**7.7**	**4.3**
Other elements	3.5	4.9	2.7	-4.5	3.2	9.7	17.0	0.9	9.6	8.0
GDP	**2.4**	**4.1**	**2.1**	**-6.3**	**2.8**	**5.3**	**4.2**	**3.6**	**7.9**	**4.7**

Source: Banco Central del Ecuador, CUENTAS NACIONALES

10-1-3 Trade Structure

(1) Structure of Exports

Ecuador gave up its policy of protectionism based on import substitution and promoted economic liberalization in the 1990s. Because of the small size of its domestic economy, Ecuador has a high ratio of exports compared to GDP, second only to Chile among 10 South American countries[84]. Due to the recent inflation of oil prices and expansion in exports, the share of the petroleum sector among overall exports has increased, and this sector accounted for 60% of the

[84] See Commissioned Survey B: Table 1.

total value of exports in 2005. Relatively speaking, the ratio of traditional products in 2005 declined to half of what it was 10 years earlier, however, bananas, which account for US$1 billion per year and one-third of total world exports, and shrimps, which have recovered from the white spot disease damage of 2000, remain key exports behind petroleum.

As for non-traditional products, the growth rate is relatively gentle, however, diversification has recently been advancing based mainly on primary products and processed items. Exports displaying conspicuous growth are canned marine products such as tuna, and cut flowers such as roses, etc., which are mainly harvested on highlands in the center and north of the country. Other export growth items include vegetables and fruit such as broccoli in the area of primary products, metal products in the area of manufactured goods, clothing and chemical products, etc.

Looking at export destinations, the United States is the largest partner accounting for 40% of all exports. Major items are petroleum, fisheries (shrimps) and fruit (bananas) and, thanks to access to the U.S. market based on Andean Trade Promotion and Drug Eradication Act (ATPDEA)[85], exports of clothing and timber products have also been prosperous since 2003. Looking ahead to the expiration of ATPDEA in 2006, Ecuador started negotiations aimed at securing a bilateral free trade agreement (FTA) with the United States in 2004, however, negotiations have been broken off since the current Palacio administration cancelled a petroleum contract with the U.S. company Occidental in June 2006.

Exports to the Andean Community of Nations are also growing year by year. Whereas exports to this region didn't even account for 10% ten years ago, they have now grown to around 15%. In particular, Peru and Columbia have recently grown in importance, with the former mainly importing petroleum, and the latter mainly importing automobiles and auto parts and processed items such as fish and shrimps, etc. Meanwhile, exports to Mercosur countries account for only a fraction, i.e. 1.4% in 2004. Incidentally, Ecuador was approved as an associate member country of Mercosur together with Columbia and Venezuela in December 2004.

Within the Asian region, due to the rapid increase in petroleum exports, South Korea ha overtaken Japan to become the number one export destination. Other exports include shrimps and fish, etc. Exports to Japan mainly consist of bananas, however, the value of exports has been going down in recent years.

[85] The United States has applied this to Peru, Bolivia, Columbia and Ecuador since 2002. In return for cooperation in eradicating drugs, the United States recognizes the zero tariff import of approximately 6,000 items from these countries.

Table 10-2 Composition of Ecuador's Exports

Export Value (FOB) Unit: US$ million

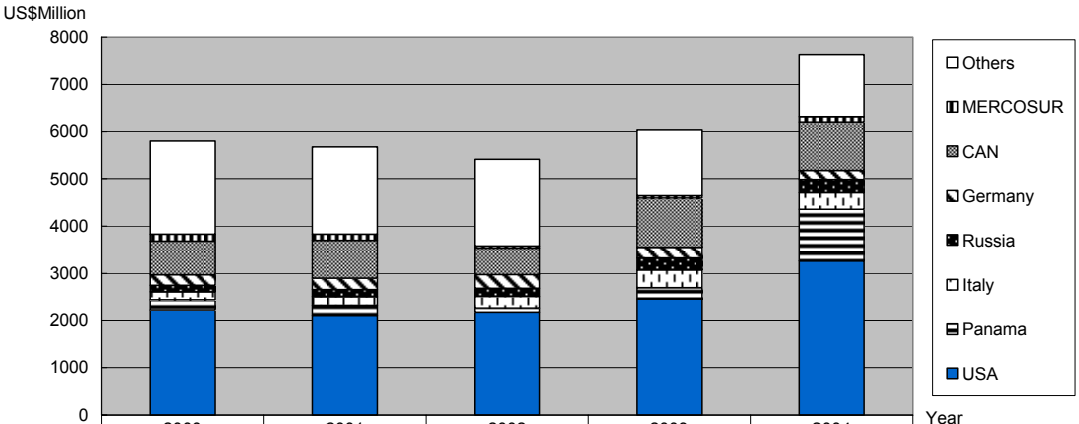
Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
1.Traditional products	2,012.4	2,565.3	2,177.1	1,815.3	1,302.0	1,363.9	1,480.7	1,737.3	1,673.8	1,864.8
Bananas	973.0	1,327.2	1,070.1	954.4	821.4	864.5	969.3	1,100.8	1,023.6	1,082.3
Coffee	159.5	121.5	105.1	78.1	45.6	44.1	41.7	70.4	84.1	88.3
Cacao	163.6	131.8	47.1	106.3	77.4	86.6	129.1	169.6	154.2	167.7
Prawns	631.5	886.0	872.3	607.1	285.4	281.4	252.7	299.0	329.8	445.0
Fish, tuna	84.8	98.8	82.5	69.4	72.2	87.3	87.9	97.5	82.1	81.5
2.Petroleum and petroleum derivatives	1,748.7	1,557.3	923.0	1,479.7	2,442.4	1,900.0	2,055.0	2,606.8	4,234.0	5,869.5
Petroleum	1,520.8	1,411.6	789.0	1,312.3	2,144.0	1,722.3	1,839.0	2,372.3	3,898.5	5,396.8
Petroleum derivatives	227.9	145.7	134.0	167.4	298.4	177.7	216.0	234.5	335.5	472.7
3.Non-traditional products	1,111.5	1,142.0	1,103.1	1,156.0	1,182.4	1,414.9	1,500.3	1,878.3	1,845.0	2,090.4
A. Primary products	378.7	378.1	294.6	324.8	314.8	406.4	475.6	533.7	573.0	606.9
Cotton thread	14.7	14.9	12.5	10.4	8.3	6.7	7.9	8.9	9.4	7.6
Timber products	29.4	37.9	22.8	26.3	20.5	24.0	30.9	42.1	48.1	49.5
Minerals	130.3	68.9	17.3	20.1	9.4	6.3	12.3	11.9	12.5	15.9
Fruit trees	12.2	5.1	11.1	13.0	15.7	20.2	29.3	46.2	49.1	51.3
Tobacco	6.1	7.7	9.6	11.9	8.2	9.8	14.6	14.9	19.2	24.1
Flowers	104.8	131.0	162.0	180.4	58.0	238.1	290.3	308.7	354.8	364.6
Others	81.2	112.6	59.3	62.7	194.7	101.3	90.3	101.0	79.9	93.9
B. Industrial products	732.8	763.9	808.5	831.2	867.6	1,008.5	1,024.7	1,344.6	1,272.0	1,483.5
Metal products	55.1	59.9	66.5	62.4	68.3	88.3	90.2	159.9	130.0	171.4
Transportation equipment	53.9	82.2	63.2	27.2	67.3	99.7	52.8	126.2	79.0	133.7
Chemical products and pharmaceuticals	46.1	51.3	56.5	59.3	61.2	68.2	72.5	94.0	88.7	75.6
Juice, concentrated juice	38.7	56.1	58.1	73.6	62.8	57.5	54.6	81.4	80.6	96.6
Fish meal	53.6	22.9	13.4	10.2	19.2	22.3	11.9	19.2	20.4	20.4
Processed marine products	1.6	3.2	1.0	2.1	2.9	3.6	2.6	6.4	10.5	7.8
Canned processed marine products	150.6	181.9	253.9	262.9	231.7	268.8	343.5	405.8	362.3	426.6
Textile products	34.4	38.3	31.6	34.3	39.5	42.3	37.0	40.4	49.9	43.8
Clothing	17.4	22.4	20.7	17.5	19.4	23.5	21.0	27.7	28.2	25.1
Leather products, plastic	42.3	50.3	52.6	58.5	67.3	67.9	71.0	66.4	83.9	94.4
Others	239.1	195.4	191.0	223.2	228.0	266.4	267.6	317.2	338.5	388.1
Total	4,872.6	5,264.6	4,203.2	4,451.0	4,926.8	4,678.8	5,036.0	6,222.4	7,752.8	9,824.7

Note: 2004-05 data are provisional.

Composition Ratio Unit: %

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
1.Traditional products	41.3	48.7	51.8	40.8	26.4	29.2	29.4	27.9	21.6	19.0
Bananas	20.0	25.2	25.5	21.4	16.7	18.5	19.2	17.7	13.2	11.0
Coffee	3.3	2.3	2.5	1.8	0.9	0.9	0.8	1.1	1.1	0.9
Cacao	3.4	2.5	1.1	2.4	1.6	1.9	2.6	2.7	2.0	1.7
Prawns	13.0	16.8	20.8	13.6	5.8	6.0	5.0	4.8	4.3	4.5
Fish, tuna	1.7	1.9	2.0	1.6	1.5	1.9	1.7	1.6	1.1	0.8
2.Petroleum and petroleum derivatives	35.9	29.6	22.0	33.2	49.6	40.6	40.8	41.9	54.6	59.7
Petroleum	31.2	26.8	18.8	29.5	43.5	36.8	36.5	38.1	50.3	54.9
Petroleum derivatives	4.7	2.8	3.2	3.8	6.1	3.8	4.3	3.8	4.3	4.8
3.Non-traditional products	22.8	21.7	26.2	26.0	24.0	30.2	29.8	30.2	23.8	21.3
A. Primary products	7.8	7.2	7.0	7.3	6.4	8.7	9.4	8.6	7.4	6.2
Cotton thread	0.3	0.3	0.3	0.2	0.2	0.1	0.2	0.1	0.1	0.1
Timber products	0.6	0.7	0.5	0.6	0.4	0.5	0.6	0.7	0.6	0.5
Minerals	2.7	1.3	0.4	0.5	0.2	0.1	0.2	0.2	0.2	0.2
Fruit trees	0.3	0.1	0.3	0.3	0.3	0.4	0.6	0.7	0.6	0.5
Tobacco	0.1	0.1	0.2	0.3	0.2	0.2	0.3	0.2	0.2	0.2
Flowers	2.2	2.5	3.9	4.1	1.2	5.1	5.8	5.0	4.6	3.7
Others	1.7	2.1	1.4	1.4	4.0	2.2	1.8	1.6	1.0	1.0
B. Industrial products	15.0	14.5	19.2	18.7	17.6	21.6	20.3	21.6	16.4	15.1
Metal products	1.1	1.1	1.6	1.4	1.4	1.9	1.8	2.6	1.7	1.7
Transportation equipment	1.1	1.6	1.5	0.6	1.4	2.1	1.0	2.0	1.0	1.4
Chemical products and pharmaceuticals	0.9	1.0	1.3	1.3	1.2	1.5	1.4	1.5	1.1	0.8
Juice, concentrated juice	0.8	1.1	1.4	1.7	1.3	1.2	1.1	1.3	1.0	1.0
Fish meal	1.1	0.4	0.3	0.2	0.4	0.5	0.2	0.3	0.3	0.2
Processed marine products	0.0	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Canned processed marine products	3.1	3.5	6.0	5.9	4.7	5.7	6.8	6.5	4.7	4.3
Textile products	0.7	0.7	0.8	0.8	0.8	0.9	0.7	0.6	0.6	0.4
Clothing	0.4	0.4	0.5	0.4	0.4	0.5	0.4	0.4	0.4	0.3
Leather products, plastic	0.9	1.0	1.3	1.3	1.4	1.5	1.4	1.1	1.1	1.0
Others	4.9	3.7	4.5	5.0	4.6	5.7	5.3	5.1	4.4	4.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Banco Central del Ecuador, CUENTAS NACIONALES



	2000	2001	2002	2003	2004
Others	1974.9	1849.9	1841.6	1385.8	1318.1
MERCOSUR	149.3	133.5	46.5	52.5	110.4
CAN	703.3	789.7	549.2	1055	1024.9
Germany	226	247.8	291.9	206.9	193.5
Russia	142.4	150.8	173.9	260.8	270.5
Italy	167.2	182.8	247	377.4	354.4
Panama	213.3	215.2	90.1	244.1	1088.6
USA	2224.7	2105.2	2173.6	2451.6	3269.7

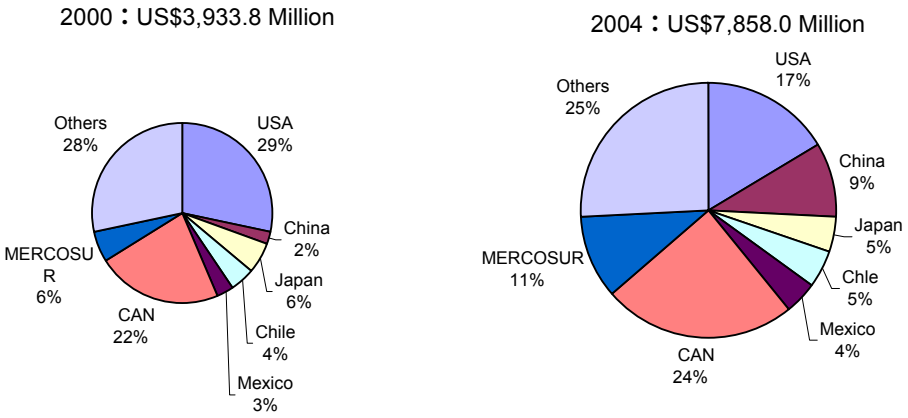
Source: IMF, Direction of Trade Statistics Yearbook 2005

Figure 10-1 Main Export Destinations of Ecuador

(2) Composition of Imports

Imports to Ecuador declined sharply as a result of the economic recession and currency depreciation at the end of the 1990s, however, following economic recovery based on the dollar conversion policy from 2000 onwards, the purchasing power of citizens has been restored and imports (apart from some exceptions) have been growing at around 20% per year. Imports of mainly industrial raw materials and capital goods have increased in line with pipeline construction and other petroleum-related investment; moreover, in reflection of inflation in the international price of petroleum, imports of fuel and lubricant have also increased sharply. The ratio of consumer goods within imports has increased from around 20% 10 years ago to almost 30% now. This has been underpinned by the increase in purchasing power caused by conversion to the dollar as well as remitted earnings from overseas migrants.

In terms of import trade partners, the United States is the largest, although the ratio of American imports has declined from 34% in the mid 1980s to 29% in 2000 and 17% in 2004. In contrast, imports from the Andean Community of Nations have increased from just 6% in the mid 1980s to 14% in the mid 1990s and 24% in 2004. In particular, the second largest importer is now Columbia, which supplies petroleum, automobiles and auto parts, etc., while the fourth largest is Venezuela, which mainly supplies iron and steel. The promotion of integration under the CAN has greatly expanded Ecuador's trade with other countries in the region, however, since imports far outstrip exports, Ecuador has increased its trade deficit regarding these countries and Ecuadorian corporations are now exposed to very tough competition on the regional level. Incidentally, the third largest importing nation is recently China, which supplies machines and electric instruments, etc.



Source: IMF, Direction of Trade Statistics Yearbook 2005

Figure 10-2　Main Import Sources of Ecuador

10-1-4　Acceptance of Direct Investment from Overseas

Incoming direct overseas investment was around US$500 million in the middle of the 1990s; it dropped off during the subsequent economic recession, however, it has been growing again since the turn of the century. In 2003, the amount of incoming investment was US$1.55 billion[86]. Over the past 10 years, over 80% of investment has been directed towards the petroleum and energy sectors, whereas only 4% has been directed to manufacturing with food and pharmaceutical companies conspicuous. The United States and Canada account for 60% of investment, while European countries also invest with Spain accounting for 15%. The largest South American investors are, in order, Argentina, Chile, Brazil and Columbia.

[86] UNCTAD “World Investment Report 2005”

10-2 Industrial Promotion Policies and Systems

10-2-1 Current Industrial Policy and its Background

After the national diet passed the bill to dismiss President Gutierrez on April 20, 2005, President Palatio (the former vice president) was sworn in and a new administration was started. The new administration is continuing the long-term plan (Government Multiple Year Plan 2003-2007) that was announced by the previous administration, however, there appears to be no conspicuous progress concerning the priority issues (five basic objectives) of corruption countermeasures, eradication of poverty, improvement of law and order for citizens, economic revitalization and improvement of competitiveness, and political reform. Incidentally, there is not expected to be any major change in the basic framework of policy following the change of administration at the end of this year.

The five government activity objectives (policy guidelines) contained in the above long-term plan are as follows:

- The fight against corruption, unfair exemption of criminal punishment and social inequality
- The fight against poverty and unemployment
- Citizen safety, law and order, judicial security, food security and environmental conservation
- Improvements and enhancement of productivity in order to increase competitiveness
- Consistent political reform and foreign policy in line with actual conditions

Out of the priority policy issues raised by the current administration, economic issues are outlined in the following sections.

(1) Poverty Problem

The major issue is the regional disparity of wealth; in particular, economic and social disparities (water supply and sewerage dissemination rates, basic education and literacy, medical insurance, employment opportunities, infrastructure development, etc.) between the cities and rural areas are conspicuous. Concerning the reasons for these regional economic disparities, constraints on economic activities such as the improper utilization of natural resources, lack of finance for small and medium enterprises, inadequacy of commercialization and product distribution channels, low productivity, restriction of job opportunities due to illiteracy and so on are pointed to. Incidentally, the budget for social investment in Ecuador is small at just 5% of GDP (compared to 14% in other South American countries), and poverty is the worst among the four poorest nations in the continent.

According to the national statistical survey department (INEC), the most recent (May 2006) average income of an average family of four is US$298.67, which is less than the minimum cost of living (CFV) and the basic cost of living (CFB) (see below).

Table 10-3 Average Family Income

	Amount	Difference
Average income	US$298.67	—
CFV	US$302.00	US$3.33
CFB	US$446.80	US$148.13

Source: INEC

(2) Environmental Conservation

Ecuador has one of the most diverse biota in the world, and careful and strict measures need to be taken to guard against development that may lead to destruction of the ecosystem. In economic development, too, it is necessary to compile plans based on the premise of environmental conservation. Moreover, as an element of economic and technical cooperation, environmental countermeasures are an important cooperation project in Ecuador. Also, tourism development and eco tourism are regarded as important topics in economic development policy, and these are predicated on harmonization of the environment and development.

(3) Economic Vitalization

The economy of Ecuador depends heavily on petroleum production, which accounts for 25.2% of GDP and 60% of exports (2004). In the non-petroleum sector, agriculture, forestry and fisheries account for 10.5% of GDP and 22.7% of exports, thereby indicating an industrial structure in which primary industries play a central role. In particular, since primary products account for more than 80% of exports, this structure contains instability with respect to international market fluctuations. Meanwhile, domestic markets are restricted, and with exports to CAN nations in a rut, the expansion of exports holds the key to economic stabilization and growth. Therefore, measures to boost added value, strengthen competitiveness and raise productivity of agriculture, stockbreeding, forestry and fisheries products, i.e. the major export items, are the priority issues in industrial policy. However, compared to the situation in other Latin American countries, the added value of Ecuadorian agriculture, stockbreeding, forestry and fisheries products is especially low (see later) and, in addition to boosting productivity and competitiveness, it is necessary to increase added value through raising the processing level of products.

10-2-2 Current Framework of Measures and Issues

Concerning the framework of measures, guidelines for policies in response to the issues are given in the above long-term plan, together with objectives, policy items, activity items and implementing agencies, etc. However, component items of measure are by no means systematic or prioritized, but rather sweeping and uncoordinated. The main industrial support framework and systems in Ecuador are outlined below.

(1) Financial System

After the banks went bust during the economic crisis of 1998, the American dollar was adopted as the national currency in January 2000 in order to curb hyperinflation, control interest and prevent the flight of capital, and the economy stabilized as a result. Financial policies aimed

at enhancing export competition based on currency manipulation were no longer operative. Concerning industrial financing, new funds were established for manufacturing industrial finance and small and medium enterprise finance, and emphasis is placed on small and medium enterprises in particular. In future, it is anticipated that micro finance will be strengthened and that a guarantee fund system will be established for medium-size corporations.

(2) Tax System

Due to the FTA with the United States, no preferential taxes are adopted. However, all taxation is exempted within free trade zones (FTZ) in the country.

(3) Business Launch Support

Support for business launches includes an incubation support system based on the CAF fund, a government technical support system for limited periods based on FEIREP (government fund), the CORPEI entrepreneur development program, and the refugee entrepreneurship promotion support program based on UNHCR.

(4) Research and Development

- The government's research and development agency SENACYT conducts research and development into basic science and technologies.
- There are technical universities in Quito, Guayaquil and Chimborazo, however, they are not reputed to have active research and development activities.
- CORPEI (Export and Investment Promotion Corporation) conducts the development of exports and services. This is operated on funds collected as 1% of exports.
- There are two techno parks in Guayaquil and Chimborazo, however, these are not very active.

(5) Education and Training

- There are 57 universities and technical colleges (polytechnics), however, most of their courses are related to service fields and management fields, whereas technical courses are limited. Technical education is largely implemented as in-house training in corporations.
- Under guidance from UNIDO, the NCCHR human resources reinforcement center has been established in the chamber of industry, which is a branch of FEDECAMARA (federation of corporations), and this conducts training with corporations bearing 20% of its costs.

(6) Management Consultant System

As part of small and medium enterprise support, there is a system for dispatching leaders at cost, however, these are not referred to as management consultants. There is no certification system for management consultants.

(7) Standardization

MNAC (agency in charge of weights and measures, standardization, certification and accreditation) conducts support regarding international standards for exports. However, it is said to be having difficulty clearing epidemic prevention standards of export destinations for agricultural products such as fruit and vegetables, etc. It is thought that standards are not prescribed in various sectors in the country. Some producers have acquired certification under ISO (9000s, 14000s), HACCP and FSC.

(8) Export Promotion

- Export promotion is an important function of CORPEI (Export and Investment Promotion Corporation), which compiles national export plans, implements product and market diversification programs, takes part in cluster programs and value chain programs, and promotes various projects such as the planting of teak forests, etc.
- Draw Back System: This is a system of tariff rebates on the imported portion of exports
- Five free processing zones (Zonas Francas) have been established in Esmeraldas, Manabi (two), Pichincha and Azuay, and approximately 100 corporations are operating in them.
- The Maquila system has been institutionalized based on the same thinking as in Mexico, however, this is not functioning sufficiently.
- A tariff system improvement plan is being implemented under the CAF program.

(9) Bolstering of Competitiveness

A survey of competitiveness and cluster formation program are being implemented under support from UNIDO. Moreover, a competitiveness reinforcement project is being implemented under the CAF program.

(10) Solid Waste Management

Corporations are responsible for disposing of industrial waste, whereas local governments conduct general waste and sewage disposal.

10-2-3 Policy Systems and Administration Required of the Government

Generally speaking, the role of government in promoting economic and industrial development has moved away from induced development of the development dictatorship era to the formulation of policies for indirectly supporting private sector dynamism based on market economy rules. However, reflecting the instability of the political situation, policy lacks fixed reference points and is failing to secure private sector confidence. The present administration, espousing public participation and public-private integration systems, has established a conference (the CNPC) aimed at building trust between the public and private sectors, however, this is still not functioning efficiently. Moreover, government corruption is said to be the second worst in South America behind Paraguay and the policy of corruption control, which is one of the five priority objectives of the government, is denounced by citizens who responded to a survey in April that corruption now is worse than it was under President Guttierez, who was dismissed for corruption.

As a result of the recent “small government” policy, the number of central government employees has been greatly reduced, but decentralization is not making good progress despite being a reform issue. The local government in Guayaquil has earned the praise of private corporations for its flexible cooperation in industry, indicating that policy implementation can be made more effective by strengthening administration and systems more closely linked to the private sector.

10-2-4 Relationship between Trade and Industrial Promotion

The population of Ecuador is approximately 13,000,000 and per capita GDP is over

US$2,000, however, average income in the vast poverty class is low and the domestic market is small. Moreover, because the industrial base is weak, manufactured goods are generally not very competitive. As a result, the basic tenet of industrial development is to place expectations on local primary products and processed derivatives that have a certain degree of competitiveness. Moreover, Ecuador must seek markets for such products in export destinations. Accordingly, the industrial development strategy and promotion policy of Ecuador will entail placing emphasis on improving the productivity and level of processing (added value) of primary products, enhancing export competitiveness and developing export markets, etc.

10-2-4-1 Bilateral and Inter-Regional Relations

(1) CAN Nations

Regional economic integration (CAN), which was formed with the goal of reinforcing relatively small domestic markets, has hit a ceiling in development because the members produce similar products, and it is only the more industrialized nations that can benefit from the common market. In other words, neighboring CAN countries are rivals in the same products, and CAN is regarded as a community for maintaining peace on borders and conducting external negotiations.

The external negotiation topic that is of common interest to all CAN countries is the development of export markets, and the main partners in negotiation are the United States, the EU and the League of Arab States, etc. Now that Venezuela has withdrawn, CAN as a whole places the greatest emphasis on relations with the United States, however, in reflection of an undercurrent of anti-U.S. feeling, there is a growing trends towards the EU. Moreover, the United States does not intend to renew the ATPDEA (Andean Trade Promotion and Drug Eradication Act), which aims to eradicate drugs, and this will expire at the end of this year.

Relations with Columbia

13 border area development projects are being implemented with priority handling (power network linkage, environmental development, response to emergency situations such as natural disasters, education, tourism, culture-related, etc.)

Relations with Peru

Bilateral projects for border area development are being promoted (electrification, sanitation, construction of public health facilities, international roads).

(2) Other Bilateral Relations

Relations with the United States

The U.S. is the ultimate export market for Ecuador, which aims to emulate Columbia and Peru in binding a free trade agreement. Negotiations are being held up by the revocation of the oil drilling contract of Occidental Oil Co. and revision of the hydrocarbons law, etc., and when the strong anti-American sentiment of people in poverty and native peoples s considered, the situation looks grim.

Relations with Venezuela

Agreement has been reached to supply Ecuador’s crude oil in return for cheap petrochemical products. A crude oil and petrochemical products trade agreement has been signed based on a maximum level of 100,000 barrels per day.

Relations with Mexico

- Both sides have agreed to deepen the existing ACE29 with a view to realizing a future FTA.
- A business agreement has been reached in the energy sector with PEMEX.
- The countries have agreed to sign a memorandum of cooperation concerning an agricultural production strengthening program.

Relations with China

- A boycott campaign against Chinese products was started in Guayaquil and this calls for safeguards against Chinese shoes.
- Foreign minister Callion visited China from May 31 to June 3, during which he requested Chinese investment in Ecuador. He also made a renewed request for support in Ecuador's bid to join APEC.

Relations with Malaysia

Both countries signed an agreement to cooperate in the economic, science and technology and cultural fields. Ecuador also requested support in its bid to join APEC, while Malaysia requested permission to take part in a major ITT project for petroleum development in the Amazon area.

10-2-5 Main Industries and Policies

10-2-5-1 Industrial Overview of Ecuador

The recent breakdown of GDP by industrial sector in Ecuador is as follows.

Table 10-4 GDP Composition by Industry

(Unit: US$1 billion, 2000 prices)

Industrial sector	2001	2002	2003	2004
Agriculture, forestry, fisheries and hunting	1.70	1.83	1.86	1.87
Oil and mining	3.49	3.37	3.58	4.48
Manufacturing	2.23	2.25	2.32	2.39
Electricity, gas and water supply	0.18	0.18	0.18	0.18
Construction	1.17	1.34	1.35	1.37
Commerce and hotels	2.80	2.90	2.96	3.05
Transport and telecommunications	1.75	1.77	1.79	1.86
Services and finance	1.50	1.54	1.60	1.62
Others	0.37	0.40	0.38	0.35
Total	16.75	17.32	17.81	17.81

10-2-5-2 Trends and Future Prospects of Leading Industries

(1) The Economically Important Petroleum Industry

The petroleum industry in Ecuador has developed mainly around oil fields in the Amazon basin, and recent production has varied between approximately 500,000-560,000 barrels per day. However, since Ecuador cannot develop the industry under its own technology, it is searching for third countries as partners in new large-scale oilfield development projects (ITT), with Mexico

(PEMEX), Brazil (PETROBRAS), Malaysia (PETRONAS) and Venezuela (PDVSA), etc. as likely candidates. Moreover, due to the problems caused by revocation of the oil drilling contract of Occidental Oil Co. due to a contract violation and revision of the hydrocarbons law (both incidents occurring in 2006), it is predicted that a certain degree of control will be imposed on the entry of private sector corporations to petroleum industry development. In any case, the petroleum industry is of utmost importance to the national economy of Ecuador and, together with the development potential of the Amazon basin, it will no doubt be a key industry for the foreseeable future. Also, concerning the reinforcement of two oil refining facilities and development of the petrochemical industry, no immediate developments are planned and it is thought that the industry will proceed based on crude oil exports.

(2) Agriculture – The Most Important Sustainable Industry

The traditional exports of Ecuador are bananas, cacao and coffee, and flowering plants, herbs, broccoli, fresh fruit, shrimps and canned tuna, etc. have joined these items in recent years. The agriculture, forestry and fisheries sector now accounts for 10.5% of GDP and 27.0% of exports (as of 2004). On the other hand, agricultural production has been in decline since reaching a peak in 1997, and the reasons suspected for this are soil degradation, insufficient transfer of technology to small-scale farmers, lack of infrastructure development, lack of financial resources, poor spread of cooperation among small farmers, low yield rates, sow breed improvement, influx of rural population into cities, and so forth. Moreover, overall productivity is low compared to the other countries of Latin America.

The importance of agriculture in Ecuador can be clearly seen from figures depicting agriculture in the broad sense including industrial sectors that use agricultural resources as raw materials (farm processing). In other words, whereas the GDP share of agricultural production alone is 7% (7.3% in 2005), it is more than 16% (16.1% in 2005) when seen in the broad sense (including processed farm products), and the value added ratio to agricultural raw materials is 221%. However, compared with other Latin American countries, as shown in Table -2, these figures are extremely low, and it is thought that improvement in agricultural productivity and expansion and strengthening of agricultural processing sectors have great potential and hold the key to development of industry in Ecuador in the future.

Table10-5　GDP and Agricultural GDP of Latin American Countries (1997)

		GDP	Agricultural GDP		Agriculture in the Broad Sense		
		(1) US$ 1 billion	(2) US$ 1 billion	(2)/(1) %	(4) US$ 1 billion	(4)/(1) %	(4)/(2) %
1	Argentina	326.0	14.9	4.6%	104.9	32.2%	704.0%
2	Brazil	789.7	34.0	4.3%	206.9	26.2%	608.5%
3	Chile	76.1	4.3	5.7%	24.4	32.1%	567.4%
4	Columbia	94.6	7.6	8.0%	30.4	32.1%	400.0%
5	Ecuador	23.6	3.7	15.7%	6.1	25.8%	164.9%
6	Peru	64.9	4.3	6.6%	20.6	31.7%	479.1%
7	Uruguay	19.1	1.2	6.3%	6.6	34.6%	550.0%
8	Venezuela	83.7	3.4	4.1%	7.2	8.6%	211.8%

Source: prepared from BCE information

The importance of agricultural development in social terms goes without saying when it is considered that this sector employs approximately 40% of the population and 60% of the population in poverty, it has a high ratio of female workers, and it absorbs much of the unskilled labor in the country.

10-2-6　Micro, Small and Medium Enterprises and Policies

(1) As is indicated in the basic objectives of the long-term plan, industrial promotion policy in Ecuador as a whole is primarily based on strengthening of competitiveness and improvement of productivity. Meanwhile, the issue of poverty, which is the most important social topic, is a “fight with poverty and unemployment = employment creation,” and small and medium enterprise problems are viewed as an important topic separate from industrial promotion. In addition to policies to care for people in poverty and socially disadvantaged people, the multiple year program includes priority programs comprising a program for providing small loans to functional citizens in disadvantaged citizen groups and micro enterprises, a non-fiscal support program for small-scale production facilities and micro enterprises, and a program for the promotion of small-scale industries. Moreover, in the area of industrial policy, policies are being compiled in order to “promote the development of small and medium enterprises and micro enterprises as the key to providing support and creating employment in order to overcome poverty.”

(2) Concerning specific measures to support micro, small and medium enterprises, a micro enterprise association based in Guayaquil administers 213 micro enterprise groups throughout the country and implements various support activities (provision of business information, promotion of corporation networks, support for business procedures, mediation system, issue of point of origin certificates, BDS development support, fundraising support, staging of free seminars, business start support, management guidance, ISO acquisition support, patent acquisition support, etc.) with the help of 37 experts covering 12 industrial sectors. Moreover, through legal support of artisanal farmers and vitalization programs based on loan mediation, etc., it supports the organization of farmers and establishment of production chains including agricultural processing. Through cooperating with the National Promotion Bank, the said association established a credit

guarantee system for micro enterprises in 2000, and this conducts financing for up to two years maximum. Moreover, this association receives support from Guayaquil municipal government in the area of medical care.

(3) Priority Projects and Programs

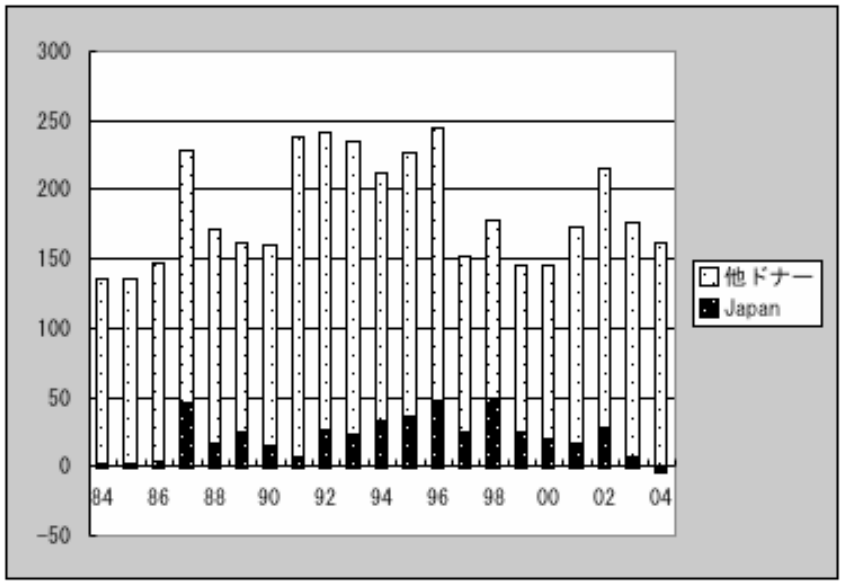
Programs for implementing micro, small and medium enterprise support policies in the long-term plan include the following:

(i) Comprehensive sector-based promotion program for micro, small and medium enterprises
(ii) Occupational training program for boosting competitiveness of micro, small and medium enterprises
(iii) Occupational training program for craftsmen
(iv) Tourism dispersion, tourism and tourism goods planning and development program
(v) Program for inter-regional and sustainable tourism
(vi) Program for tourism-related micro and small enterprises
(vii) Second stage of the national handicraft map
(viii) Management programs: 1) quality control on the micro economic level, 2) corporate productivity
(ix) UNIDO/MICIP programs
(x) Program for Ecuador paradise tourism on the Pacific coast

10-3 Aid Trends

10-3-1 Overall Trend

Aid to Ecuador (including ODA and aid from international agencies and DAC major aid nations) varied between US$2.0-2.5 million between 1990-1996, when aid was implemented in the energy sector, and since then it has been between US$1.5-2.0 million. The largest aid donors for Ecuador are: in terms of bilateral assistance, the United States (US$89 million), followed by Germany (US$ 52 million), Japan (US$ 28 million) and Spain (US$ 25 million)[87]. In terms of multilateral aid, the largest donors are the EU (US$ 52 million), GFTAM (General Fund for Tuberculosis, Aids and Malaria) (US$ 7 million) and UNICEF (US$ 2 million), etc.[88]

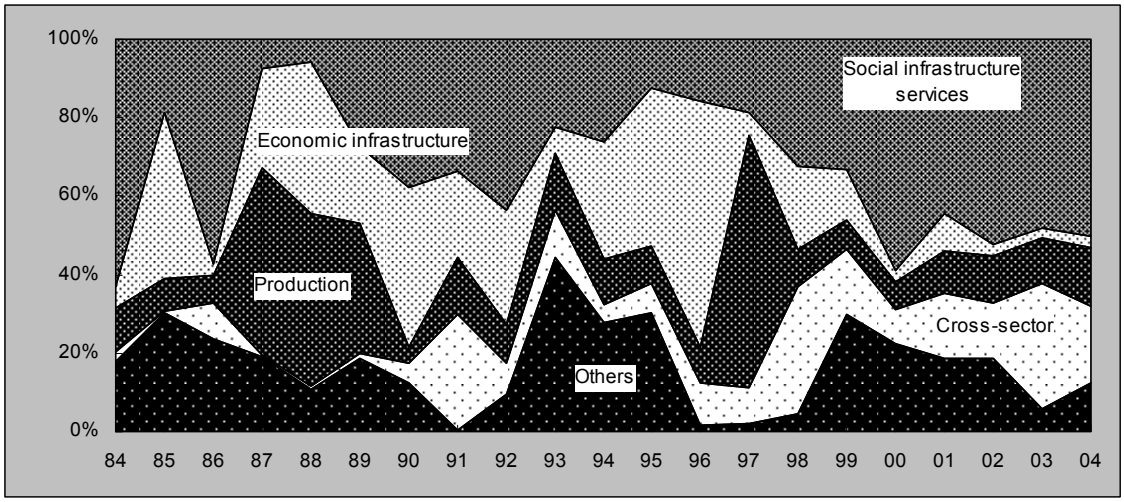


Note: Based on net disbursement
Source: Prepared from DAC International Development Statistics (IDS)

Figure 10-1 Past Aid to Ecuador (US$ million)

Looking at trends by sector, support for economic infrastructure has increased in approximately five-year cycles after 1985, however, it fell off sharply after peaking in 1995, when Japan provided loan aid for a transmission line project and irrigation project and Spain and Italy provided aid for the energy sector. Japan hasn't provided a yen loan since the Porto Piejo River basin water conveyance project in 1997. As a recent trend, aid for social infrastructure and service sectors such as elementary education and public health, etc. have overtaken aid for economic infrastructure and now account for 50% of overall aid, and aid for the environmental conservation field is also increasing.

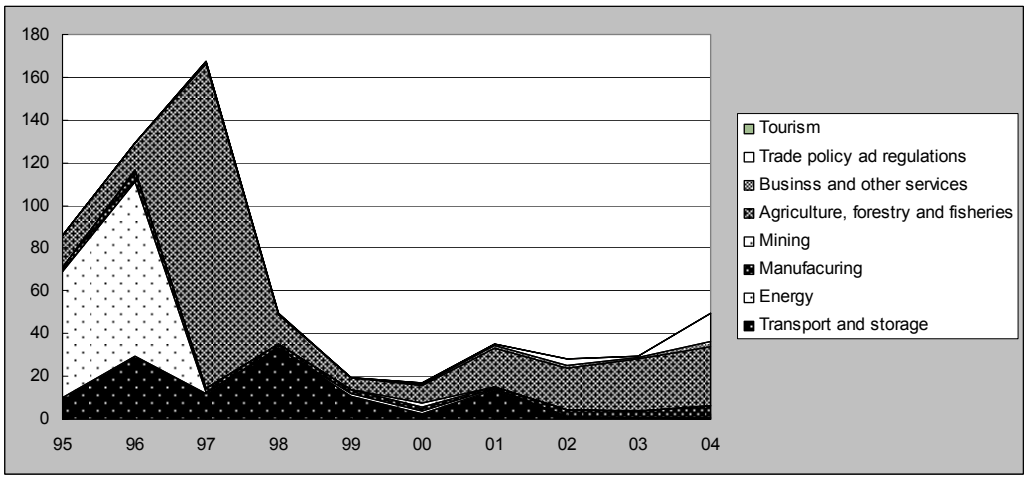
[87] DAC International Development Statistics, 2004
[88] Ditto



Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 10-4 Past Aid by Sector in Ecuador (1984-2004)

Figure 10-5 shows aid in the economic development field over the past 10 years[89]. Up until 1996, support for the energy sector accounted for 40% of aid, however, support for agriculture has been increasing since 1997. After peaking at US$167 million in 1997, aid in the economic development field decreased to US$17 million by 2000, although it has been on the rise again in recent years. Moreover, in addition to agriculture, aid is recently increasing towards the trade policy and regulation sector, the manufacturing sector and the business and other services sector (albeit in small amounts), indicating a growing diversity of aid.



Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 10-5 Past Aid by Sector for the Economic Development Field in Ecuador (1995-2004, US$ million)

[89] Summated assuming the economic development sectors of: transport and storage, energy, manufacturing, mining, agriculture, forestry, fisheries, business and other services, trade policy and regulations, and tourism.

	95	96	97	98	99	00	01	02	03	04
Economic development (US$mill)	85.7	129.2	167.2	49.6	19.8	16.9	35.1	28.2	29.5	49.6

Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure10-6 Past Aid for the Economic Development Field in Ecuador (1995-2004, US$ million)

10-3-2 Projects in the Economic Development Field (Japan and Major Donors)

(1) Japan

Until 10 years ago, Japan implemented development studies and yen loan projects mainly in the hard economic development field. Since 2002, however, the only technical cooperation project implemented in this sector has been an occupational training improvement project. Following policy discussions in July 2005, Japan's priority aid areas regarding Ecuador are: (i) poverty countermeasures, (ii) environmental conservation, and (iii) disaster prevention, and the economic development field is treated under "Industrial development and employment creation (human resources development)" under poverty countermeasures. In response to this, JICA has compiled a micro enterprise promotion program and is conducting support based mainly on occupational training. JBIC has not conducted financial cooperation to Ecuador since 1997 and there is little prospect of it doing so in the future.

Major Japanese projects implemented in the economic development field since 1995
[Development studies[90]] Guayaquil Port Master Plan Formulation, Southern Sierra Production Vitalization and Poverty Reduction Project Study
[Technical Cooperation Projects] Occupational Training Improvement Project
[Grant Aid] Project for Strengthening of Road Construction Equipment in the East, Project for Strengthening of Road Construction Equipment in Azuay Province, Project for Strengthening of Road Construction Equipment in Eloro Province, Project for Strengthening of Road Construction Equipment in the Southern Border Region, Occupational Training Improvement Project
[Load Aid] Second Transmission Network Project Phase B-2

(2) Major Donors

The following paragraphs describe the trends of aid by major donors in the economic development field, and summarize the points that require particular attention when considering support in this area.

USAID[91] Priority sectors are environmental conservation, democratization and creation of

[90] Concerning development studies, major projects in the economic development field implemented between 1995 and 2004.
[91] Ecuador Operational Plan FY2006", USAID, June 15, 2006, and results of local hearings

economic opportunities. In budget terms, support for environmental conservation is largest. USAID support in the economic development field is regarded as important for encouraging Ecuador to participate in FTA negotiations. The central component in this sector is micro finance, under which approximately 385,450 enterprises had benefited between 2001 and the present (corresponding to 31% of 1,250,000 micro enterprises). The amount of USAID support to Ecuador is going down, and it will be necessary to further prioritize sectors in the future. Major economic development field projects planned for fiscal 2007 are a competitiveness-strengthening project in the private sector giving consideration to the environment, a trade investment increase project, and a coca substitution economic development project in rural areas.

Important points to consider

- Implement support to the economic development field simultaneously with measures to promote democratization, i.e. transparency of the judicial system and support for local governments, etc.
- Give priority to support for key persons in economic activities rather than human resources development.

GTZ[92] Priority sectors are, (i) environmental conservation and resource management and (ii) state modernization, decentralization and local government support. Support for the economic development field is conducted as regional economic promotion under decentralization. In specific terms, related officials discuss impediments to economic development and relative areas of superiority in workshops held in each region, and short-term actions (3 months) are compiled. Local finances are then secured to start work on the short-term actions in 35 districts, and training is implemented where necessary. Through this process, early problem-solving is sought and cooperation is promoted between the public and private sectors and between administrative agencies. Moreover, success stories are periodically collated and introduced in seminars and awards are presented to successful local governments.

Important points to consider

- Initiative by the National Council of Competitiveness (CONCOPE), recruitment of consultants (Ohio University) and strengthening of provincial competitiveness under the auspices of the Ministry of Industry are effective measures.
- Priority areas of economic development are cocoa, tourism, fisheries, stockbreeding and business environment.

EU[93] Priority sectors and issues are threefold: (i) rectification of social disparities, (ii) economic stimulation, and (iii) regional integration and cooperation. Concerning the rectification of social disparities, aid is given to the education and public health sectors, environmental conservation and resource management for sustainable growth. Concerning economic stimulation, based on the framework of the WTO and Doha Summit, support is provided for building of the business environment, building of the overseas investment environment and protection of intellectual

[92] GTZ in Ecuador http://www.gtz.de/en/weltweit/lateinamerika-karibik/ecuador/1226.htm and results of local hearings.
[93] "Country Strategy Paper Ecuador 2002", EU and results of local hearings

property rights, etc. In the area of regional integration and cooperation, support is mainly directed towards the construction of transport infrastructure.

Important points to consider

- Give priority to the strengthening of industry groups and expansion of member corporations.
- Directly support industry groups without working through government agencies, for example, via expert education, staging of exhibitions and promotion of exchange between groups, etc.

IDB[94] Priority sectors are, (i) support for laying the foundations for industrial structure, and (ii) promotion of social development and protection of socially disadvantaged people. Concerning (i), support is provided based around a. systems building, b. improvement of production infrastructure (improvement of production infrastructure centering on transportation and electric power, modernization of the labor market, support of the finance market (micro finance), support of micro, small and medium enterprises), and c. promotion of economic diversification (trade agreements, export diversification, resource management and resource risk management).

Important points to consider

- Since administration and policies are more stable on the local level than the central government level, it is planned to increase the number of projects targeting local governments.
- The Government of Ecuador has sufficient fiscal funds due to inflation in the price of oil and revenue from state-owned enterprises, however, it is weak in terms of information and management.
- The success of projects is largely determined by the stance and capability of receiving agencies, however, there are numerous failures in the social sector (education, public heath, labor, etc.), especially investment projects with limited objectives. Projects are more likely to succeed in cities because the governments there are better equipped.

AECI[95] Priority sectors are, (i) support for the building of democratic government (judicial support, local government administration support), (ii) social sector support (social security, elementary education), and (iii) economic promotion support based on micro, small and medium enterprises. Concerning (iii), in addition to micro finance support, support for improving production management and planning capacity in the agricultural sector is provided with women, native peoples and migrant workers the priority targets.

[94] "The Bank's Country Strategy With Ecuador 2004", IDB and results of local hearings
[95] Documento de Estrategia Pais 2005-2008 Ecuador" Cooperacion Espanola and results of local hearings

Table 10-6　Priority Aid Sectors of Donors in Ecuador and Features of Aid in the Economic Development Field

Agency	Priority Sector	Aid Priorities in the Economic Development Field	Specific Examples
JICA	**①Poverty reduction** ②Environmental conservation ③Disaster prevention	・Industrial development and employment promotion through promotion of micro enterprises (human resources development) -Human resources management and quality control capacity strengthening based on key industry (oil) -Strengthening of competitiveness and promotion of employment in micro, small and medium enterprises -Human resources development through nurturing teachers in job training agencies -Human resources development and employment promotion among people in poverty (especially women and native peoples) ・Promotion of regional social development through agricultural development and rural development -Improvement in household economy of farmers through increasing agricultural productivity and utilizing rural resources -Higher productivity through grouping of artisanal fishermen	【Micro Enterprises Promotion Program】 Technical cooperation project: Occupational Training Improvement Project Expert dispatch: Micro, small and medium enterprise management, quality control, guidance in using job training machinery, etc. 【Agricultural Development and Rural Development Program 】 Development Study: ：Southern Sierra Production Vitalization and Poverty Reduction Project Study JCPP：Fisheries Cooperative Strengthening Project
USAID	①Environment ②Democratization **③North-South border regions development** ④Poverty reduction	・Promotion of Ecuador's FTA participation ・Financial sector strengthening	【Small Trust Projects】 ・Enabling loans to micro enterprises through providing funds to 21 small-scale financial institutions. The fund amount gradually increased from US$86 million in 2001 to US$302 million in 2004. ・Support for export of local products (in support for leather products in Quenca, local producers were matched with American buyers). ・Discovery and networking of promising business leaders.
GTZ	①Environmental conservation and resource management ②State modernization (decentralization and local government support)	Strengthening of competitiveness of regional economy	【Business Environment Project】 ・GTZ organized a Participatory Analysis of Competitiveness Analysis (PACA) team in each area, examined relative superiority and, when common awareness of problems was achieved, constructed problem-solving setups with universities, etc. and took actions geared to improvement.
EU	①Rectification of social disparities **②Economic stimulation** ③Regional integration and cooperation	Development of business environment between EU and Ecuador, Development of overseas investment environment, protection of intellectual property rights	【Banana Industry Support】 ・Support for strengthening of negotiating power and quality control of micro enterprise groups. Not support to the government - rather direct support to industrial groups.
IDB	**①Support for laying the foundations for industrial structure** ②Promotion of social development and protection of socially disadvantaged people	・Policy to increase productivity and competitiveness, organizational framework building, formulation of business development programs ・Infrastructure development to aid productivity improvement ・Higher market efficiency ・Promotion of economic diversification	
AECI	①Support for the building of democratic government (judicial support, local government administration support), ②Social sector support (social security, elementary education ③E**conomic promotion support based on micro, small and medium enterprises**	Support and financial services for micro enterprises	Corporate support, regional tourism promotion, agricultural products processing

Source: Prepared by the Study Team based on the country-separate strategies and plans of JICA and donors and the results of local hearings


BOLIVIA
0 100 200 km
0 100 200 mi
Capitán Pablo Lagerenza
BRAZIL
Fuerte Olimpo
Doctor Pedro P. Peña
Gran Chaco
Pedro Juan Caballero
Concepción
San Pedro
Salto del Guairá
ASUNCIÓN
Ciudad del Este
Villeta
Villarrica
ARGENTINA
Pilar
Encarnación
Río Paraná

Chapter 11 Paraguay

11-1 Economic Overview

11-1-1 Resources and Geographical Conditions

Paraguay is situated almost in the center of the South American continent at lat. 20-28° S. Its land area (410,000 km2) is approximately 1.1 times the size of Japan and it has a population of roughly 6,000,000. It is a landlocked nation bordered by Brazil to the east, Argentina to the south and west, and Bolivia to the north. The climate belongs to the subtropics, and terrain is generally flat. The Paraguay River that runs north to south through the center of Paraguay divides the country into eastern Paraguay and western Paraguay. Eastern Paraguay, which covers approximately 40% of the national land, has relatively fertile land and forested hills and is home to 95% of the population; whereas western Paraguay, which covers 60% of the national land, comprises vast undeveloped grasslands, while the northwest of the country near the border with Bolivia is akin to desert.

The majority of economic activities in Paraguay are conducted in the east of the country. Starting with the capital Asuncion, which has developed on the banks of the Paraguay River on the border with Argentina, all the major cities including Siudadel Este on the border with eastern Brazil and Encarnacion in the south are located on this side of the country. In Alto Parana Province and other areas close to the border with Brazil, agricultural production centered on soybeans and raw cotton is carried out.

Moreover, dairy farming has traditionally been conducted by immigrant farmers from Europe, mostly Germany, in western Paraguay, also known as Gran Chaco, and this area has developed as an export center of beef and dairy products in recent years. Large-scale production and exporting is conducted by German-affiliated cooperatives, and per capita GDP in this region is said to be the highest in all Paraguay.

Paraguay does not have any conspicuous mineral resources apart from nonferrous metals and limestone that is used in the local construction industry and so on. Meanwhile, utilizing the water resources of Parana River on its southern borders, Paraguay operates the Itaipu Hydropower Station in a joint effort with Brazil, and this has the largest hydropower generating capacity in the world. It also operates the Yashereta Hydropower Station in a joint effort with Argentina. Since domestic demand only accounts for 5% of the generated electricity, the remaining 95% is exported to the partner nations, making Paraguay one of the biggest exporters of electricity in the world.

Table 11-1 Sector-Separate Composition of GDP in Paraguay

Production amount — Unit: Billion guarani

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 *
Agriculture	3,043.9	3,003.9	3,210.2	3,249.6	3,290.2	3,061.1	3,417.5	3,559.6	3,845.3	3,995.3
Mining	20.1	18.8	18.3	17.6	17.5	16.6	15.2	13.8	16.0	16.4
Manufacturing	2,162.3	2,203.2	2,221.9	2,218.5	2,206.7	2,157.9	2,142.6	2,112.5	2,128.1	2,198.2
Meat processing	359.8	356.3	364.5	369.1	364.9	334.3	336.8	338.1	331.6	378.1
Fat and oils	82.3	75.2	75.4	75.5	77.1	78.9	79.4	80.1	79.7	86.8
Beverages, tobacco	218.9	237.8	238.3	249.3	257.2	265.2	264.9	268.1	274.1	279.6
Textiles and clothing	334.9	345.7	331.1	332.4	333.0	338.4	335.7	336.3	380.7	399.8
Leather and shoes	88.1	85.9	88.1	84.3	86.8	89.1	88.4	85.8	83.3	88.8
Timber products	145.1	140.1	134.3	132.3	124.1	117.4	109.9	106.4	98.2	99.3
Non-metal processing	198.9	199.7	205.1	203.1	202.9	188.9	184.8	165.0	178.5	181.6
Other manufacturing	734.4	762.6	785.0	772.5	760.7	745.6	742.8	732.7	701.8	684.2
Electricity and water	221.6	219.1	224.3	228.7	232.5	236.9	241.5	244.1	255.3	264.5
Construction	716.4	668.7	651.7	647.4	610.0	562.1	554.0	504.7	577.1	589.5
Commerce	2,830.7	2,867.1	2,824.6	2,865.6	2,685.3	2,582.5	2,581.5	2,536.0	2,683.1	2,826.1
Transport and telecommunications	730.2	772.5	916.8	937.0	948.7	962.0	982.0	1,001.5	1,008.7	1,105.9
Financial services	372.0	375.9	396.8	364.1	352.5	332.2	335.5	334.9	312.5	314.7
Government services	994.4	1,045.0	1,098.9	1,087.3	1,103.2	1,096.5	1,015.5	997.7	991.3	1,025.5
Other services	1,558.9	1,591.8	1,619.0	1,666.5	1,681.1	1,691.2	1,682.7	1,689.5	1,680.5	1,716.1
GDP total (including taxation)	13,941.4	13,997.6	14,416.4	14,499.9	14,285.0	13,807.1	14,092.1	14,085.3	14,626.1	15,230.9

Note: 1994 as reference. * indicates provisional values.

Composition Ratio — Unit: %

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 *
Agriculture	21.8	21.5	22.3	22.4	23.0	22.2	24.3	25.3	26.3	26.2
Mining	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Manufacturing	15.5	15.7	15.4	15.3	15.4	15.6	15.2	15.0	14.5	14.4
Meat processing	2.6	2.5	2.5	2.5	2.6	2.4	2.4	2.4	2.3	2.5
Fat and oils	0.6	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.5	0.6
Beverages, tobacco	1.6	1.7	1.7	1.7	1.8	1.9	1.9	1.9	1.9	1.8
Textiles and clothing	2.4	2.5	2.3	2.3	2.3	2.5	2.4	2.4	2.6	2.6
Leather and shoes	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Timber products	1.0	1.0	0.9	0.9	0.9	0.9	0.8	0.8	0.7	0.7
Non-metal processing	1.4	1.4	1.4	1.4	1.4	1.4	1.3	1.2	1.2	1.2
Other manufacturing	5.3	5.4	5.4	5.3	5.3	5.4	5.3	5.2	4.8	4.5
Electricity and water	1.6	1.6	1.6	1.6	1.6	1.7	1.7	1.7	1.7	1.7
Construction	5.1	4.8	4.5	4.5	4.3	4.1	3.9	3.6	3.9	3.9
Commerce	20.3	20.5	19.6	19.8	18.8	18.7	18.3	18.0	18.3	18.6
Transport and telecommunications	5.2	5.5	6.4	6.5	6.6	7.0	7.0	7.1	6.9	7.3
Financial services	2.7	2.7	2.8	2.5	2.5	2.4	2.4	2.4	2.1	2.1
Government services	7.1	7.5	7.6	7.5	7.7	7.9	7.2	7.1	6.8	6.7
Other services	11.2	11.4	11.2	11.5	11.8	12.2	11.9	12.0	11.5	11.3
GDP total (including taxation)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Growth Rate — Unit: %

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 *
Agriculture	11.8	-1.3	6.9	1.2	1.3	-7.0	11.6	4.2	8.0	3.9
Mining	2.4	-6.1	-3.0	-3.8	-0.4	-5.2	-8.3	-9.1	15.6	2.7
Manufacturing	-2.3	1.9	0.8	-0.2	-0.5	-2.2	-0.7	-1.4	0.7	3.3
Meat processing	0.6	-1.0	2.3	1.3	-1.1	-8.4	0.8	0.4	-1.9	14.0
Fat and oils	2.7	-8.6	0.3	0.1	2.2	2.4	0.5	1.0	-0.6	9.0
Beverages, tobacco	5.7	8.6	0.2	4.6	3.1	3.1	-0.1	1.2	2.2	2.0
Textiles and clothing	4.5	3.2	-4.2	0.4	0.2	1.6	-0.8	0.2	13.2	5.0
Leather and shoes	-0.4	-2.5	2.6	-4.4	3.0	2.7	-0.8	-2.9	-2.9	6.6
Timber products	0.8	-3.4	-4.2	-1.5	-6.2	-5.4	-6.4	-3.2	-7.7	1.1
Non-metal processing	4.1	0.4	2.7	-1.0	-0.1	-6.9	-2.2	-10.7	8.2	1.7
Other manufacturing	-10.8	3.8	2.9	-1.6	-1.5	-2.0	-0.4	-1.4	-4.2	-2.5
Electricity and water	1.6	-1.2	2.4	1.9	1.7	1.9	1.9	1.1	4.6	3.6
Construction	2.2	-6.7	-2.5	-0.7	-5.8	-7.8	-1.4	-8.9	14.4	2.1
Commerce	2.6	1.3	-1.5	1.5	-6.3	-3.8	0.0	-1.8	5.8	5.3
Transport and telecommunications	7.8	5.8	18.7	2.2	1.3	1.4	2.1	2.0	0.7	9.6
Financial services	-1.0	1.0	5.6	-8.2	-3.2	-5.8	1.0	-0.2	-6.7	0.7
Government services	3.3	5.1	5.2	-1.1	1.5	-0.6	-7.4	-1.8	-0.6	3.5
Other services	1.8	2.1	1.7	2.9	0.9	0.6	-0.5	0.4	-0.5	2.1
GDP total (including taxation)	5.5	0.4	3.0	0.6	-1.5	-3.3	2.1	0.0	3.8	4.1

Source: Banco Central del Paraguay

11-1-2 Industrial Structure

Looking at the breakdown of Paraguay's GDP by industry, agriculture (including stockbreeding and forestry) accounts for more than 20%, which is by far the highest ratio out of all the countries in South America[96]. In the background to this is the absence of a mining sector, which is an important industry in other Andean nations and comparatively slow development of the manufacturing sector. Even among the four poorest nations on the continent, Paraguay is the purest agricultural nation. Within the agricultural sector, agricultural production accounts for approximately 70%, stockbreeding for approximately 20% and forestry for the remainder, however, over the past 10 years the first two sectors have extended production while forestry production has been in slow decline. Manufacturing accounts for around 15% of GDP and this

[96] For comparison with other South American countries, see Commissioned Survey A: Table 9.

ratio has remained more or less constant over the past 10 years. Major products are processed foods and processed primary products such as meat, textiles, clothing, beverages and tobacco. There is some non-metal processing, metal processing, petroleum refining and chemicals manufacturing, etc., however, the scale of these activities is small.

Ever since a civilian government was established in the early 1990s, Paraguay has promoted economic liberalization, macro economic stabilization based on tax reform and economic restructuring based on privatization; however, these reforms triggered civil disturbance and political instability. Moreover, feeling the impact of economic deterioration in Brazil and Argentina, the Paraguayan economy fell into recession and per capita GDP fell from almost US$2,000 in 1996-7 to around US$1,000 in 2003. President Doarte, who was appointed the same year, succeeded in stabilizing the macro economy through reducing the external debt and conducting tax reform, etc. and the GDP recorded positive growth for three years running. However, there is criticism that the outcomes of this have not translated into expansion of employment and improvement of incomes. Recent economic growth has mainly occurred on the back of expansion of agricultural products and processed goods exports, but the future issues will be to overcome fragility of the industrial structure that is dependant on primary products and to continue working for reform of the socioeconomic structure in order to enable all citizens to enjoy the benefits of economic growth.

11-1-3 Trade Structure

(1) Structure of Exports

Paraguay's exports increased for three consecutive years up to 2005 and reached the highest ever level of US$1.69 billion; however, the rate of growth fell sharply in 2005. Primary agricultural products account for the majority of exports, while processed agricultural products dominate exports of manufactured goods too. Looking at the trend over the past 10 years, the total value of exports fell at the end of the 1990s and in 2002, indicating a clear link with the economic performance of Brazil and Argentina. Major exported agricultural products are soybeans, meat (beef) and raw cotton. Raw cotton was the largest export commodity during the 1980s, however, exports declined due to falling prices, and soybeans replaced this as the largest export item, accounting for one-third of total export value. Modern production based on large-scale investment including that by major U.S. corporations is carried out, and Paraguay is now the world's fourth largest producer of soybeans[97]. Beef production and exports have increased rapidly in recent years. Until now, due to the restrictions placed on beef exports in response to the outbreak of foot and mouth disease in 2002 and problems arising from quarantine in other countries, beef exports struggled to grow, however, large-scale exporting is now taking place mainly towards Chile and Brazil. Other major exports are vegetable oil (to Uruguay and Brazil, etc.) and timber products (to the United States and Argentina, etc.), each accounting for 7% and 5% of total exports, respectively.

In terms of export destinations, the main countries are Uruguay followed by Brazil and Argentina (2004). After 2000, exports to these Mercosur nations reached more than 60% of all

[97] 2003 data (source: Economist Intelligent Unit)

Paraguay's exports, and the Mercosur market is growing in importance[98]. However, considering that 50% of Paraguay's imports were already directed to this region in the mid 1990s[99], when the Mercosur tariff union was established, the effect of regional integration in terms of export expansion has not been as large as expected; rather, it could be said that Paraguay has only increased the level of its dependence on the economic condition of Brazil and Argentina. Major export destinations behind Mercosur are the EU, Switzerland and the United States.

Table 11-2 Composition of Paraguay's Exports

Value of Exports (FOB) Unit: US$1,000

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004*	2005*
Primary products	610,863	668,172	633,205	447,678	497,582	580,179	511,812	695,922	909,814	919,330
Agriculture	**522,078**	**576,603**	**524,939**	**375,294**	**368,772**	**443,684**	**381,753**	**580,107**	**694,893**	**611,883**
Raw cotton	188,146	72,857	75,419	61,546	78,493	83,469	35,961	58,098	110,079	40,289
Coffee	846	1,958	718	93	385	38	149	119	62	69
Tobacco	8,816	8,010	8,222	6,170	3,673	3,427	4,309	4,153	5,707	4,902
Mate	113	180	265	351	297	436	650	778	340	435
Soybeans	324,157	493,598	440,315	307,135	285,924	356,315	340,684	516,959	578,705	566,188
Livestock	**88,785**	**91,569**	**108,265**	**72,383**	**128,810**	**136,494**	**130,059**	**115,815**	**214,921**	**307,447**
Meat	46,826	49,202	69,462	35,394	72,728	78,091	72,471	61,071	161,706	253,813
Leather	41,959	42,367	38,803	36,989	56,082	58,403	57,588	54,744	53,216	53,634
Manufactured goods	439,432	480,796	390,755	305,338	380,024	419,449	449,105	557,757	735,708	787,141
Alcohol, distilled liquor	**3,095**	**2,273**	**925**	**261**	**191**	**152**	**1,103**	**60**	**107**	**295**
Sugar	**3,755**	**3,916**	**8,931**	**11,986**	**8,057**	**9,270**	**9,214**	**11,981**	**18,831**	**18,353**
Vegetable oil	**77,237**	**69,162**	**86,259**	**62,233**	**52,030**	**63,411**	**97,299**	**111,951**	**143,399**	**113,006**
Coconut oil	2,328	1,103	1,253	743	586	160	1,027	841	979	2,127
Wood oil	3,377	7,352	3,451	2,570	2,216	1,254	2,278	2,546	4,989	6,450
Soybean oil	58,144	47,952	60,935	35,993	30,955	42,087	70,998	83,355	109,949	76,350
Refined oil	13,388	12,755	10,764	10,681	10,024	10,488	12,679	13,168	8,545	9,431
Timber products	**94,018**	**100,722**	**69,657**	**58,797**	**75,062**	**68,738**	**56,155**	**58,431**	**74,856**	**79,503**
Others	**261,327**	**304,723**	**224,983**	**172,061**	**244,684**	**277,878**	**285,334**	**375,336**	**498,515**	**575,985**
Total	1,043,445	1,142,779	1,014,103	740,769	869,357	990,205	950,600	1,241,504	1,626,584	1,687,823

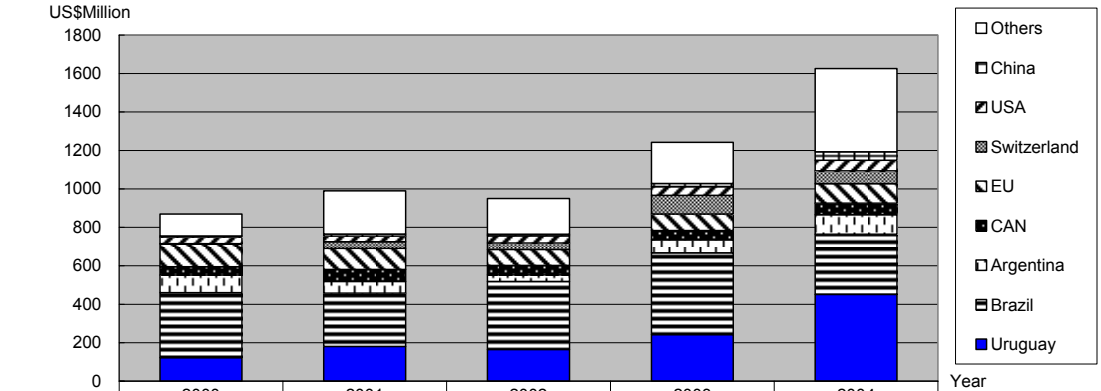
* indicates provisional values.

Composition Ratio Unit: %

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004*	2005*
Primary products	58.5	58.5	62.4	60.4	57.2	58.6	53.8	56.1	55.9	54.5
Agriculture	50.0	50.5	51.8	50.7	42.4	44.8	40.2	46.7	42.7	36.3
Raw cotton	18.0	6.4	7.4	8.3	9.0	8.4	3.8	4.7	6.8	2.4
Coffee	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tobacco	0.8	0.7	0.8	0.8	0.4	0.3	0.5	0.3	0.4	0.3
Mate	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0
Soybeans	31.1	43.2	43.4	41.5	32.9	36.0	35.8	41.6	35.6	33.5
Livestock	8.5	8.0	10.7	9.8	14.8	13.8	13.7	9.3	13.2	18.2
Meat	4.5	4.3	6.8	4.8	8.4	7.9	7.6	4.9	9.9	15.0
Leather	4.0	3.7	3.8	5.0	6.5	5.9	6.1	4.4	3.3	3.2
Manufactured goods	42.1	42.1	38.5	41.2	43.7	42.4	47.2	44.9	45.2	46.6
Alcohol, distilled liquor	0.3	0.2	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Sugar	0.4	0.3	0.9	1.6	0.9	0.9	1.0	1.0	1.2	1.1
Vegetable oil	7.4	6.1	8.5	8.4	6.0	6.4	10.2	9.0	8.8	6.7
Coconut oil	0.2	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1
Wood oil	0.3	0.6	0.3	0.3	0.3	0.1	0.2	0.2	0.3	0.4
Soybean oil	5.6	4.2	6.0	4.9	3.6	4.3	7.5	6.7	6.8	4.5
Refined oil	1.3	1.1	1.1	1.4	1.2	1.1	1.3	1.1	0.5	0.6
Timber products	9.0	8.8	6.9	7.9	8.6	6.9	5.9	4.7	4.6	4.7
Others	25.0	26.7	22.2	23.2	28.1	28.1	30.0	30.2	30.6	34.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Banco Central del Paraguay

[98] However, almost half of exports to Uruguay (28% of all exports in 2004) comprise soybean-related products, many of which are thought to be re-exported to third countries outside of the region.
[99] See the Commissioned Survey report B: Table A.2.



	2000	2001	2002	2003	2004
Others	114.5	224.9	186.3	213.3	432.6
China	5.9	10.7	7.7	16.7	44.5
USA	33.7	29.3	38.0	45.0	55.0
Switzerland	1.6	34.4	33.4	97.1	66.7
EU	118.4	110.1	83.0	85.7	101.5
CAN	43.8	62.1	49.4	49.4	60.1
Argentina	92.0	60.8	34.7	66.4	101.8
Brazil	336.6	277.9	353.0	424.9	312.5
Uruguay	123.0	180.0	165.1	243.1	451.2

Source: IMF, Direction of Trade Statistics Yearbook 2005

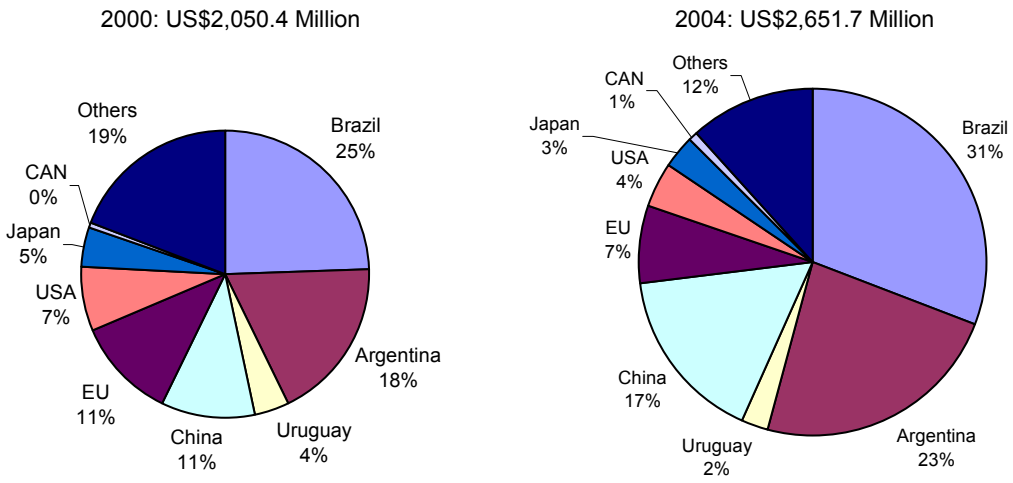
Figure 11-1 Main Export Destinations of Paraguay

(2) Composition of Imports

Except for minor exceptions, imports have greatly exceeded exports in Paraguay over the past 30 years. The value of imports in 2005 was US$3.25 billion, which was roughly twice as much as the value of exports. The ratio of imports to GDP in 2005 was approximately 45%, far higher than the other South American countries[100], indicating that Paraguay is a small economy with high dependence on imports. The import ratio of capital goods, raw materials and intermediate goods, and consumer goods is roughly one-third each, demonstrating the fragility of production activities in general including everyday items.

As for import sources, Mercosur countries are the biggest trade partners as in the case of exports, and imports from the three Mercosur countries in 2004 were 57% of the total. In contrast to exports, imports demonstrated dramatic growth from 39% in the mid 1990s[101]. In other words, for Paraguay the impact of trade expansion because of the establishment of Mercosur has been to greatly increase the inflow of products from Brazil and Argentina in particular. Moreover, devaluation of the Brazilian and Argentinean currencies has also had a major impact on this process. Major imports from Brazil are fertilizers, boilers and machines, while the biggest imports from Argentina are petroleum and gas. Apart from Mercosur countries, imports from China have been growing in recent years, and these mainly comprise machines and electric instruments.

[100] See the commissioned Study Report B: Table 1.
[101] See the commissioned Study Report B: Table A.4.



Source: IMF, Direction of Trade Statistics Yearbook 2005

Figure 12-2 Main Import Sources of Paraguay

11-1-4 Acceptance of Direct Investment from Overseas

Direct overseas investment to Paraguay was almost non-existent up until the 1980s, however, it gradually increased in the 1990s and the net incoming amount in 1998 was approximately US$330 million. However, it declined again after that due to the economic recession over the whole region, the slow pace of privatization and opacity of the political situation. Investment has been growing slowly since 2003 and reached US$100 million in 2005. Cumulative investment until 2004 was US$1.03 billion, and the main investing nations in order were the United States, Luxembourg, Brazil, the Netherlands and Argentina. Investment is mainly directed towards the food processing and beverage sectors based on large-scale agricultural exports (23% of all investment in 2003), followed by commerce, telecommunications and finance.

It is generally recognized that the stagnation of investment into Paraguay is caused by the country's ambiguous legal system, lack of transparency in government agencies, shortages of skilled labor, under-development of electric, telecommunications and transport infrastructure and general inadequacy of the investment environment. According to the WTO (Trade Policy Review: Paraguay 2005), economic integration within the Mercosur region has not stimulated overseas investment into Paraguay, and the long-term keys to higher investment in the future will be improvement of institutions and governance.

11-2 Industrial Promotion Policies and Systems

11-2-1 Current Industrial Policy and its Background

The dictatorship of General Stroessner was beaten in the presidential election of 1989, and the victorious President Rodriguez established a democratic constitution, marking the beginning of democratic politics. However, successive administrations lost the support of the people because of scandals and power struggles. In April 2003, the administration of President Gonzalez Macchi, who lost public confidence due to corruption and the problem over privatization of the state telephone and telecommunications corporation, lost the election and a new government was started. During this period, the economy of Paraguay suffered major damage due to the start of Mercosur in 1995, devaluation of the Brazilian currency in 1999 and devaluation of the Argentinean peso in January 2002. In recent times, the economy of Paraguay has remained overly dependent on agricultural products but it is managing to develop at a slow rate thanks to the steady international price of soybeans and growth in meat exports. However, due to the fragility of industrial structure and increasingly large poverty classes, the economy lacks any potential for basic improvement.

The present administration that was started in April 2003 has raised a policy that puts poverty reduction at the center of the agenda, and it has published a development-related paper having the following contents:

- August 2003: 2003-2008 Government Program
- November 2003: National Strategy for Reduction of Poverty and Disparities and Protection of Socially Disadvantaged People
- November 2004: Fair Economic Growth Plan

In the said plan, the following are raised as the “6 priority areas” of development policy:

- Administrative reform and modernization
- Development of an economic environment in which there is confidence and it is possible to make predictions
- Sustainable economic growth
- Equalization of education opportunities for improving human resources
- Expansion of outward looking perspective and participation in international society
- Poverty reduction and support of the socially disadvantaged

However, the background to these policies is held back by numerous restrictions and issues in terms of history of the economy of Paraguay, society, geopolitics, resources and foreign diplomacy. The policy issues of the present administration can be interpreted as follows in terms of industrial policy:

- Development of the business environment whereby efficient economic activities become possible through the modernization of administration
- Promotion of investment and attraction of overseas capital through development of a stable business environment
- Stable and sustainable economic growth through industrial structural improvement and

economic vitalization

- Development of the industrial base through thorough implementation of basic education and development of human resources
- Participation in international trade going beyond regional markets, and development of new products geared to international markets
- Increase in income and creation of business start opportunities through vitalization of peasant farmers and micro and small enterprises

11-2-2 Current Framework of Measures and Issues

(1) Financial System

As of October 2005, there are 13 banks, 12 deposit and loan companies and 23 foreign currency companies. Foreign banks own 49% of all bank assets, and foreign-affiliated local banks hold 38% of all deposits. The two main banks are ABN-AMRO and Citibank – both foreign-owned banks. Citibank, which downsized operations to just corporate lending in 2003, owns 15% of all commercial bank assets. Due to the new law that was enforced in 1994, credit operations and commercial transactions, which until then had been limited to just the Paraguayan currency, were liberated to include foreign currency transactions. As a result, dollar-based transactions increased and 67% of all bank deposits in 2002 came to be based in foreign currencies. However, depreciation of the dollar in 2003 caused people to shift back to the local currency, and the ratio of deposits in the local currency as of the end of 2005 had returned to 49%. Interest on loans in Paraguayan currency by commercial banks continues to be high in reflection of high spreads, however, the situation was somewhat improved from 2004 onwards.

Table 11-3 Loan Rate of Interest

Currency	2004	2005
Guarani	33.5%	26.6%
US$	8.1%	9.1%

An industrial banks having the goal of providing credit to industry has been established, and this offers loans via commercial banks. There is also a two-step loan system geared to aiding agricultural development, however, there is no credit system for very small farmers and, even if commercial finance is conducted relatively smoothly, there is need for a political financing support system for businessmen.

(2) Education and Training

1) Basic Training

Problems confronting basic education in Paraguay are large numbers of illiterate people and high dropout rates. Meanwhile, the present education budget is low at just 4% of GDP, and levels of school infrastructure development, textbooks and educational literature provision, etc. are extremely low. In response to this situation, infrastructure development has been conducted at 47 schools (2003) and equipment has been supplied to 11 local schools in two prefectures, however, apart from this, all efforts have focused on teacher training. Other aid efforts have

included school building construction and extension and an improvement plan for elementary education by the IDB, improvement of secondary education and teacher retraining (AECI) by the World Bank, and so forth. However, basic issues remain in the shape of teacher shortages due to lack of budget, low quality of teachers, shortages of schools in depopulated areas, lack of hardware installation, and lack of awareness of the importance of education in rural areas.

2) Specialized Education

Until recently Paraguay only had two universities (national university and Catholic university), however, the establishment of 10 private universities was permitted at the start of the 1990s. However, all of these universities are low-level institutions. In addition, there are training centers in specialized technologies (small and medium enterprise centers, etc.) and various training systems run by international agencies. In the agricultural field, dormitory-style high schools are operated under the jurisdiction of the Ministry of Agriculture and Stockbreeding.

(3) Support for Small Farmers and Peasants

People living in poverty account for 46% of the total population of Paraguay and 50.5% of the population in rural areas[102]. The rural areas also have high concentrations of the poorest classes including landless peasants, and this situation is a major social problem. Countermeasures to this situation are important support themes relating to agriculture, which is the central pillar of Paraguayan industry, and poverty problems. Major issues related to this matter are the advancing separation of large farmers and small farmers, anti-social movements by landless peasants, shortage of employment opportunities in rural areas, shortages of cash crops, poor development of sales routes, and poor access to social security, education and occupational training, etc., and numerous donors are conducting various kinds of support under the cause of poverty countermeasures.

Government-sponsored countermeasures include the following: credit system for small farmers (Agricultural Trust Association – CAH), domestic market development and export promotion through a program for promotion of 14 commodity crops and dairy products (MAG), agricultural test and research of agricultural products MAG-IAN), granting of land deeds (IBR), rural area permanent establishment program (IBR), and a project for the revitalization of cotton cultivation, etc. Examples of support by international agencies and other donors are as follows: project for rationalization of land use and reduction of poverty (WB), rural colonia strengthening (IDB), promotion of entrepreneurship (AECI), small farming micro finance (International Agricultural Development Fund), family agriculture support (EC), credit for owners of farmland less than 20 ha (JBIC), natural resources development and management project for family farm workers (WB), etc.

(4) Infrastructure Development

Due to the poor development of arterial highways and inadequate maintenance of existing roads, domestic transportation costs are increasing, and this is having an impact on the

[102] 2002 Household Survey

competitiveness of products comprising mostly agricultural products. Problems that form the background to this situation are lack of government budget, corruption in the area of road construction, low maintenance and management technology and a lack of rational construction plans, etc. Meanwhile, the government's infrastructure development plans include bridge construction over Parana River, a port construction plan on Parana River, construction of cereals distribution centers and so on. In addition, numerous road projects are being implemented under financing from the IDB, AECI and JBIC, etc.

(5) Special Tax System

As special tax systems for industrial promotion, value added tax is exempted on exports (draw back) a part of the export promotion policy, and import commission and tariffs are exempted on components for export items. Other special measures include tax exemption measures in FTZ, provisional import measures and value added tax exemptions in the Maquila system, and exemption of the Mercosur common tariff on capital, raw materials, parts and other components.

(6) Research and Development

Research and development is carried out into agricultural products, which are the main products of Paraguay, and agriculture-related technologies. The major themes of research and development implemented by government agencies (with cooperation from CETAPAR, CAPECO and MAG-JICA too) are soil degradation countermeasures and land use technology. Moreover, research of disease and pest damage countermeasures (genetic research and varietal development, etc. by CAPECO and MAG) and seed strengthening support (United States IICA) are implemented. Training of soil management technicians and forestation engineers is carried out simultaneously with such research and development.

(7) Promotion of Exports

The population of Paraguay is 6 million, however, about a half of the people live in poverty and the domestic market is restricted. Through joining Mercosur, if Paraguay is exposed to free competition (without tariff barriers) with industrial powerhouses such as Brazil that have major domestic markets, most of its manufactured goods will have no chance of survival because Paraguay has no domestic raw materials and poor technical capability. According to the industrial federation of Paraguay, 400 corporations have gone bankrupt due to the country's membership of Mercosur. Meanwhile, Paraguayan products that can be internationally competitive are agricultural products such as soybeans and raw cotton and livestock products such as meat, etc., which are blessed with vast land and appropriate climate, can be produced in large quantities, and are international commodities that can be pass in international markets. However, primary products such as these have low added value and productivity, and they are fragile in that revenue is greatly affected by international prices and weather conditions. The key to developing products that can contribute to economic stability, have high productivity and added value and are internationally competitive lies in the development of export markets.

Paraguay has recently awoken to the importance of export promotion and, under the national

export plan, it has set up specialized agencies such as REDIEX and PROPARAGUAY to actively deploy new export promotion policies. Government ministries and agencies, the National Science and Technology Commission (CONACYT), the National Technical Standards Agency (INTN), private sector NGOs, corporate groups, universities and research agencies take part in the implementation of such measures, which include a wide range of activities including the following: unification of export and investment procedures, the Maquila system, an export preferential investment system, promotion of collaboration between export-oriented corporations, establishment of a confederation of export-related personnel, establishment of sector-based policies for exports, movements in exports of non-traditional products, development of new exporters, building of an industrial priority support system, participation in overseas exhibitions, development of overseas retail centers, setting of target markets, development of overseas markets, acquisition of market information and construction and disclosure of a database, establishment of overseas offices, and so forth. Moreover, REDIEX and PROPARAGUAY mutually collaborate in order to promote exports and investment.

(8) Domestic Market Development

The priority sales market for domestic products is the home market. In particular, direct sales markets for micro enterprises and small farmers are local markets, where they are most able to display their retailing capability. Moreover, development of domestic markets is connected to the vitalization of local areas and directly contributes to improvement in the incomes of local citizens. Accordingly, the necessary requisites for this are the preparation of wholesale markets and free sale markets in regional cities and development of distribution infrastructure for local products.

11-2-3 Policy Systems and Administration Required of the Government

- Whereas market expansion was anticipated following Paraguay's entry to Mercosur, in reality private sector corporations are annoyed that non-tariff barriers are impeding the development of Paraguayan exports. It is necessary for the government to develop a backup system comprising guidance on standardization and establishment of inspection agencies, etc., as well as to conduct forceful negotiations with member nations concerning the simplification of trade procedures, etc. If there are guarantees that entry to the major markets of Mercosur will go smoothly, it is likely that many overseas investors will be interested in investing in industries that are founded on Paraguayan products.
- As an aspect of measures to support small farmers, it is necessary to develop infrastructure for linking regional cities with rural villages, and to construct wholesale market and free market facilities in regional cities.
- The government should examine electric power efficient utilization plans based on hydropower generation from Itaipu. Through raising the efficiency of power transmission and distribution, it will be possible to minimize wasteful thermal power generation. It may even be possible to utilize the CDM.
- If river transport infrastructure on Paraguay River, etc. can be improved, thereby improving access to the Atlantic Ocean and reducing transport costs, this will lead to

strengthening in the export competitiveness of Paraguayan products. Investment of public funds is desired in order to implement dredging works, build a modern barge transportation system and improve current shipping, etc.

11-2-4 Relationship between Trade and Industrial Promotion

(1) Regional Collaboration (Mercosur)

According to statistics, exports to Mercosur countries account for 53% of Paraguay's exports. It is suspected that, since Paraguay is an inland nation and it receives large investment from Brazil, these exports include many products that are re-exported to third countries via Brazil. In any case, economic ties between Brazil and Paraguay are very close and it is thought will have a major impact on future industrial development strategy. Other important export destinations are CAN counties (4% of exports), Europe and the EU (13%), Asia (8%), NAFTA (4%), the Caribbean (13%) and Africa (1%). Relations with CAN and North America are not particularly important, whereas attention is directed to trade relations with Europe, Mexico, Latin American countries and Asia.

As a geographically landlocked country, because Paraguay's access to the world's markets apart from neighboring countries is limited to land and river routes through neighboring countries and air routes, it is confronted with major problems in terms of market access. Through the Mercosur agreement, Paraguay has basically committed itself to trade liberalization, however, in reality it is troubled with non-tariff barriers (mainly transportation procedures, import quarantine and inspection standards). Rather than being basic issues in terms of regional collaboration, such problems are considered to arise from differences in institutions and business customs and differences in state disparities. Accordingly, Paraguay needs to study and respond to the systems of export destination countries while taking into account its relations with its other export trade partners.

Also, as an issue requiring even greater emphasis regarding regional collaboration, it is necessary to consider the future outcome and impacts of promoting economic liberalization between major powers such as Brazil and small countries such as Paraguay.

11-2-5 Main Industries and Policies

(1) Agriculture and Stockbreeding

Agriculture and stockbreeding accounts for 25.6% of GDP (2005) and is the key industry in the Paraguayan economy. Moreover, agriculture and stockbreeding products provide more than 80% of exports, and this rises to more than 90% when processed products are included. Agriculture and stockbreeding is also the most important industry in terms of employment, providing employment for one-third of the working population. The two main products are soybeans and raw cotton, while other traditional products are beef, leather, timber, maize, wheat, tobacco and sugar. Non-traditional products that have developed in recent years are processed items such as nutritional supplements, textile products and leather products, etc.

Under standing the importance of this key sector, the government treats the improvement, maintenance and sophistication of agriculture and stockbreeding as a priority area and is implementing numerous related policies. Major policy fields include the above-mentioned

supports for small farmers, improvement of agricultural products, disease and pest countermeasures, soil improvement research, export promotion, human resources development and improvement of agricultural products distribution, etc. Moreover, with a view to realizing higher added value of traditional agriculture and stockbreeding products, the government is working on the development and diversification of new products, promotion of agricultural production processing, improvement of quality and development of special products (organic products), etc.

(2) Manufacturing

The manufacturing sector in Paraguay witnessed numerous bankruptcies (400 corporations) in the years following entry to Mercosur, and minus growth was recorded up to 2002; however, a trend of recovery was entered from 2003 and the economy has maintained growth of around 3% since 2004. In the background to these developments, it is understood that the entry of industrial imports from Brazil, etc. following entry to Mercosur led to the natural thinning of domestic makers, while competitive products such as processed agricultural items steadily became industrialized and steadily boosted their share. As future issues, it will be important to develop new products and promote the development of new industrial commodities that are based on local raw materials, are competitive and have high added value and productivity based on a policy of upgrading agriculture and stockbreeding raw materials processing industries. Moreover, strengthening of the industrial base for this purpose (human resources development, strengthening of research and development, strengthening of the sales setup, introduction of capital and technology, etc.) should be made into a policy pillar.

(3) Forestry

Paraguay was previously a highly wooded nation with more than 70% of the national land area covered in forests, however, following the cutting of natural forests that was promoted in order to expand agricultural land from the 1970s onwards, the forestation ratio now stands at around 50%. Even though the export of logs has been prohibited in order to arrest this trend, farmland expansion is still continuing and the area of forests felled in eastern Paraguay close to the timber export market of Brazil is 166,000 ha per year (1999-2003). Moreover, it is reported that the felled area of forests in western Paraguay, which is home to 70% of the country's forest resources, is as much as 100,000 ha per year. According to the results of survey by the FAO and other international agencies, approximately 500,000 ha of forests were felled between 1999 and 2002. Paraguay is currently a timber exporting nation, although it also imports some timber products. 40% of the raw materials supplied to the domestic timber processing industry come from tree felling on ranches, and 60% are supplied from natural forests.

The environment of Paraguay including its climate is extremely suited to forestry, and it may be worth studying cases such as Uruguay, which has switched from stockbreeding to eucalyptus and pine planting, and examining the economic benefits of artificial forestation. There is considered to be potential for nurturing a new key industry in addition to agriculture through promoting bio industries based on protection of natural forests (for conservation of the natural environment) and plantation of artificial forests.

11-2-6 Micro, Small and Medium Enterprises and Policies

General policy themes for reducing poverty include support for micro and small enterprises, support for small farming, promotion of entrepreneurship, development of small and medium enterprises geared to promoting employment, finance for small and medium enterprises, and so on. In Paraguay, however, there is a stronger policy orientation towards promotion of exports, development of export products and strengthening of export competitiveness, etc. There is a micro, small and medium enterprise vitalization agency under the jurisdiction of the Ministry of Commerce and Industry, however, the contents of its activities are unclear.

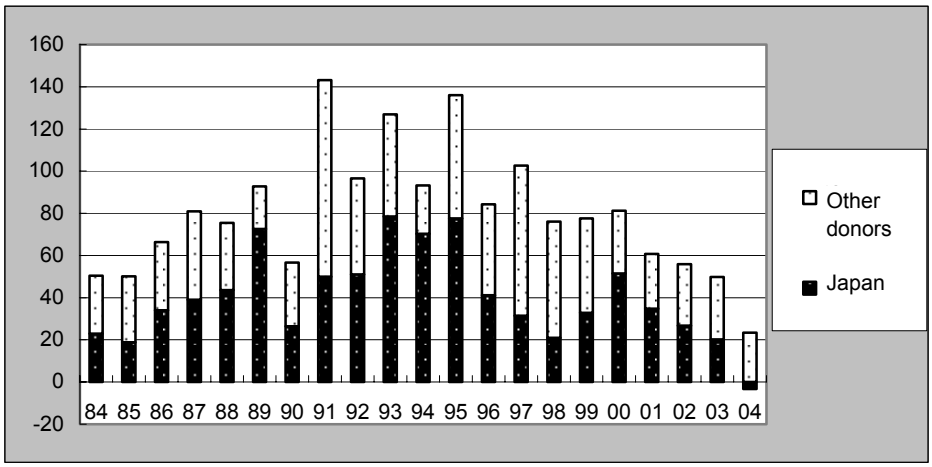
Government measures and policies include a credit system for small farmers (CAH), guidance on development of small farm products, a project for revitalization of raw cotton cultivation (MAG), support for small farm management, a clean production program for micro, small and medium enterprises in order to boost competition (MIC), strengthening of activities of the handicraft promotion center (MIC/SPA), an entrepreneur incubator system (MIC) and entrepreneurial human resources development (CONACYT), etc. Meanwhile, measures by donors and international agencies include small-scale credit for small farmers (International Agricultural Development Fund), strengthening of small enterprise starts (AECI), credit for family-run small farms (JBIC), credit for small and medium enterprises, export products and micro enterprises (IDB), research at the small and medium enterprise center (Taiwan), program for the strengthening and expansion of small and medium enterprise market competition (IDB), and so forth.

11-3 Aid Trends

11-3-1 Overall Trend

Net aid to Paraguay (including ODA and aid from international agencies and DAC major aid nations, as can be seen in Figure 11-3 below, gradually rose from 1984 and exceeded US$140 million in 1991. From 1995, it started to decrease and fell to US$20 million in 2004, les than half the amount it was 20 ears earlier.

Japan was the largest donor nation for Paraguay from 1976 onwards, providing between 60-70% of that country's bilateral aid and 50-60% of total aid including that from international agencies, however, the United States overtook Japan for the first time in terms of net aid expenditure in 2004. Based on funding from the Millennium Counter Challenge Fund that was established by President Bush, the United States aims to reinforce support geared to countering corruption and formalizing the economy (transferring the informal sector to the formal sector) in the "Threshold program" over the next two years.



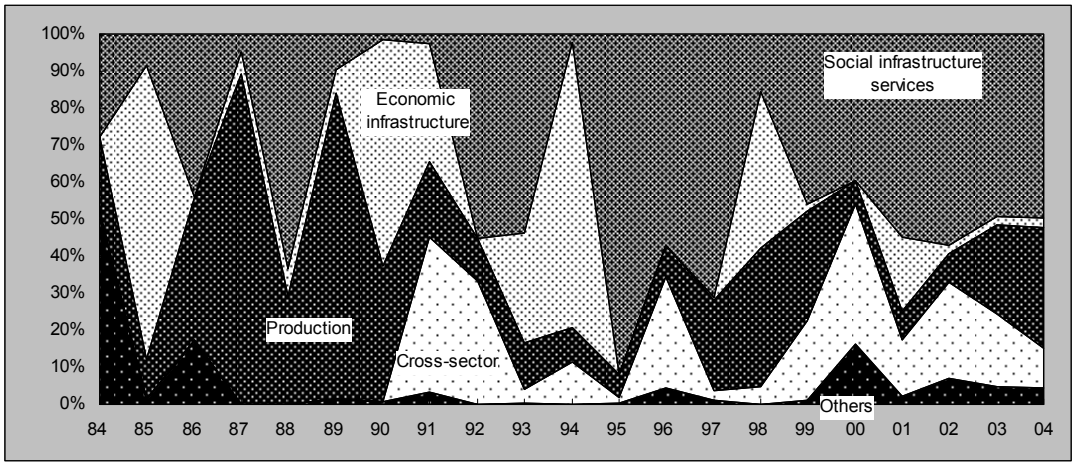
Note: Based on net disbursement
Source: Prepared from DAC International Development Statistics (IDS)

Figure 11-3 Past Aid to Paraguay (US$ million)

Looking at trends by sector, aid for production sectors based mainly on agriculture was the main area until 1990, while sectors became more diversified after that. Moreover, from 1995, social infrastructure and services became the main aid sectors, and these accounted for 60% of total aid in 2004 (see Figure 11-4). Changes can also be seen in the contents of the social infrastructure and service sectors. Up until 1995, aid was mainly directed towards education, water supply and sewerage, however, after that aid increased to the government and civil society sectors, which came to account for 40% of all aid to social infrastructure and services by 2004. According to the 2005 report of Transparency International, which assesses administrative transparency, Paraguay is ranked extremely low at 144th out of 158 countries together with Congo, Kenya, Pakistan, Somalia, Sudan and Tajikistan[103], and in view of this situation, donors are now

[103] Japan was 21st, Brazil 62nd, Peru 65th, Bolivia 117th and Venezuela 130th.

placing greater emphasis on support for governance. In relation to this, another finding in the local hearings was that donors are selecting private sector corporations and agencies as aid counterparts ahead of government agencies, which have low governance capability.



Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 11-4 Past Aid by Sector in Paraguay (1984-2004)

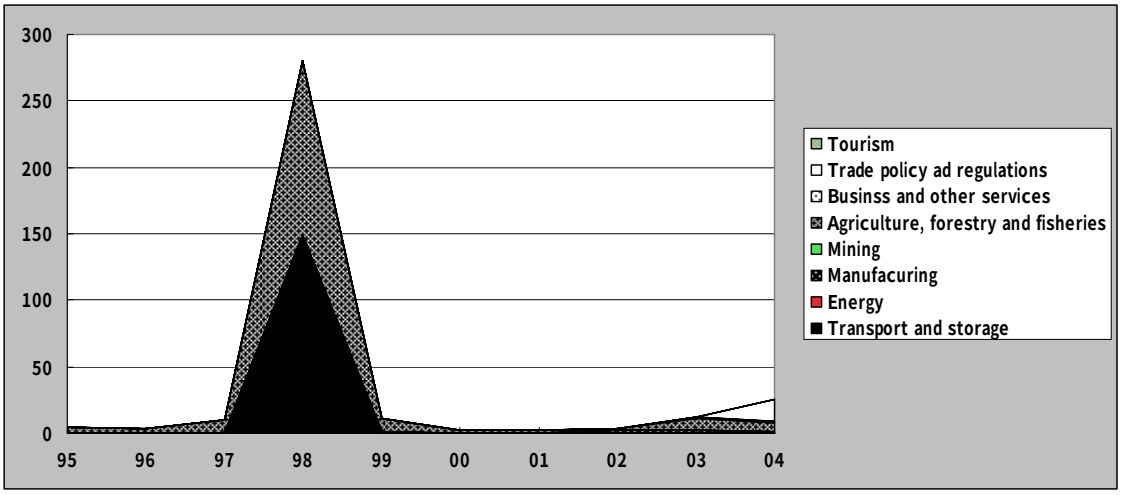
Figure 11-5 shows aid in the economic development field over the past 10 years[104]. Except for 1998, when there was a major leap in aid due to support provided to the transport and storage sectors, aid in the same sectors has remained at around US$8.4 million per year. As a recent trend in the economic development field, whereas aid to agriculture was the main area before, the ratio of aid to the industrial sector increased from around 2002, while that to trade policy and regulations and the business and other service sectors increased from 2004, indicating a diversification of aid distribution.

	95	96	97	98	99	00	01	02	03	04
Economic development (US$mill)	4.4	3.7	9.8	280.2	11.5	2.7	2.5	3.1	12.4	25.5

Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 11-6 Past Aid by Sector for the Economic Development Field in Paraguay (1995-2004, US$ million)

[104] Summated assuming the economic development sectors of: transport and storage, energy, manufacturing, mining, agriculture, forestry, fisheries, business and other services, trade policy and regulations, and tourism.



Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 11-6 Past Aid for the Economic Development Field in Paraguay (1995-2004, US$ million)

11-3-2 Projects in the Economic Development Field (Japan and Major Donors)

(1) Japan

Japan has so far provided aid to the economic development field centering on agriculture, while putting priority on strengthening of competition and promotion of economic growth in response to Paraguay's entry to Mercosur. Major aid projects from 1995 onwards are as follows.

Major Japanese projects implemented in the economic development field since 1995

[Development studies[105]] Small Farming Reinforcement Project, East-Central Arterial Road Construction Project Study, National Highways 2 and 7 Improvement Project Study, Economic Development Study, Project Study for Improvement of Packaging Technology for Intra-Regional Distribution in Mercosur, Export Corridor Development Project Study

[Grant Aid] N/A

[Technical Cooperation Projects] Small Vegetables Production Technology Improvement Project, Japan-Paraguay Occupational Capability Promotion Center, Soybeans Production Technology Research Project, Mass Certification and Inspection Technology Improvement Project, Paraguay Agricultural General Test Center, Project for Development of Leaders to Vitalize Small and Medium Enterprises, Project for Improvement of Small and Medium Farm Management via Dairy Farming, Asuncion Central Wholesale Market Management Improvement Project, Maquila Promotion Support, Strengthening of Container Inspection and Certification Functions, Food Safety and Hygiene and Nutrition Laboratory Strengthening Project, Mercosur Tourism Promotion, Ceramic Industry Technology Improvement Project, Regional Backbone Engineers Training Expansion Project, Diagnosis and Recommendations for Strengthening of the Export

[105] Concerning development studies, major projects in the economic development field implemented between 1995 and 2004

Promotion agency (Proparaguay), Macro Measurement Model and Inter-Industry Relations Table for Measuring the Effects of Tariff Unification in Mercosur [Load Aid] Road Construction Project (II), Agriculture Strengthening Project (II), Iguas Hydropower Station Construction Project

Positioning the "strengthening of economic cooperation for mitigation of imbalances and promotion of growth in Mercosur" as a priority target, JICA intends to continue providing support to the economic development field[106]. JICA has compiled the following six programs in order to achieve this goal.

(i) Support for production of major agricultural products such as soybeans, etc.
(ii) Support for development of human resources in micro, small and medium enterprises
(iii) Support for enhancement of technology and development of systems for animal inspections, industrial standard inspections and certification
(iv) Support of institutional development for strengthening of domestic industry and promotion of exports and investment
(v) Support for promotion of specific industries (formation of industrial clusters, etc.)
(vi) Support for basic infrastructure development and maintenance capacity building for industrial activities

Meanwhile, JBIC provides aid to the priority areas of (1) economic infrastructure (regional transport infrastructure) and (2) poverty reduction, Particularly in the area of (1) economic infrastructure, it proposes to support IIRSA projects that will be needed in order to integrate the domestic market of Paraguay with the Mercosur markets.

(2) Major Donors

The following paragraphs describe the trends of aid by major donors in the economic development field, and summarize the points that require particular attention when considering support in this sector.

USAID[107] It is implementing the "Private Sector Competitiveness Reinforcement Program" in order to enhance incomes of people in poverty, and provide technical cooperation on agricultural product marketing and production chain management to individual corporations in order to secure retail routes for corporations and expand employment. In this program, priority is especially directed towards creating export products and strengthening ties between the private sector and the world economy. In addition, in order to enhance economic policy and improve the business environment, USAID provides support to government tax agencies to boost efficiency and

[106] Paraguay Counter-Based Project Implementation Plan (August 2005)
[107] "USAID/Paraguay Strategic Plan for FY2001-2005, Sep.16 1999", "Paraguay Operational Plan FY2006", USAID, June 15, 2006 and results of local hearings

transparency, support for the strengthening of internal audit capability in the Ministry of Finance, and support for the simplification of business start application procedures, etc.

Important points to consider

- Efforts to establish legislation for dividing water rights failed badly due to political factors, etc.
- In the Threshold Program, it proposes to tackle corruption, however, this will only be possible with the cooperation of the Paraguay government.
- It attempted to promote a FTAA with the Ministry of Trade as the counterpart, however, due to lack of interest from the other side, it changed the counterpart to the business association.

AECI[108] Priority sectors in the strategy from 2005 to 2008 are, (i) support for the building of democratic government and public participation, (ii) enhancement of social services, (iii) economic promotion, (iv) environmental conservation, and (v) gender and development. Concerning (iii) economic promotion, it provides support to micro, small and medium manufacturers concerning business management and product diversification, etc., and it supports infrastructure development in the field of electric power.

IDB[109] Priority sectors in the strategy from 2004 to 2008 are, (i) strengthening of governance, (ii) strengthening of the foundations for growth through aiming for deepening of the market economy and regional and global integration, and (iii) poverty reduction. Concerning (ii) strengthening of the foundation for growth through aiming for deepening of the market economy and regional and global integration, this is implemented based on the belief that the private sector should assume leadership and that it is necessary to promote fiscal, social and environmental responsibility through a development model that is based on regional collaboration, export diversification and economic formalization. Specifically, it is working on four areas: (i) enhancement of the business environment, (ii) strengthening of fiscal systems, (iii) expansion, rehabilitation and maintenance of basic infrastructure, and (iv) deepening of globalization and regional integration. Furthermore, in support for enhancement of the business environment, it provides business development loans with a view to strengthening entrepreneur capabilities and extracting the latent competitiveness of the agricultural sector. In future, the IDB is prepared to provide finance for sector programs aimed at realizing competitiveness and product diversification and for development of science, technology and innovation. Concerning technical cooperation, it plans to offer support for securing technology and safety in Paraguayan products in order to contribute to standardization and harmonization within the Mercosur community.

Important points to consider

- The non-tariff barriers of Brazil and Argentina have long been a problem but they do not need to be raised as special issues.
- Paraguayan soybeans are not directly exported to the rest of the world; rather, they are sent to Uruguay, where they are blended with soybeans from other countries. The same

[108] "Documento de Estrategia Pais 2005-2008, Cooperacion Espanola, Paraguay

[109] "The Bank's Country Strategy With Paraguay 2004-2008", IDB and results of local hearings

is true of beef: this first goes to Chile, where it is mixed with beef from other countries before being supplied to world markets. Accordingly, rather than exporting directly to world markets, it is important to realize that Paraguayan products are passed from the "intra-regional market" to "external markets." When viewed in this way, although it is true that non-tariff barriers in Brazil and Argentina are high, it is still realistic for Paraguay to target Mercosur markets.

EU[110] Priority areas are, (i) state modernization and organizational development, (ii) production development and investment in Paraguay's regional integration framework within Mercosur, and (iii) human development and poverty reduction. Concerning (ii) production development and investment in Paraguay's regional integration framework within Mercosur, it was originally planned to promote exports, increase direct investment from the EU, provide technical support according to the WTO framework, improve the trade sector, take countermeasures against the informal trade sector and integrate EU-Mercosur trade relations. However, following the emergence of an NGO corruption scandal in 2004 (disappearance of 2 million Euros), aid to the Government of Paraguay is behind schedule in all areas. Moreover, concerning the strengthening of trade relations between the Mercosur secretariat and EU, it may be difficult to achieve results because the Mercosur secretariat is not functioning and the countries of Mercosur are straying away from their original objective of economic development and moving towards a political agenda.

Important points to consider

- The EU also places priority on regional integration, however, it will be difficult to provide direct support because the Mercosur secretariat is too fragile to function as a counterpart. Mercosur and the EU have been conducting free trade negotiations for 10 years, but these are making little progress.

GTZ[111] Support is provided to two priority areas: (1) governance (state modernization and decentralization), and (2) sustainable management of resources (especially soil conservation, forestation and direct planting). Under (1) governance, support is provided for regional economic vitalization, and experts have been dispatched to provide guidance to Fultika (a local fruit juice company), silk producing companies, Shirasawa (sesame), and corporations making alcohol, organic products, woodwork products, furniture and medicinal herbs, etc. Because of cuts in the ODA budget back home, the number of ODA target countries has been reduced from 80 to 60; moreover, because no improvements have been seen in good governance, GTZ plans to discontinue aid to Paraguay in three or four years. In the present situation, considering the achievements, the main counterparts of aid should be selected from private sector corporations, however, because German ODA policy is based on government aid, it will be difficult to continue supporting the private sector. This is thought to be another reason for the suspension of aid to Paraguay.

Important points to consider

[110] Republic of Paraguay European Community, Country Strategy Paper 2001-2006 and National Indicative Program
[111] GTZ in Paraguay http://www.gtz.de/en/weltweit/lateinamerika-karibik/642.htm and results of local hearings

- There is a market for bio diesel in Paraguay alone. Since cheap organic sugar is imported from Brazil, competition cannot be realized in the domestic market alone. Bio diesel is exported to Europe. Competition in Paraguay exists for fultika tomatoes and organic sugar.
- Concerning the four countries of Mercosur, support is provided to small and medium enterprises with the environment in mind. In Uruguay, Brazil and Argentina, the Ministry of Environment acts as the counterpart, while in Paraguay the Ministry of Environment and Ministry of Commerce and Industry are the counterparts.
- The secretariat has extremely weak organization; in particular it has no budget. In this sense, Mercosur is not structurally complete. Since Mercosur meetings are held twice per year, it is necessary to advance work around these.

Table 11-4 Priority Aid Sectors of Donors in Paraguay and Features of Aid in the Economic Development Field

Agency	Priority Sector	Aid Priorities in the Economic Development Field	Projects and Programs in the Economic Development Field
JICA	②Enhancement of social services to the poor and maintenance/improvement of incomes ②Mitigation of inequality under Mercosur and strengthening of economic competition to promote growth ③Environmental conservation and sustainable development of natural resources ④Administrative organization and institutional development (good governance)	• Support for production of major agricultural products such as soybeans, etc. • Support for development of human resources in micro, small and medium enterprises • Support for enhancement of technology and development of systems for animal inspections, industrial standard inspections and certification • Support of institutional development for strengthening of domestic industry and promotion of exports and investment • Support for promotion of specific industries (formation of industrial clusters, etc.) • Support for basic infrastructure development and maintenance capacity building for industrial activities	[Development studies] Project Study for Improvement of Packaging Technology for Intra-Regional Distribution in Mercosur, Export Corridor Development Project Study (EDEP) [Technical Cooperation Projects] Small Vegetables Production Technology [Technical Cooperation Projects] Mass Certification and Inspection Technology Improvement Project, Project for Development of Leaders to Vitalize Small and Medium Enterprises, Asuncion Central Wholesale Market Management Improvement Project, Maquila Promotion Support, Strengthening of Container Inspection and Certification Functions, Food Safety and Hygiene and Nutrition Laboratory Strengthening Project, Mercosur Tourism Promotion, Regional Backbone Engineers Training Expansion Project, Diagnosis and Recommendations for Strengthening of the Export Promotion Agency (Proparaguay), etc.
JBIC	**①Economic infrastructure (regional transport infrastructure)** ②Poverty reduction	Economic infrastructure support with Mercosur markets in mind	IIRSA registration projects
USAID	①Democratization ②Environment ③Reproductive health ④Economic growth	• Improvement of incomes for people in poverty in specific economic zones • Promotion of employment through market and product diversification • Reduction of the informal sector	• Private Sector Competitiveness Reinforcement Program, emphasizing support for improvement of corporate management Hear the problems and necessary problem-solving methods (technical cooperation) confronted by individual corporations, and only provide technical cooperation to those deemed to be in need. Problem-solving-oriented approach • Study on Trade and Logistics There is study budget geared to FTAA promotion too, however, since FTAA talks are not well advanced, this was switched to trade in general. • Improvement of economic policy and business environment.
AECI	① Support for the building of democratic government and public participation ②Enhancement of social services ③**Economic promotion** ④Environmental conservation ⑤Gender and development	Support to micro, small and medium manufacturers concerning business management and product diversification	Strengthening of the establishment of small enterprises
IDB	**①Strengthening of competitiveness** ②Social sector development ③Governance Other priorities: Infrastructure and financial sector support	Strengthen the base for sustainable growth through the following activities: • Enhancement of the business environment • Strengthening of fiscal systems • Expansion, rehabilitation and maintenance of basic infrastructure • Deepening of globalization and regional integration	• Spiral initiative • PR100 (micro enterprises support project) • Technical trade barriers through establishment of a certification system • Paraguay Export and Investment Promotion Agency (PROPARAGUAY) strengthening (planned) • Program for strengthening and expansion of SMEs market competitiveness • International transactions management
EU	①State modernization and organizational development **②Production development and investment in Paraguay's regional integration framework within Mercosur** ③Human development and poverty reduction	Promote exports, increase direct investment from the EU, provide technical support according to the WTO framework, improve the trade sector, take countermeasures against the informal trade sector and integrate EU-Mercosur trade relations.	-
GTZ	①State modernization **②Decentralization)** ④Poverty mitigation ⑤Natural resources ⑥Criminal code reform	• Emphasis on support for regional economic vitalization. Similar contents to USAID. Technical support for corporations via the problem solving approach.	• Support program for enhancement of corporate activities (higher productivity)

Source: Prepared by the Study Team based on the country-separate strategies and plans of JICA and donors and the results of local hearings


Equator
72
COLOMBIA
ECUADOR
Amazon
Iquitos
Talara
Paita
Piura
Yurimaguas
BRAZIL
Chiclayo
Río Marañón
Río Huallaga
Río Ucayali
Pucallpa
Trujillo
Salaverry
Chimbote
Nevado Huascarán
ANDES
Huánuco
SOUTH PACIFIC OCEAN
LIMA
Callao
Huancayo
Río Madre de Dios
Puerto Maldonado
Cusco
Ica
BOLIVIA
Arequipa
Lago Titicaca
Matarani
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Tacna
CHILE
300 km
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16
8

Chapter 12 Peru

12-1 Economic Overview

12-1-1 Resources and Geographical Conditions

Peru, having an area of approximately 1,285,000 km2, is the third largest country in South America behind Brazil and Argentina. In terms of latitude, it is located between the Equator and the tropic of Capricorn and more or less belongs to the tropics. In terms of topography, the country is divided into three zones: the mountain belt centered on the Andes that run through the center of the country, the forest belt to the east, and the coastal belt to the west. Due to the diversity of each zone, weather conditions and resources display great diversity and there are distinct production activities in each area.

The mountain belt accounts for approximately one-third of the national land area and population. There is little cultivatable land and the land is barren in inhabited areas over 3,500 m in altitude. On the other hand, these areas have abundant metal mineral resources such as copper, lead, gold, silver, zinc and molybdenum, etc.

The forest belt that lies adjacent to Columbia and Brazil is composed of jungle and basins of tributaries that lead to the Amazon River. This belt accounts for approximately 60% of the national land area but just 13% of the population. Coca, which is the raw material for making cocaine, is grown in this area and is "exported" to neighboring Columbia along rivers. This area is also confronted with environmental problems caused by the felling of Amazon forests.

The coastal belt on the Pacific seaboard runs 2,400 km from north to south and covers a width of 30-50 km, and although it only accounts for just under 10% of the national land area, it is home to more than 50% of the population. This belt largely has a desert climate and hardly any rain falls throughout the year, however, agriculture is conducted in green belts situated around the rivers that run from the Andes into the Pacific Ocean. Sugarcane, raw cotton and rice are produced in the northern part, while raw cotton, grapes and olives, etc. are produced in the south. Moreover, the ocean off the coast contains rich fishing grounds. Industry is concentrated in the Lima metropolitan area, and there is also some industrial location in Chimbote 300 km to the north.

12-1-2 Industrial Structure

Following the minus growth of the 1990s, the economy of Peru has been growing and it displayed 4% growth for three consecutive years from 2002.

Looking at the sector-separate composition of GDP over the past 10 years, there has been little fluctuation in the ratios of agriculture, stockbreeding and fisheries (8-9% of GDP), manufacturing (15%) and services. However, mining has been extending its share in recent years due to strong production levels and increasing prices of minerals. Meanwhile, there are sectors that are prone to the effects of natural conditions; in particular the fisheries industry displays very large fluctuations and is greatly impacted by yearly changes in the environment of fishing grounds and demand. Meanwhile, the mining sector has recorded constant growth in excess of GDP growth over the past 10 years. Furthermore, against the background of mainly textile exports to the United States and solid domestic demand, the non-primary product manufacturing industry has

displayed good growth.

Table 12-1 Sector-Separate Composition of GDP in Peru

Production Value — Unit: Million nuevo sol

Year	1996	1997	1998	1999	2000	2001	2002	2003*	2004*	2005*
Agriculture and stockbreeding	8,630	9,099	9,145	10,069	10,729	10,796	11,455	11,677	11,879	12,452
Agriculture	5,692	5,852	5,855	6,614	7,032	6,722	7,116	7,226	7,242	7,538
Stockbreeding	2,868	3,081	3,136	3,354	3,565	3,793	4,019	4,160	4,329	4,612
Fisheries	584	574	497	637	704	626	664	581	778	787
Mining	5,045	5,501	5,705	6,451	6,608	7,263	8,133	8,573	9,019	9,754
Manufacturing	16,862	17,758	17,139	17,010	18,001	18,118	19,185	19,806	21,270	22,652
Primary product prc	3,580	3,650	3,290	3,814	4,159	4,089	4,277	4,403	4,725	4,826
Non-primary produc	13,281	14,108	13,848	13,197	13,842	14,029	14,908	15,403	16,545	17,826
Construction	6,305	7,245	7,289	6,521	6,099	5,700	6,148	6,413	6,712	7,276
Commerce	16,095	17,352	16,817	16,645	17,291	17,444	18,083	18,613	19,693	20,719
Electricity and water supply	1,985	2,237	2,376	2,447	2,525	2,566	2,706	2,820	2,949	3,106
Other services	43,333	45,682	45,680	46,466	47,414	47,177	49,111	51,345	53,630	57,034
Tax payments	10,920	11,847	11,875	11,341	11,686	11,625	12,084	12,717	13,534	14,679
GNP	109,760	117,294	116,522	117,587	121,057	121,314	127,569	132,546	139,463	148,458

Note: 1994 as reference. * indicates provisional values.

Composition Ratio — Unit: %

Year	1996	1997	1998	1999	2000	2001	2002	2003*	2004*	2005*
Agriculture and stockbreeding	7.9	7.8	7.8	8.6	8.9	8.9	9.0	8.8	8.5	8.4
Agriculture	5.2	5.0	5.0	5.6	5.8	5.5	5.6	5.5	5.2	5.1
Stockbreeding	2.6	2.6	2.7	2.9	2.9	3.1	3.2	3.1	3.1	3.1
Fisheries	0.5	0.5	0.4	0.5	0.6	0.5	0.5	0.4	0.6	0.5
Mining	4.6	4.7	4.9	5.5	5.5	6.0	6.4	6.5	6.5	6.6
Manufacturing	15.4	15.1	14.7	14.5	14.9	14.9	15.0	14.9	15.3	15.3
Primary product prc	3.3	3.1	2.8	3.2	3.4	3.4	3.4	3.3	3.4	3.3
Non-primary produc	12.1	12.0	11.9	11.2	11.4	11.6	11.7	11.6	11.9	12.0
Construction	5.7	6.2	6.3	5.5	5.0	4.7	4.8	4.8	4.8	4.9
Commerce	14.7	14.8	14.4	14.2	14.3	14.4	14.2	14.0	14.1	14.0
Electricity and water supply	1.8	1.9	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Other services	39.5	38.9	39.2	39.5	39.2	38.9	38.5	38.7	38.5	38.4
Tax payments	9.9	10.1	10.2	9.6	9.7	9.6	9.5	9.6	9.7	9.9
GNP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Growth Rate — Unit: %

Year	1996	1997	1998	1999	2000	2001	2002	2003*	2004*	2005*
Agriculture and stockbreeding	5.2	5.4	0.5	10.1	6.6	0.6	6.1	1.9	1.7	4.8
Agriculture	10.9	2.8	0.1	13.0	6.3	-4.4	5.9	1.5	0.2	4.1
Stockbreeding	1.0	7.4	1.8	7.0	6.3	6.4	6.0	3.5	4.1	6.5
Fisheries	-4.8	-1.7	-13.4	28.2	10.5	-11.1	6.1	-12.5	33.9	1.2
Mining	5.1	9.0	3.7	13.1	2.4	9.9	12.0	5.4	5.2	8.1
Manufacturing	1.5	5.3	-3.5	-0.8	5.8	0.6	5.9	3.2	7.4	6.5
Primary product prc	3.8	2.0	-9.9	15.9	9.0	-1.7	4.6	2.9	7.3	2.1
Non-primary produc	0.9	6.2	-1.8	-4.7	4.9	1.4	6.3	3.3	7.4	7.7
Construction	-2.3	14.9	0.6	-10.5	-6.5	-6.5	7.9	4.3	4.7	8.4
Commerce	0.9	7.8	-3.1	-1.0	3.9	0.9	3.7	2.9	5.8	5.2
Electricity and water supply	5.9	12.7	6.2	3.0	3.2	1.6	5.5	4.2	4.6	5.3
Other services	3.9	5.4	0.0	1.7	2.0	-0.5	4.1	4.5	4.5	6.3
Tax payments	0.5	8.5	0.2	-4.5	3.0	-0.5	3.9	5.2	6.4	8.5
GNP	2.5	6.9	-0.7	0.9	3.0	0.2	5.2	3.9	5.2	6.4

Source: Banco Central de Reserva del Peru, Memoria 2005

12-1-3 Trade Structure

(1) Structure of Exports

Exports from Peru have increased rapidly these past few years and are providing the driving force behind the ongoing economic expansion. The main factors in this are the healthy demand for raw materials from the Andean region and access primarily of textile products to the United States market based on the Andean Trade Promotion and Drug Eradication Act (ATPDEA)[112].

In the area of traditional products, exports of minerals have greatly increased in response to the upturn in international market prices. In 2005, copper, gold and molybdenum accounted for 80% of mineral exports, and these were followed by zinc, lead, silver and tin. Prices and export volumes have increased for almost all mineral items. Agricultural products (coffee, sugar, cotton)

[112] The United States has applied this to Peru, Bolivia, Columbia and Ecuador since 2002. In return for cooperation in eradicating drugs, the United States recognizes the zero tariff import of approximately 6,000 items from these countries.

and fisheries products (of which anchovy meal accounts for 90%), which recorded good performance in 2004, slowed down in 2005. Meanwhile, in the non-primary products sector, exports of clothing and other textile products broke through the U$1 billion barrier in 2004 and have become the largest export area. Steady growth has also been recorded in the primary sectors of agricultural products (beans, fruit, tea and cacao, etc.), fisheries products (frozen products, frozen crustaceans, etc.) and chemicals (organic and inorganic chemical products, plastics, etc.). Looking at the structure of Peru's exports for the past 10 years, dependence on minerals was always conspicuous, however, following the recent growth described above, minerals have recently come to account for more than 50% of all exports and 70% of all traditional product exports.

In terms of comparison of the top 10 export items[113], the top 10 in 2003 were smelted copper, fish meal, zinc concentrate, copper concentrate, petroleum products, underwear, crude oil, outer wear and gold, accounting for 67% of total export value. In 1995, the top 10 consisted of smelted copper, fish meal, gold, coffee, blister copper, zinc concentrate, lead concentrate, crude oil and petroleum products, accounting for approximately 62%. The only new export item has been textile products (underwear and outerwear). The major export items based around primary products are largely fixed and are accounting for an increasingly large share.

Looking at export destinations, the United States, which is the largest trade partner, accounts for approximately 30% and receives mostly non-traditional products such as textiles, asparagus and gold adornments. Exports to China are also increasing very fast, and in 2004 it became the second largest export destination. Exports to China increased by almost 50% in 2005, making China's share among Peru's total exports even higher. The major export items to China are fishmeal, copper concentrate, molybdenum, timber products and fisheries products. Japan was the fifth largest export destination in 2004 (sixth in 2005), and its major imports from Peru are fishmeal, copper concentrate and silver. Other major export destinations are the U.K. and Chile, etc. Meanwhile, exports to the Andean Community of Nations (CAN) account for just 6.4% (2004 and 2005), and this ratio hasn't increased in the last 10 years[114]. Exports to four Mercosur countries account for just 3%, and almost all of these go to Brazil.

(2) Composition of Imports

Imports, too, have been expanding since 2001 and reached US$12.1 billion in 2005, representing a 23.5% increase over the previous year. In particular, raw materials and intermediary goods/capital goods, which account for 55% and 25% of imports respectively, are continuing to grow. Concerning the former, imports of fuel and lubricants are growing in reflection of inflation in the price of crude oil, while concerning the latter, building materials and industrial capital goods are displaying remarkable growth against the background of brisk investment in mining and export-related manufacturing sectors, etc. Meanwhile, imports of consumer goods increased by just 16%, which was lower than the increase in imports overall. In terms of import sources, the United States is again the largest trade partner, accounting for 31% of all imports in 2004. Recently, increases in imports of freight vehicles, petroleum and cereals have

[113] ECLAC, Statistical Yearbook for Latin America and the Caribbean, 2004
[114] See Commissioned Survey B: Table A.2.

been conspicuous[115]. Imports from the CAN block accounted for just 10% of the overall total in 2004, and these mostly comprised petroleum from three nations not including Bolivia. Other major imports are sugar from Ecuador and plastic products, etc. from Columbia. Imports from Bolivia comprise soybeans, animal feed made from processed soybeans and sugar, etc.

Table 12-2 Composition of Peru's Exports

Export Value (FOB) Unit: US$ million

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
1.Traditional Products	4,213.5	4,704.7	3,711.9	4,141.8	4,804.4	4,730.3	5,368.0	6,356.3	9,198.6	12,918.7
Fisheries products	908.8	1,125.9	409.9	600.9	954.7	926.2	892.3	821.3	1,103.7	1,303.0
Agricultural products	297.1	471.7	322.7	282.1	248.9	207.5	216.2	224.1	325.1	330.6
Mining products	2,654.4	2,730.5	2,746.7	3,008.0	3,220.1	3,205.3	3,808.9	4,689.9	7,123.8	9,759.5
Petroleum and petroleum pro	353.2	376.5	232.5	250.8	380.7	391.3	451.1	621.0	646.0	1,525.6
2.Non-traditional products	1,589.7	2,046.5	1,966.9	1,876.4	2,043.7	2,182.8	2,256.1	2,620.4	3,479.1	4,276.5
Agricultural and livestock pro	323.3	339.9	302.2	405.7	394.0	436.7	549.8	623.6	800.6	1,008.7
Fisheries products	212.0	277.5	224.9	190.3	176.8	197.0	163.8	205.0	277.1	322.5
Textile products	454.5	572.6	533.6	575.4	700.7	664.2	676.7	823.3	1,092.4	1,275.0
Timber, paper and timber pro	32.8	56.2	68.7	100.9	123.0	142.1	177.1	172.4	214.3	261.3
Chemical products	167.2	207.3	196.8	194.8	212.3	246.6	255.9	316.4	415.0	537.6
Non-metal minerals	37.4	51.4	51.6	51.4	46.7	57.7	68.0	73.5	94.5	118.1
Base metals and adornments	267.7	363.4	355.0	254.5	264.8	242.5	222.4	262.0	391.1	493.3
Metal products and machines	48.7	56.8	105.0	76.3	96.6	160.0	109.6	99.4	136.1	190.1
Others (Note 1)	46.1	121.4	129.2	27.1	28.8	35.8	32.9	44.9	58.0	69.9
3. Others (Note 2)	74.5	73.5	78.0	69.3	106.7	112.6	89.2	114.0	131.5	141.1
Total exports	5,877.6	6,824.6	5,756.8	6,087.5	6,954.9	7,025.7	7,713.9	9,090.7	12,809.2	17,336.3

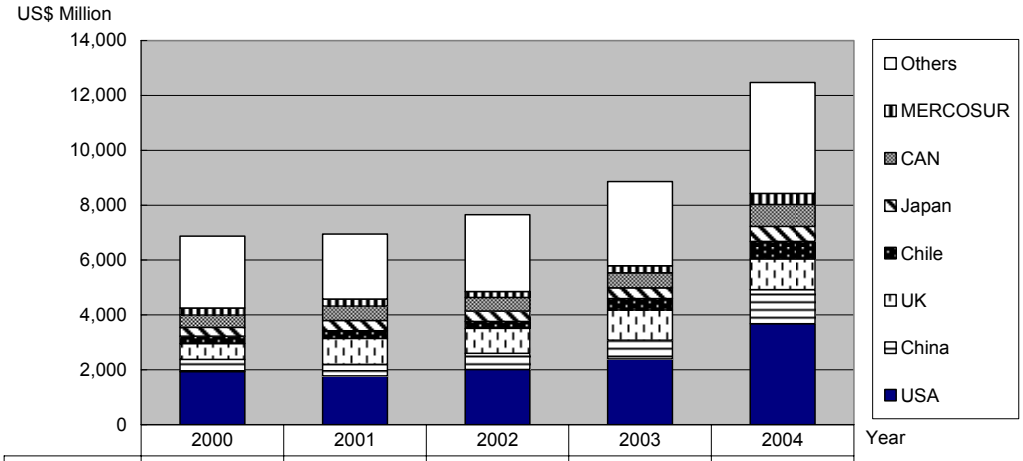
Composition Ratio Unit: %

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
1.Traditional Products	71.7	68.9	64.5	68.0	69.1	67.3	69.6	69.9	71.8	74.5
Fisheries products	15.5	16.5	7.1	9.9	13.7	13.2	11.6	9.0	8.6	7.5
Agricultural products	5.1	6.9	5.6	4.6	3.6	3.0	2.8	2.5	2.5	1.9
Mining products	45.2	40.0	47.7	49.4	46.3	45.6	49.4	51.6	55.6	56.3
Petroleum and petroleum pro	6.0	5.5	4.0	4.1	5.5	5.6	5.8	6.8	5.0	8.8
2.Non-traditional products	27.0	30.0	34.2	30.8	29.4	31.1	29.2	28.8	27.2	24.7
Agricultural and livestock pro	5.5	5.0	5.2	6.7	5.7	6.2	7.1	6.9	6.3	5.8
Fisheries products	3.6	4.1	3.9	3.1	2.5	2.8	2.1	2.3	2.2	1.9
Textile products	7.7	8.4	9.3	9.5	10.1	9.5	8.8	9.1	8.5	7.4
Timber, paper and timber pro	0.6	0.8	1.2	1.7	1.8	2.0	2.3	1.9	1.7	1.5
Chemical products	2.8	3.0	3.4	3.2	3.1	3.5	3.3	3.5	3.2	3.1
Non-metal minerals	0.6	0.8	0.9	0.8	0.7	0.8	0.9	0.8	0.7	0.7
Base metals and adornments	4.6	5.3	6.2	4.2	3.8	3.5	2.9	2.9	3.1	2.8
Metal products and machines	0.8	0.8	1.8	1.3	1.4	2.3	1.4	1.1	1.1	1.1
Others (Note 1)	0.8	1.8	2.2	0.4	0.4	0.5	0.4	0.5	0.5	0.4
3. Others (Note 2)	1.3	1.1	1.4	1.1	1.5	1.6	1.2	1.3	1.0	0.8
Total exports	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note 1: Leather products, folk handicraft, etc.
Note 2: Sale of food and fuel to foreign vessels, and other

Source: Banco Central de Reserva del Peru, Memoria 2005

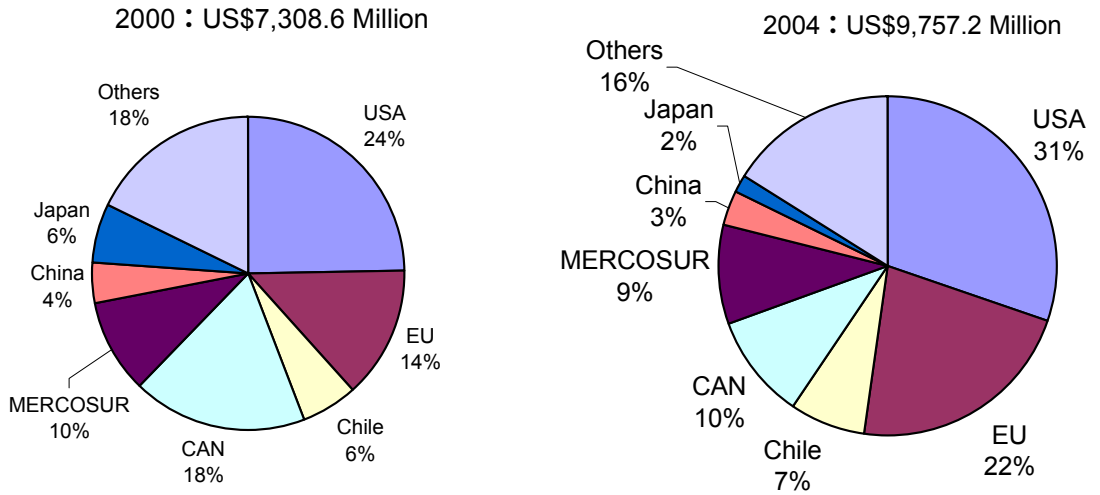
[115] JETRO "JETRO Trade and Investment White Paper 2005"



	2000	2001	2002	2003	2004
Others	2,624.0	2,370.0	2,800.4	3,068.6	4,039.3
MERCOSUR	253.9	253.9	213.2	260.6	403.6
CAN	449.5	520.6	498.7	543.7	798
Japan	321.1	375.3	371.1	393.0	548.3
Chile	265.4	284.0	255.3	414.5	637.0
UK	581.6	941.4	905.3	1,101.8	1,120.3
China	446.3	425.9	599.0	680.1	1,239.5
USA	1,929.9	1,772.9	2,005.2	2,397.0	3,682.4

Source: IMF, Direction of Trade Statistics Yearbook 2005

Figure 12-1　Main Export Destinations of Peru



Source: IMF, Direction of Trade Statistics Yearbook 2005

Figure 12-2　Main Import Sources of Peru

12-1-4　Acceptance of Direct Investment from Overseas

Incoming foreign direct investment, which slumped to US$810 million in 2000 due to the prolonged period of political instability that started from the dismissal of the Fujimori administration, has been recovering thanks to the fiscal improvement and economic growth

boosted by inflation in minerals prices, and in 2004 this reached US$1.8 billion[116]. In addition to the expansion and modernization of production equipment in the mining sector, since there are numerous projects in progress for copper mines and so on, investment in this sector is expected to keep growing in future. However, the cumulative investment until now of US$14.6 billion[117] is still one of the lower figures among the main investment receiving nations in South America.

Looking at accumulated direct investment by sector (1983-2004), the top sector has been telecommunications (29% of the total), followed in order by manufacturing (14.5%), finance (14.3%), mining (13.4%) and energy (12.7%). The major investing nations have been Spain, represented by the telecommunications corporation Telefonica (24.8% of all incoming investment, directed to telecommunications, energy and finance, etc.), the U.K. (22.1%, telecommunications, mining and finance, etc.), and the U.S. (15.4%, energy, mining and finance, etc.). The major investors among nearby countries are Chile (4.8%, finance, trade and energy, etc.) and Columbia (1.5%, energy, etc.)[118].

[116] UNCTAD "World Investment Report 2005" and UNCTAD "World Investment Directory"
[117] As of June 2005 (source: Economist Intelligent Unit, Peru Country Profile 2006)
[118] Accumulated investment figures by sector and country are based on amounts provided by the Investment Promotion Agency (based on registrations according to the legal stabilization agreement).

12-2 Industrial Promotion Policies and Systems

12-2-1 Current Industrial Policy and its Background

The overall macro economy of Peru is displaying sound growth in reflection of inflation in the international prices of minerals (its main products) and diversification in the areas of agricultural and fisheries production and manufacturing, etc. However, the country's biggest policy issue of "poverty" as manifested in increase in the urban population, growing disparities between the cities and rural areas, and disparities between the coastal belt and mountain and Amazon areas (in terms of public health and medical care, education, employment opportunities and infrastructure, etc.) shows no signs of improving. In the area of industry too, the structure is unstable in that mining, which has a low employment effect, and agriculture, etc., which has low productivity, account for more than 70% of exports. Other structural problems exist in that there are disparities in civil conditions between wealthy farmers that live in coastal areas with good access to markets and poor farmers in the mountain and Amazon areas, who do not even have the benefits of the market economy, and micro enterprises and the informal sector account for most of the corporations in the country. Moreover, since the poverty class accounts for more than 50% of the population and the poorest class 20% (mainly in mountain areas), the average purchasing power of citizens is low, and the small size of the domestic market is hindering the development of local industries (in particular the light manufacturing industry).

Against such a background, the new government is aiming to deploy policy based around measures to tackle poverty. Industrial policy also places priority on agriculture and micro and small enterprises with poverty reduction the primary objective, and the following concrete development targets have been raised:

- Promotion of agricultural and livestock products from mountain areas
- Infrastructure development (irrigation, roads, transportation systems) in mountain areas
- Support for micro, small and medium enterprises and peasant farmers (financial support, promotion of business launches)

However, Peru does not have a systemized long-term development policy or industrial policy. Moreover, although sector plans do exist, there is no order of priority to the sectors.

12-2-2 Current Framework of Measures and Issues

(1) Finance

Basically, there is no policy-based financial system for promoting industry apart from small farmers' banks and CONFIDES. Private sector corporate finance is smoothly provided. In particular, micro finance is smoothly managed. However, contrary to the original objectives of the system, interest rates on loans are high. The capital market is small and does not receive much government support. The bad debt ratio of financial institutions stood at around 10% at the start of the 1990s, however, this currently stands at around 2.5%. The stock market is small and currently has around 250 listed companies. Public venture capital (direct finance) is prohibited. Moreover, the new government has announced a doubling of financing for farmers' banks and additional finance for micro and small enterprise loans (two-step loans).

(2) Education and Training

The education level in Peru is said to be the lowest in South America. Identifying the inadequate education budget as a problem, President Toledo first increased the budget for the education ministry by 2.4 times with a view to providing higher salaries for teachers. However, due to many years of low investment in teaching human resources and materials and inflation of prices, the effects of this are slow to emerge. Even so, the basic education dropout rate from 2001 to 2004 fell by 3% to 21.6%.

Basic education is free, however, 8% of the population does not receive any education, 30% only receive elementary education, 40% receive secondary education, and 20% receive higher education. Illiteracy is 18.5% among citizens over 15 living in poverty (2000) and 7% among people living above the poverty level. In a survey conducted in 2003, illiteracy in two prefectures including Ayacucho was 30%, while illiteracy in Lima and Callao was 5%.

There are 80 higher education facilities throughout the country, and one-third of these are located in Lima. However, most of these institution are arts and literary schools, whereas there are not may science and engineering schools. High-level training facilities comprise just two private colleges (SENATI, TECSUP). SENATI (Servico Nacional de Adiestramiento en Trabajo Industrial) conducts activities all over the country and, in addition to entire period courses, it runs short-term courses and sandwich courses, etc. TECSUP (The Instituto Superior Tecnologico) has 1,000 full-time students at its two schools in Lima and Arequipa.

Other higher education opportunities comprise CITE, SENATI and ministry of labor agencies, occupational training under donor support programs, and entrepreneur development programs and systems.

(3) Transport Infrastructure

Road Transport

Out of 78,600 km of roads in Peru, 14.1% are paved (2004) and most of these lack maintenance. A major recent road project is the Brazil-Peru Highway, which runs from Acre in Brazil, through Inapali on the Peruvian border, and on to the port towns of Ilo, Matarani and Maracona on the Pacific coast. It is anticipated that this will shorten transport times, promote border trade and boost exports of Brazilian products to Asian markets, etc. Project work will be carried out in 2005-2006.

Ports and Harbors

Concerning ports and harbors, following the removal of regulations at 37 domestic ports during the 1990s, it was anticipated that trade costs would be reduced and commerce would become more efficient and so on, however, Peru still lacks competitiveness compared with surrounding countries. The APN (state port authority) approved a Newport development plan in 2004 and gave authorization for construction of a private container terminal in Callao in 2006. As a result of this, the free trade and industrial district in Ilo will handle large quantities of freight from Bolivia.

Air Transport

Since road access to remote parts such as mountain areas and the Amazon basin is impossible, air transport is an indispensable element of transport infrastructure. Peru currently has more than

50 airports including international airports at Lima, Cuzco, Tacna, Arequipa and Iquitos. Lima Airport granted operating rights in return for US$1.2 billion of investment for 30 years to a consortium comprising Frankfurt Airport Inc., Lima Airport Partners, Vecter and COSAPI in 2001, and it collects royalties on the revenue. The government also plans to transfer the operating rights for six domestic airports to the private sector.

Rail Transport

The national railway company sold off all its facilities in 2000 to Peru Rail Company (a consortium of eight private companies) on condition that the consortium pays 33.4% of profits to the government for 30 years.

(4) Telecommunications Infrastructure

The national telephone corporation was privatized in 1994 and is now operated by Telefonica del Peru (Spain). The telecommunications sector was liberalized in 1998, however, the same company essentially monopolizes the fixed telephone market. The mobile telephone market is a competition between the two companies Telefonica Moviles (Telefonica del Peru) and Movistar (America Movil Corp.: Mexico). As for the Internet, there are approximately 2,000,000 PCs in the country. The number of personal owners is small but it is growing. Moreover, ISPs and IPCs are increasing rapidly. ISDN, ADSL, cable modems and wireless can also be used. Media consists of TV and radio, and there are nine TV stations in the country.

(5) Tax System

The large number of informal corporations is hindering tax revenue and industrial development. Commodity tax on agricultural products and processed agricultural products is 15%, tax on pisco (liquor) is 30%, while the mining industry, despite not employing large numbers, receives preferential tax treatment because of its contribution to foreign currency acquisition. No taxation is applied to environmental pollution load.

(6) Research and Development

The government has no industrial technology research and development agencies. CONSITEC (Conference for Science and Technology) under the supervision of the education ministry solely conducts basic research. SENATI is a private sector occupational training agency and is efficiently operated. CITES (Technology Innovation Center), an agency under the ministry of production, has 13 centers throughout the country and carries out technical improvement research, collaboration with small and medium enterprises, and technical training, etc. for the processing industry based around agriculture, stockbreeding and forestry products, however, it is not reputed to be operated well. Transfer of technology is the central activity, but its development function cannot be anticipated. FONCIT (Science and Technology Fund) will be implemented from now on, however, its budget of US$120 million has been cut to US$36 million. In future it is scheduled for joint research to be conducted between industry, government and academia. There is also the ITP (Peru Technology Institute), which conducts technical research and development and product development, etc.

12-2-3 Policy Systems and Administration Required of the Government

Officials of related ministries and agencies are demanding the formulation of a systemized development policy of the government. In other words, since each ministry and agency currently prepares its own policies and programs, there is inevitably an overlapping of policies and programs within the government. Moreover, there is no office to review and coordinate these policies and measures.

With the economy doing well, now is the time that government funds should be used to invest in the economy and social infrastructure with a view to reducing poverty. For example, there is need to provide guidance on plans for efficiently using regional allowances allocated from income tax on mining production, to promote the distribution of products by peasant farmers through developing infrastructure in poor areas, and to develop systems for disseminating market information on agricultural products.

12-2-4 Relationship between Trade and Industrial Promotion

(1) Regional Collaboration

Since CAN nations are regarded as rivals in some quarters, little hopes are voiced concerning collaboration in industrial fields. However, CAN does serve as a collaboration vehicle for conducting external negotiations such as discussions with the EU, discussions on South American integration and discussions for joint measures to stop drugs, etc. In reality, for the sake of border security between adjoining countries, it is common for countries to conduct bilateral collaboration for the joint development of distribution infrastructure and so on.

(2) Bilateral Relations

United States

FTA negotiations with the United States were finished and signed at the end of 2005, and the senates of both countries are due to ratify the agreement during 2006. Since Mr. Umara, one of the candidates in this year's presidential election, hinted at reviewing the FTA with the U.S., doubts were raised over ratification at one point, however, following the election of President Garcia, there should be no doubt about the ratification from now on. Meanwhile, the American side is said to be refusing to extend the ATPDEA with CAN nations and this is scheduled to expire at the end of this year; however, since Peru will switch to the FTA, it will not be affected too much. In particular, exports of non-traditional products (asparagus, artichokes, paprika, etc.) to the United States, which increased greatly under ATPDEA, will be sustained under the FTA, and this is a major benefit for Peru. Meanwhile, import tariffs on imported American rice and sugarcane will be phased out over 17 years and 12 years respectively, while exports of high-quality beef, silk cotton, soybeans, soy curd, rough soy oil, fruits and vegetables, etc. from Peru to the United States will become tariff-free.

Ecuador

Peru and Ecuador were in dispute from 1940. Most recently, a border dispute between the two countries was settled under the Rio Protocol of 1942. Under this, Ecuador was given navigation rights along the Amazon River, while Peru was allowed to use two ports. Currently the two countries are promoting bilateral projects (electrification, sanitation, construction of public health

facilities, international highway) along the border.

Chile

A territorial waters dispute arose between the two countries in 2004 and this is currently under mediation in the International Court of Justice (ICJ). Relations between the two countries are, however, generally good.

Bolivia

Peru has historically had friendly relations with Bolivia, and the two countries are seeking to promote close economic integration in the energy sector.

Brazil

Peru and Brazil are currently advancing the Brazil-Peru highway project (see 10-2-2 (3) above).

Mexico

Peru and Mexico have conducted 6-7 rounds of FTA negotiations and these have reached a fairly advanced stage.

China

Of exports to China, 90% are minerals and 10% are fisheries products, so there is hardly any impact on employment. Concerning the issue of a FTA with China, this could potentially deal a massive blow to the countries light manufacturing industries (textile industry and shoe industry).

12-2-5 Main Industries and Policies

(1) Mining

Peru is one the biggest mining countries in the world: it possess resources of the major nonferrous metal resources and boasts production in the world's top 10 for many of these. Major mineral products are copper, tin, iron, gold, silver, lead, zinc and molybdenum, etc., and production of silver is the highest in the world. Furthermore, reflecting the recent inflation in minerals prices, new development investment is being carried out and this sector forms an important foundation of the Peruvian economy. Moreover, exports of mineral products amount to US$7 billion (2004), accounting for 55% of the value of all Peru's exports.

However, most of these minerals are limited to production of raw materials for the materials industry and, because the country does not have adequate capital and smelting technology, downstream industries as far as metal products are not developed. Future development issues revolve around how to realize added value, employment effect and economic ripple effect. Moreover, most mine developments are conducted under overseas capital (Japanese corporations that have invested include Mitsui Metals, Mitsubishi Shoji, Sumitomo Mining and Sumitomo Shoji, etc.). The areas hosting mine development receive local rebate tax whereby 50% of income tax is distributed to the areas in question, however, there are not utilized positively because the local governments lack ingenuity and the local citizens lack awareness. Moreover, the local governments in development areas request that investing corporations conduct training programs, human resources development and local contribution projects, etc. on the local level, and this is considered to be a good opportunity for conducting the regional dispersion of ODA for local development and poverty countermeasures.

(2) Agriculture, Stockbreeding, Forestry and Fisheries

Thanks to diverse climate conditions, Peru is able to produce almost every kind of cereal, and 1,3000,000 ha of land are cultivated along the coast. Agriculture is the second most important key industry in Peru behind mining, however, it is faced with numerous problems such as depression of international markets, land ownership problems, rural depopulation and declining competitiveness. The tradition agricultural products are rice, maize, bananas, sugar, potatoes and coca, etc., however, imports of maize, rice, sugar, soybeans and wheat, etc. are increasing in recent years because of declining self-sufficiency. Traditional exports are coffee, sugar and raw cotton, etc., while exports of non-traditional products such as asparagus, artichokes, paprika, mangoes and avocados, etc. to the United States are doing well. Moreover, the eastern slopes and the Andes and highland jungle areas are suited to cultivation and produce tea, coffee and cocoa, however due to shortages of transport infrastructure and long-term depressed prices for agricultural products, many farmers are said to have lost their incentive and are going back to growing coca. Incidentally, coca production in Peru is the second largest in the world (US$500 million - US$1 billion per year) behind Columbia, and although it declined in the late 1990s due to efforts to promote conversion to asparagus and coffee, etc., it has been uniformly increasing ever since.

(3) Fisheries

The central activities of fisheries are fishmeal manufacturing and fish canning. Peru currently boasts the world's highest production of fish meal at 10 million tons per year. However, because catches fell dramatically in 2003 due to recent over-fishing, the government is periodically issuing no-fishing orders in an effort to preserve resources. Another uncertain element in this area is damage caused by the El Nino phenomenon that occurs every 7-8 years. Under recent investment, deteriorated fishing boats from 1992 have been renewed and modernization of plants for making high-quality fish meal from cultured fish has been conducted in order to raise fish prices. Future development policies will be the development of frozen fish for export (merluza, giant ??) and development of coastal artisanal fisheries (shrimps, crabs, shore fish). Policy goals are the establishment of fisheries management, setting of legislation, job creation and securing of income, development of aquaculture (seawater and freshwater), dissemination of table fish and promotion of artisanal fisheries.

(4) Energy Industry

The United States, Argentina, Brazil and state-owned corporations produce 90% of petroleum. Petroleum production reached 190,000 barrels per day during the 1970s and 1980s, however, it has fallen in recent years due to a lack of new development investment and lack of maintenance, and it was 91,000 barrels in 2003. The start of condensate production from the Camisea natural gas field in 2004 helped petroleum production recover to 112,000 barrels in that year. However, the country is still not self-sufficient in petroleum; as a result, whereas it exports crude oil, on the other hand, it imports petroleum products.

The gas field that was discovered in Camisea, located in the jungle area in the southeastern part of Cuzco Province, in 1997 is a massive gas field containing reserves equivalent to 2.4 billion

barrels of oil (slightly less than Bolivia). A joint venture between Shell and Mobil Oil failed to reach a contract agreement with the government, however, a J/V between Argentina, the U.S. and S. Korea acquired joint development rights for 40 years, with a J/V of six companies from Argentina and elsewhere acquiring rights to the transportation and supply network, and a Belgian company gaining control of the supply service to Lima and Callao. Following completion of the main pipeline to Lima, gas supply to power stations was commenced in August 2004, however, the supply system to general households is not complete yet. The next objective is to utilize gas in CNG, and work on exporting LNG to the west coast of the United States and Mexico by 2009 has already started.

Peru has electric power generating capacity of 5,910 mw and the supple of electricity exceeds demand. Hydropower accounts for two-thirds of power generation; thermal generation based on diesel, coal and heavy oil accounts for 19%, and thermal generation based on NG accounts for 16.7%. The government aims to reduce the ratio of hydropower due to instability arising from rainfall fluctuations, and it plans to expand thermal power generation based on NG. Plans to privatize the state power transmission and distribution corporation have not been realized ever since an opposition movement in Arequipa escalated into riot in 2002.

12-2-6 Micro, Small and Medium Enterprises and Policies

(1) Actual State of Micro and Small Enterprises

Classifications of corporation sizes in Peru are stipulated in the micro and small enterprises law according to number of employees and unit of tax payments as follows.

Table 12-3 Classifications of Corporation Sizes in Peru

Scale of Enterprise	Employees	Unit of Tax Payment (UIT)
Micro enterprise	1-10	150
Small enterprise	1-50	850

Note: 1 UIT = 3200 sol

The breakdown of corporations according to scale (2004) is as shown below. However, these figures refer only to companies in the formal sector. Informal sector enterprises are said to account for 57.9% of all enterprises, and this is the second highest figure behind Bolivia's 65.6% in South America. Moreover, 60% of small informal enterprises are farmers/employees living in rural communities. The majority of people living in poverty are said to be farmers or employees in small informal enterprises.

Table 12-4 Composition of Corporation Sizes in Peru

	Micro Enterprises	Small Enterprises	Medium-Large Enterprises
Number of enterprises	662,209	25,938	10,899
Composition	94.4%	3.9%	1.7%

When sales are viewed in terms of UIT, 91.3% of enterprises are 75 UIT or less, and 98.35%

of enterprises are below 850 UIT, which is the upper limit for small-scale enterprises. If the estimated number of informal enterprises is added, it works out that 99.63% of enterprises pay taxes of less than approximately US$75 per year. Incidentally, the average tax payment of micro and small enterprises in the formal sector is US$13 per year.

When viewed in terms of sector, micro and small enterprises comprise 49.7% in commerce, 33.3% in service, 11.0% in manufacturing, 2.9% in dairy farming, 2.5% in construction, 0.4% in mining, and 0.3% in fisheries. In terms of regional distribution, 52% of micro and small enterprises are located in Lima metropolitan area, 19% in northern areas, 18% in southern areas, 7% in central areas and 4% in eastern areas.

(2) Micro and Small Enterprise Policies

Small and medium enterprise problems in Peru are regarded as problems of micro and small enterprises, whereas medium and large enterprises are not targeted by promotion policies. Moreover, jurisdiction over micro and small enterprises promotion was transferred from the Ministry of Production to the Ministry for Labor and Employment Promotion (MTPE) in 2001. In other words, problems of micro and small enterprises are treated in direct connection with problems of poverty and unemployment. Based on the Micro and Small Enterprises Law (CODEPYME: Law 28015-2003), the Department of Micro and Small Enterprises in the said ministry is promoting the following policies as part of its employment promotion policy.

Objectives

- Strengthening of competition
- Formalization of enterprises
- Creation of employment opportunities and improvement in quality of workers
- Improvement in productivity and profitability of enterprises
- Contribution to GDP
- Expansion of the domestic market and promotion of exports
- Contribution to tax revenue

Employment promotion policies

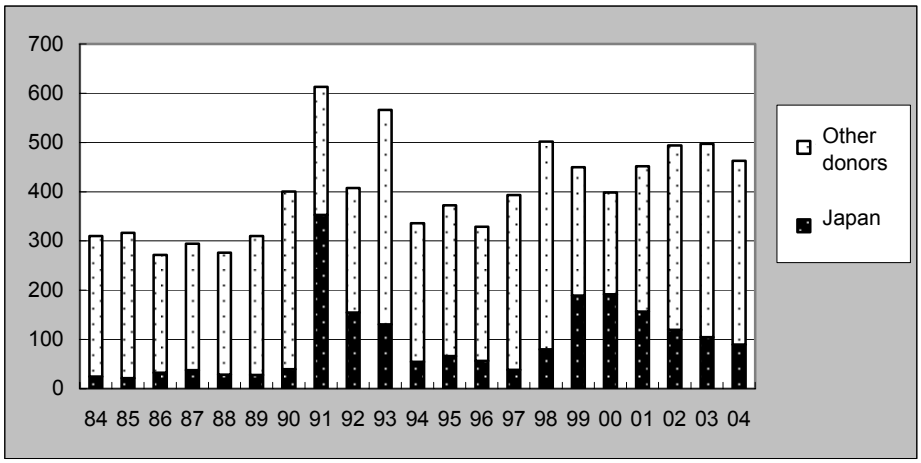
- Measures to strengthen the quality of employment
- Measures to improve the capacity, productivity and income of workers
- Employment promotion measures based on diffusion of labor market information (Red-CIL Program)
- Measures to support creation of new employment opportunities

In accordance with these policy guidelines, the MTPE is implementing an expert skill training program, a basic technology youth training program (PROJOVE), a women's employment promotion program (PROFECE), a corporate management technology training program, an entrepreneurs improvement program and other human resources development programs, etc. under the APROLAB (support by the MTPE, Ministry of Education and EU).

12-3 Aid Trends

12-3-1 Overall Trend

Aid to Peru (including ODA and aid from international agencies and DAC major aid nations) reached US$6 million in 1991, but it subsequently declined and fell to approximately half of this in 1996. These past few years, it has been between US$4-5 million. Japan was the biggest aid donor for Peru between 1991-2000, however, the United States started to increase its aid from around 1999 and overtook Japan to become the top donor in 2001. In 2004, the top donors were the United States (US$177.9 million), Japan (US$89.8 million), Spain (US$56.1 million) and Germany US$19.7 million)[119]. In terms of multilateral aid, the largest donors are the EU (US$13.6 million), UNFPA (US$9.37 million) and the UN (US$4.2 million), etc.[120]

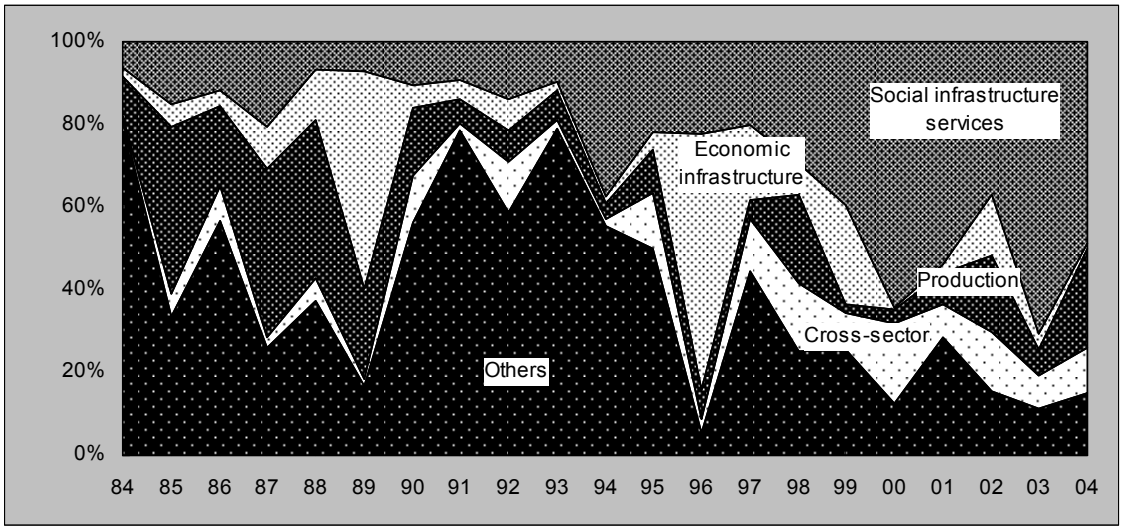


Note: Based on net disbursement
Source: Prepared from DAC International Development Statistics (IDS)

Figure 12-3 Past Aid to Peru (US$ million)

The sector in which aid has greatly increased over the past 20 years is social infrastructure and services. In the social infrastructure and services sector, the ratio of support directed towards secondary and senior education has increased, while in terms of cross-functional issues, the ratio of support directed towards environmental conservation has increased. Moreover, ratios have increased in other fields from 1989 to 1995, but this has been fiscal support and debt relief in many cases. Support for the economic infrastructure sector was higher in specific years such as 1989, 1996, 1997 and 1999, when financing was concentrated towards transport and traffic infrastructure projects.

[119] DAC International Development Statistics, 2004
[120] Ditto



Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 12-4 Past Aid by Sector in Peru (1984-2004)

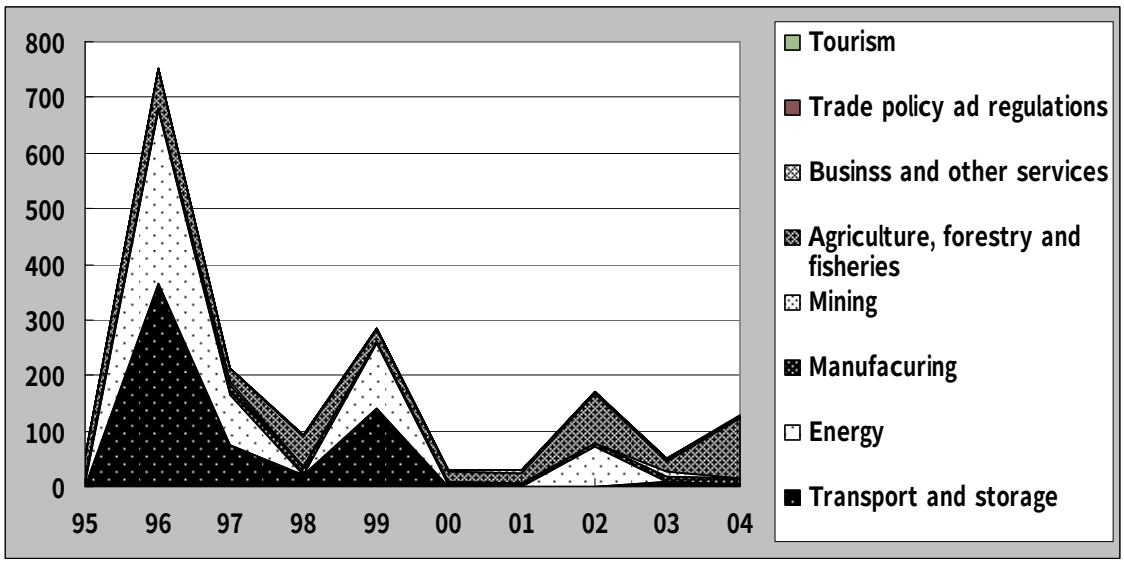
Figure 12-5 shows aid in the economic development field over the past 10 years[121]. The average amount is US$119 million per year, however, annual amounts vary greatly between years when support was provided to the energy sector and the transport and storage sector and years when it wasn't. Support for the economic development field based on infrastructure has been decreasing since 1996. A major factor behind this was that aid by donors shifted from economic development to poverty reduction following the occupation of the Japanese Embassy by the MRTA in December 1996 (the incident was eventually resolved in April 1997). Moreover, in 1997, aid in the economic development field decreased to US$17 million by 2000, although it has been on the rise again in recent years. Moreover, in addition to agriculture, aid is recently increasing towards the trade policy and regulation sector, the manufacturing sector and the business and other services sector (albeit in small amounts), indicating a growing diversity of aid. Moreover, concerning 2004, the amount of aid did not increase due to support for the energy sector; rather, the feature is that more than 80% of aid derives from support to the agriculture, forestry and fisheries sector, especially the agricultural production sector.

	95	96	97	98	99	00	01	02	03	04
Economic development (US$mill)	54	752	214	92	285	31	29	171	50	128

Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 12-5 Past Aid by Sector for the Economic Development Field in Peru (1995-2004, US$ million)

[121] Summated assuming the economic development sectors of: transport and storage, energy, manufacturing, mining, agriculture, forestry, fisheries, business and other services, trade policy and regulations, and tourism.



Note: Assistance figures based on OA (Official Aid) and commitments
Source: Prepared from DAC International Development Statistics (IDS)

Figure 12-6 Past Aid for the Economic Development Field in Peru (1995-2004, US$ million)

12-3-2 Projects in the Economic Development Field (Japan and Major Donors)

(1) Japan

Until around 1995, Japan conducted support mainly in hard sectors such as energy, electric power and roads, etc., however, since then it has shifted towards the social sector. In the JICA aid plan for Peru that was announced in August 2000, four priority areas were raised: (i) poverty countermeasures, (ii) social sector support, (iii) development of the economic base, and (iv) environmental conservation. Concerning (iii) development of the economic base, support is provided for the sustainable development of the Peruvian economy according to a. a small and medium enterprises support program (raising in technical capacity of occupational training instructors), b. an agriculture, forestry and fisheries development program (promotion of fisheries production and exports through providing fisheries training to small-scale coastal artisanal fishermen), and c. an economic infrastructure development program (transport network, electricity network, telecommunications network, etc.).

Meanwhile, JBIC has not conducted financial cooperation to Peru since 2000, although it is prepared to offer support centering on (i) economic infrastructure (public water supply and sewerage) and (ii) poverty reduction. Moreover, since JBIC regards Peru as priority nation within South America, it plans to bolster support to it in future.

Major Japanese projects implemented in the economic development field since 1995

[Development studies[122]] National Tourism Development Master Plan Preparation Study, Wide

[122] Concerning development studies, major projects in the economic development field implemented between 1995 and 2004

Area Study of Mineral Resources in South America, Urban Transport Project Study in the Metropolitan Area [Technical Cooperation Projects] Land Transportation Strengthening Plan Project [Grant Aid] Project for Construction and Improvement of Road Construction Equipment Maintenance Plant, Third Regional Micro Hydropower Plant Rehabilitation Plan [Loan Aid] Callao Port Development Project, Paucaltanbo Second Hydropower Plant Construction Project, Regional Arterial Road Development Project, Amazon Region Social Infrastructure Development Project, Regional Arterial Road Development Project II, Electricity Frontier Expansion Project

(2) Major Donors

The following paragraphs describe the trends of aid by major donors in the economic development field, and summarize the points that require particular attention when considering support in this sector.

EU[123] Priority sectors and issues are three areas of, (i) support for regulatory and institutional reform, (ii) socioeconomic development, and (iii) regional integration. Concerning (ii) socioeconomic development, the main pillars of support are, a. support for improvement of production and trade capacity (economic infrastructure, service development, strengthening of technical cooperation related to commercial functions and trade, building of information systems and improvement in quality of agriculture), and b. occupational training (enhancement of occupational training, strengthening of employment supply and demand links, and enhancement in competitiveness and productivity of native peoples and women). Concerning (iii) regional integration, support is provided via the priority projects of the Piura-Guayaquil Highway linking Peru and Ecuador, bridge repairs and development of customs clearance facilities, etc. Furthermore, in addition to bilateral cooperation with Peru, the EU provides technical support to CAN in the areas of statistics collection, quality improvement and trade.

Important points to consider

- Turning attention to communities in the regions and urban centers, projects are being implemented with success in cooperation with producers' associations and traders associations.
- Adopt a consolidated approach (provide comprehensive support for infrastructure development, bolstering of capacity of local government officials, participatory project compilation, public consultation, sector-based and overall local development plan compilation, studies of specific products such as fisheries and alpaca, etc.)

USAID[6] [124] Aid is provided in seven priority sectors: (i) democratization (strengthening of regional government functions following decentralization of basic education and public health), (ii) enhancement of economic opportunities, (iii) public health, (iv) environment, (v)

[123] "Peru Country Strategy 2002-2006", and results of local hearings
[124] "Country Strategic Plan for Peru FY 2002-2006", June 30, 2001 and results of local hearings

development of coca-substitute crops, (vi) education, and (vii) improvement in quality of living in border areas with Ecuador. In (ii) enhancement of economic opportunities, which is linked to economic development, support is provided based on the pillars of the financial sector (financial support for micro enterprises and small farmers), infrastructure and business development. Concerning business development, based on the idea that support should be directly provided to people in poverty during the 1980s-1990s, emphasis was given to supporting producers, however, this shifted to linking markets to producers from the 1990s onwards. Concerning the approach to developing businesses, first purchasers/exporters are sought out, the quality and price levels they desire are clarified, business plans for producers to satisfy productivity and standards to meet the demands of purchasers are prepared, and implementation is supported on the technical front.

Important points to consider

- Focus aid into the highland areas where poverty is most acute.
- Considering that producers are isolated from markets, find markets that will be of interest to buyers and exporters.
- When organizing residents, start from small and medium farmers and then expand to small farmers.

GTZ[125] Priority sectors are, (i) democratization, (ii) water (public water supply and sewerage), and (iii) regional development. In the economic development field, commodity development based on agricultural products and bio agricultural products is being carried out under (iii) regional development. Moreover, as a project in collaboration with private sector corporations, support is being provided to coffee producers in partnership with a global coffee corporation.

Important points to consider

- In support for the importance of local government support following decentralization, empowerment of producers so they can participate in free trade agreements, commodity development management, and support of information systems, etc., it is important to conduct direct technical support from potential buyers from EC nations to producers.

CIDA[126] Priority sectors are, (i) improvement in the quality, equality and efficiency of education services for people in poverty, and (ii) environment building for good governance. Although the economic development field is not a priority area, Canada conducts numerous investment projects in the mining sector, and it covers the costs of joint research with Peruvian universities and research agencies in the energy sector, mutual presentation of research findings and discussions with government representatives in Peru. Approximately half of the numerous research projects are relevant to economic development. Moreover, as a part of good governance, support is provided to the Energy and Mines Ministry concerning monitoring of the environment, occupational health, safety control and emergency response setup related to energy and mine resource development. Support is also given towards the digitalization of the mine name

[125] GTZ in Peru and results of local hearings
[126] CIDA-Peru http://www.acdi-cida.gc.ca/CIDAWEB/acdicida.nsf/En/JUD-129124653-NUU and results of local hearings

allocation system of the Energy and Mines Ministry (US$9.6 million between 2003-2008).

Important points to consider

- The level o civil society in Peru is high and there are good NGOs and civil groups. It is a good idea to conduct projects in cooperation with these groups.

AECI[127] Priority sectors are, (i) social and institutional capacity building, (ii) enhancement of human capacity (improvement of living environment), (iii) improvement of economic capacity, (iv) enhancement of improvement capacity aimed at a sustainable environment, (v) extension of freedom and improvement of capacity in the area of culture, (vi) women's independence and empowerment, and (vii) prevention of disputes and building of peace. Under (iii) improvement of economic capacity, which is related to economic development, the following is carried out: a. support for micro and small enterprises, which absorb 67% of the working population, and support for micro finance, and b. support for infrastructure, namely support for transport infrastructure and improvement of energy accessibility, etc.

[127] "DEP-PERU 2005-2008", Spanish Cooperation

Table 12-5　Priority Aid Sectors of Donors in Peru and Features of Aid in the Economic Development Field

Agency	Priority Sector	Aid Priorities in the Economic Development Field	Projects and Programs in the Economic Development Field
JICA	①poverty countermeasures, ②social sector support, **③development of the economic base,** ④environmental conservation	• Small and medium enterprises support program • Agriculture, forestry and fisheries development program • .Economic infrastructure development program	• Raising in technical capacity of occupational training instructors • Promotion of fisheries production and exports through providing fisheries training to small-scale coastal artisanal fishermen • Transport network, electricity network, telecommunications network, etc.).
EU	①Support for regulatory and institutional reform, **②Socioeconomic development** **③Regional integration.**	• Support for improvement of production and trade capacity • Occupational training • Regional integration • Cooperation with CAN	• Economic infrastructure, service development, strengthening of technical cooperation related to commercial functions and trade, building of information systems and improvement in quality of agriculture • Enhancement of occupational training, strengthening of employment supply and demand links, and enhancement in competitiveness and productivity of native peoples and women • Piura-Guayaquil Highway linking Peru and Ecuador, bridge repairs and development of customs clearance facilities, etc. • Technical support in the areas of statistics collection, quality improvement and trade.
USAID	①Democratization (strengthening of regional government functions following decentralization of basic education and public health) **②Enhancement of economic opportunities** ③Public health ④Environment ⑤Development of coca-substitute crops ⑥Education ⑦Improvement in quality of living in	• Finance sector • Infrastructure • Business development	• financial support for micro enterprises and small farmers • Technical cooperation to lage-scale national infrastructure • Activitiers linking small prodcuers, manuacturers, service operators and farmers to markets
GTZ	①Democratization ②Water (public water supply and sewerage) **③Regional development**	• Commodity development based on agricultural products and bio agricultural products (supported as part of regional development)	-
CIDA	①Improvement in the quality, equality and efficiency of education services for people in poverty ②Environment building for good governance	Energy and mining resources management	• Monitoring of the environment, occupational health, safety control and emergency response setup related to energy and mine resource development • Support for the digitalization of the mine name allocation system of the Energy and Mines Ministry
AECI	①Social and institutional capacity building ②Enhancement of human capacity (improvement of living environment) **③Improvement of economic capacity** ④Enhancement of improvement capacity aimed at a sustainable environment ⑤Extension of freedom and improvement of capacity in the area of culture ⑥Women's independence and empowerment ⑦Prevention of disputes and building of peace	• support for micro and small enterprises and support for micro finance • Support for transport infrastructure and improvement of energy accessibility	-

Source: Prepared by the Study Team based on the country-separate strategies and plans of JICA and donors and the results of local hearings

Part IV

Direction of Assistance

Part IV　Direction of Assistance

Chapter 13　Overview

13-1　Role of Development Assistance in Japan-South America Relations

Economic relations between Japan and South America are important to both regions for the following reasons.

- In contrast to Japan, although South America is behind in industrialization, the potential for agricultural and mineral resources is strong.
- Despite huge domestic disparity as a developing region, South America is an extremely large market. If regional economic integration continues, a huge trade market could be created.
- Although the primary leaders in external economic relations in South America are the United States and Europe, the growing market in East Asia has long-term importance.
- Approximately 1.5 million of Japanese descendants are actively promoting economic activities.

However, economic relations between Japan and South America have tended to be withdrawn (See Chapter 4) in the recent years. In the 1990s, ODA (Official Development Assistance) appeared to promote better economic relations. However, since the turn of the 21st century, ODA has seen a downward trend associated with general government budget cuts.

In the meantime, South America is diversifying its export market to not only the United States and Europe, but also Asia and the Pacific region. China is becoming the largest Asian importer of resources for many South American nations. Andean nations are holding FTA (Free Trade Agreement) discussions with the United States, East Asian and Southeast Asian nations. Therefore, if better economic relations are promoted with Asia and the Pacific region and sustainable economic growth in South American nations is improved, there is a great possibility that the relationship between Japan and South America will be closed again, not only from a trading but also an investment point of view. On the other hand, Japan's economy is changing from a structure based on the import of resources and export of products to a structure supporting resource-saving and technology-intensive-type domestic production and local market-oriented overseas investment.

Based on this future assumption, it is perceivable that future assistance toward South America will not only play a role in passing on Japan's message of upholding its relationship with South American nations, but also a role of stimulating private-sector economic exchange. If assistance contributes to development in a recipient country, it is adequate. However, in the case of South America, there is a huge potential for return through benefits to the Japanese economy.

13-2 Economic Issues in South America

13-2-1 Economic Growth and Economic Integration

South American nations are regaining stability through macroeconomic fiscal reform which has occurred over the past 10 years, which emphasizes liberalization and curtailed budgets. However, economic growth is still slow due to asset and income disparity left over from earlier expansion in the consumption market and diversification in the industrial structure. Consequently, savings tend strongly to be invested overseas instead of being invested domestically, restraining economic growth even further. Notably, recent policy reform based on the so-called Washington Consensus has helped to encourage unemployment and disparity. At the present time of recovery, poverty reduction through economic growth and economic integration in South America, an increase in employment in particular, has become a priority issue in the terms of development and assistance.

In conformity with measures for policy reform being taken by each nation, a system of economic integration has been developed—primarily through the MERCOSUR and the CAN. However, the NTB (non-tariff barrier) and many exceptional tariff items remain in large economic powers (such as Argentina and Brazil) within the regional economy. Although smuggling has increased, exports have not increased in some nations. As a matter of course, some such nations are concerned about diversification in the export markets with advanced nations outside the region through the FTA. If we combine the diversification in exported products and the export market with poverty reduction, it then becomes a theme in terms of development and assistance.

The actual direction for regional economic integration has not yet been established through the influence of international politics. Although there are few assistance projects which actively perform a role breeding a confidential relationship through cooperation among neighboring countries or interest intermediation, projects by JICA and the EU can be observed and are notable. Even in the EU, it took more than 50 years to establish full-scale integration, so it is natural for South America, with its relatively short history, to have twists and turns in its system of economic integration. However, since integration of the markets of not only all of South America but also North America will inevitably be promoted, it is possible that this will become a long-term issue of development and assistance. In this manner, support for poverty reduction will have significant meaning because the factors of domestic politics that protect weak sections often block economic integration and market opening.

13-2-2 Advanced South America and Backward South America

South America is divided east-west by the Andes. East of the Andes, there is large-scale livestock farming and a grain belt, and plantations have been developed on immense plains; so the economic relationship with Europe remain strong historically. West of the Andes, although land suitable for agriculture is limited, mineral resources are rich. In addition, due to its rugged geographic features it is comprised of relatively small countries. Each nation is intensifying its economic relationship with nations along the Pacific coast, including the United States. At the same time, South America is made up roughly of a high income temperate zone in the south and

low income tropical zone in the north. Industrial clusters have been developed along coastal areas in the southward mainly around Rio de Janeiro, Sao Paulo and northern Chile. With such a constitution, the tropical zone in the north, the Andean countries (Ecuador, Peru and Bolivia) and landlocked Paraguay in particular face many constraints in their move towards autonomous economic growth.

In the development assistance issue "from the stability to growth and poverty reduction", countries embracing high income areas (especially Brazil and Argentina) are expected to experience further economic development and expand employment by stimulating demand at home. For this, the correction of disparity (especially security of equal opportunity through education), poverty reduction and economic revitalization in rural areas are essential. Stimulating domestic demand in these countries will help to provide an opportunity for exports to surrounding nations.

On the other hand, the population of countries with low-income areas remains limited, so improvement in the domestic market cannot be expected for some time. Growth through exports should be emphasized. By reducing a dependence on traditionally exported products which are susceptible to changes in international supply and demand, diversification in the export structure and industrial structure is being recommended. In the case of exporting mining products, the domestic inter-industrial relationship is also limited. Accordingly, if the level of dependence on this can be reduced, it could stimulate domestic demand and an expansion in employment.

13-3 Assistance for Less Developed Countries (Bolivia, Ecuador, Paraguay and Peru), in South America

13-3-1 Significance

For economic growth and integration in South America, in addition to efforts taken by each government in South America and regional cooperation, assistance for nations where development is relatively deficient (LDC: less developed countries in South America) is essential for the following reasons.

(1) Economic and political instability in least developed countries in South America becomes an obstacle to economic integration and can easily create friction between neighboring countries.
(2) International cooperation for high income nations (Argentina, Brazil and Chile) has been accumulated sufficiently over the past 20 to 30 years and produced considerable results. It is natural to shift international support from high income nations to least developed countries in South America.
(3) Poverty and resources in the LDCs in South America exist side by side, so neglecting poverty can easily become an obstacle to development and exporting of resources.

13-3-2 Development Subject

Items commonly listed in the current development policies of least developed countries in

South America are outlined as follows. Since each of the policies reflects information and opinion exchanges with aid organizations, including the World Bank and the IDB (Inter-America Development Bank), the items could be regarded as common assistance subjects of LDCs in South America.

(1) Since economic level greatly depends on specific primary products and specific foreign markets, it is susceptible to external shock and difficult to achieve sustainable economic growth. In addition, an expansion in exports does not always lead to an increase in employment and poverty reduction domestically. To escape from such a situation, the industrial structure should be diversified and domestic production chains developed.

(2) Therefore, productivity should be improved in the non-traditional export sector, market competitiveness should be reinforced and the market should be diversified. The private sector will be supported, particularly through the reinforcement of competitiveness of medium and small enterprises (managerial human resources, skills and market access), better efficiency and by stabilizing the supply of ingredients of farming products, etc.

(3) Support for the private sector:
- Fairness, transparency and effectiveness of administration should be promoted.
- Infrastructure including roads should be substantiated.
- Human resources should be effectively utilized to the maximum through education, vocational training and labor market reforms.

(4) As prerequisite conditions, macroeconomic policies, social services, governance, environmental and resources conservation will be continuously reinforced.

Although the present policies often have common points, each nation has different geographical features, social traits and economic power. In the shadow of a standardized dualism whether it be market economy or nationalism, the future image of a national economy which explicitly and systematically reflects such a difference is not recognized at the present time. However, it may be clearly recognized by personnel responsible for policies in each nation while progress is made through future economic partnerships inside and outside the region. Although it is most important that assistance respond to immediate needs, when such assistance is provided, the relevant nation and donors should try to share the same future economic image and promote assistance through a sustainable partnership.

13-3-3 Present Status

Japanese assistance has responded to policy issues of the above-mentioned 4 items, especially through “support for the non-traditional export sector and the private sector including medium and small enterprises” which is directly connected to the economies; measures have been taken mainly in the following fields.

(1) Reinforcement of competitiveness of medium and small enterprises
- Training for managerial and technical human resources
- Formation of production chain. In particular, support for processing and

distribution industries in farming products
- Vocational training for non-skilled labor force

(2) Institution building necessary for industrial and export promotion
- Improvement in quality standards
- Export promotion
- Industrial finance
- Foreign investment enticement

(3) Reinforcement of regional economic development system
- Cultivation for planning capacity of municipal personnel

Except for Japan, the World Bank, the IDB, the EU, Belgium, Germany, the GTZ (German for Technical Cooperation), Spain's AECI (*Agencia Española de Cooperación Internacional*: Agency for Spanish International Cooperation) and the USAID (United States Agency for International Development), etc. are actively providing assistance. In similar manner as Japan, all deal with issues related to economic policy common to least developed countries in South America. On the other hand, some measures appear to have not been affected by Japanese assistance. Noticeable trends are as follows.

(1) Technical cooperation incorporated with trade policy

The United States is supporting the strengthening of competitiveness of medium and small enterprises which will contribute to the effective utilization of non-tariff import measures; this is a typical example. In addition, by introducing buyers form the markets of advanced nations, product development is being promoted at the place of production and improved quality based on the buyer's advice and needs. In particular, such technical cooperation is treated to be incorporated within the production chain or regional economy because it cannot be divided into agricultural and industrial sectors or rural development and urban development.

(2) Cooperation between support for decentralization and support for regional revitalization

Each of the IDB, the EU, Germany and the United States is supporting decentralization with the aim of regional economic development or formation of production centers. In a typical pattern, "a local chamber of commerce and a local government jointly provide participatory planning for regional economic development and carry out related training. For the time being, mutual consent is reached with respect to problems to be addressed. An advisor is dispatched by providing the place for discussions of persons concerned who have keys to the question." A majority narrows down to specific necessitous areas. Like the program for medium and small enterprises sector assisted by the IDB, some are aiming toward nationwide institutionalization of regional economic development.

(3) Support for micro enterprises incorporated with financial assistance and technical cooperation

In conformity with micro financing for micro enterprises, the United States, Germany, Spain

and Belgium, etc. have implemented technical cooperation for product development and provision of market information.

(4) Support for strengthening governance as part of investment climate development

The IDB, the United States and Spain, etc. aim at creating an environment in which foreign capital (funds) can be advanced and used in business by improving the judicial system and labor laws, etc. In parallel with this, the United States is taking measures for the networking of business leaders. In South American countries where personnel exchanges between politics and business circles are frequent, this seemed to be effective not only for strengthening governance itself but also for improving the investment environment.

(5) Support for returnees from migrant workers

In Spain, there are many migrant workers from nations in the Central and South America, including Ecuador. The government of Spain is implementing the agricultural cooperation program subject to the farm households of returnees.

(6) Mining support

One of the priorities of Canadian assistance to Peru is the mining sector. The contents are the intermediation of research cooperation between companies situated in Peru and overseas universities, and capacity building for the Ministry of Mining. A key industry in Canada is mining and there are many mining investments by Canadian companies, so it is understandable that Canada remains dominant.

13-3-4 Direction of Japan

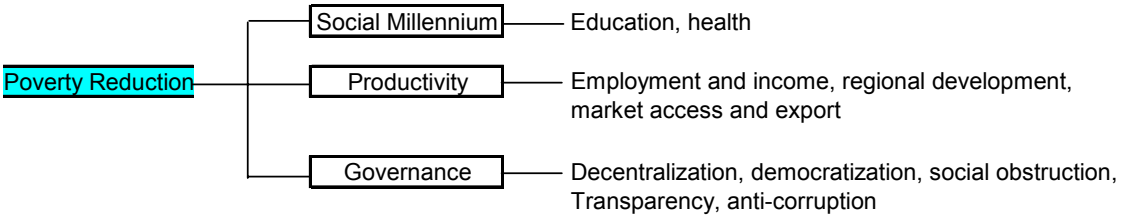
Since the turn of the 21st century, despite a decrease in Japanese assistance toward South America, other donors have increased the amount of assistance. Naturally, an increase in the number of countries with graduates having ODA recipient status is desirable. However, if they are as they are, it will be difficult to prevent the expectation for assistance in South Asia from shifting from Japan to other donors. In order maintain the trust of recipient countries and Japan's national interests, to a certain extent, to secure the amount of assistance in keeping with the international trend would appear to be a prerequisite.

On the other hand, in light of the meaning of assistance, development issues and current assistance status with respect to least developed countries in South America, since ongoing Japanese assistance in recent years conforms to major development needs, the basic Japanese direction is considered to continue and substantiate this. In any case, assuming an increasing assistance scale, it is difficult to do so. If so, existing projects should be developed by effectively utilizing them to the maximum in order to correspond to recent needs. Accordingly, the future direction is summarized as follows.

(1) Positioning of economic development through assistance for South America

Economic development is indispensable to poverty reduction. Even in the JICA country-specific aid program tree, in principle it is positioned in such a manner. However, both

are provided as parallel programs in some cases. In such the case, it is pointed out projects for poverty countermeasures tend to be treated preferentially over projects for economic development. However, both are not in a substitutive relationship, so the understanding that "economic development pushes forward for the great goal of poverty reduction" is accepted internationally. For example, the agenda on aid coordination in Peru is comprised as follows.



Starvers (people who have died of starvation) or refugees are rare in South America. The basic characteristics of poverty are not absolute poverty as in some parts in Africa, but are relative poverty, in other words, a disparity problem. Consequently, poverty reduction is not an urgent task; it is an issue for medium and long-term economic development. In this sense, the common understanding that the highest priority theme for poverty reduction in South America is economic development is indispensable not only in the formation of a project but also in the selection of a project.

(2) Importance of policy support

One of the causes of unstable politics is insufficient continuous administration and lack of trust between the private and public sectors. Consequently, many donors provide aid directly to the private sector because private organizations are more stable and sustainable so that perceptible outcomes can be easily obtained. However, the stabilization of politics and the continuity of administration are prerequisites of this. Direct support for the private sector until it is realized is effective in itself. On the other hand, continuous support for capacity building in the governmental sector is also important. The notable demands are the systematization of policies on medium and small enterprises development, reinforcement of an implementing system and breeding of the common understanding between the public and private sectors. Japan has abundant experience in this field and is also greatly expected. If not only through simple bilateral cooperation but also through mutual exchange of experiences between South American countries, policy support is effective and will lead to economic integration in the long term.

(3) Cooperation between trade and development

We cannot discuss economic development in South American nations without promoting exports. In recent years "the promotion of production centers in response to the market" and "connecting trade with poverty reduction" has attracted public interest from a policy viewpoint. The idea of a production chain also originates from the idea of "pushing forward with product development and a distribution system to meet the market" instead of the idea of "connecting

products to the market". A starting point for this idea is the market. The theory of habitat segregation between agriculture and industry or between rural and urban areas is gradually becoming unrealistic. Although Japan also has endeavored to support production center development and export promotion, ability development for the manufacturing side such as quality improvement, productivity improvement and business management improvement were subject to a significance portion of major assistance. In the future, assistance that incorporates a greater market aspect in South America is desirable. To be specific, the participation of specific buyers should be obtained for aid projects instead of the market in general. If the criteria for the selection of specific buyers, the fairness and transparency of a method are prepared, its effectiveness is already experienced by many other donors. In addition, negotiations of the FTA and EPA might move ahead more briskly. As part of this, support for trade or the reinforcement of the competitiveness might be effective in some cases. More actual cooperation between development assistance and trade promotion is desirable. With reference to the integrated approach to trade and development, one finds an example of "one-village-one-product movement" in Thailand. For this movement, JICA sent a long-term advisor and prepared a policy paper to promote rural development on the basis of the movement. At the same time, JETRO supported this movement for the purpose of promoting Japanese import from developing countries. It might worth for consideration that JICA compiles successful examples of the integrated approach to trade and development in Asia as a reference material for its technical cooperation with South American countries.

(4) Regional Economic Development

Economic development assistance includes an approach to narrow down a sector or industrial type and an approach to narrow down an area or production center. In the case of Japanese technical cooperation, an approach to narrow down an industrial type has been often applied. However, in South America, especially in its least developed countries, we cannot say that an approach to narrow down an industrial type reaches an effective stage not only from the viewpoint of the industrial system but also from the viewpoint of the administrative system. An approach to narrow down an area appears to be more effective. In addition, the decentralization of an administrative finance covers not only social services such as education and health but also industrial and agricultural development; so an area approach appears to be more effective. Many donors are providing assistance by narrowing down an area. However, almost all of the donors focus on remote least developed areas. Although this may be effective in obtaining visible achievements in light of indexes of anti-poverty measures, the level of contribution to the national economy appears to be extremely small. By focusing on areas that has reached an economic level to some extent and that will have repercussion effects, from the viewpoint of the national economy, continuous support for industrial and export base development including technical guidance to local companies, reinforcement of local administration, infrastructure development and creation of a cooperation system between the local private and public sectors should be promoted.

(5) Promotion of wide-area (regional) and south-south cooperation

Although the importance of regional cooperation in consonance with regional economic cooperation such as MERCOSUR and CAN (Andean Community) is advocated, it is not often put forward. On the contrary, each donor is more enthusiastic towards technical cooperation in due consideration of bilateral trade liberalization; so measures for regional cooperation are limited. Japan and the EU appear to be the most active with regard to aid for regional cooperation.

Accordingly, continued action by Japan for regional and south-south cooperation is important. Multilateral cooperation requires much time for preparation and coordination. On the other hand, one could say that the creation of a fiduciary relationship through a long-pending process is the most important role of regional and south-south cooperation. In addition, some are anxious about the future course of the economic integration system in South America which is easily affected by the political climate. However, since it is inevitable that South American economies will be integrated from the long-term point of view, it is important to accumulate regional cooperation by theme in consonance with such a course. The following themes and approaches to be notable in the future can be considered.

1) Cooperation through sharing and coordination of cross-border interests

JICA has implemented technical cooperation to improve packaging technology subject to the MERCOSUR which has achieved excellent results. The needs of adjoining beneficial interests exist for a long period of time, which is different from the FTA-related cooperation (for example, cross-border road improvement, environmental conservation for international rivers and cross-border quarantine inspection system, etc.). So it is easily for organizational cooperation and personnel exchange among neighboring countries to take root.

2) South-south cooperation by Japanese-descendant experts

Mainly through the activities of Japanese descendant-experts at the Sao Paulo office in Brazil, technical cooperation for nations surrounding Brazil have made significant achievements from the viewpoint of suitable cooperation content, substantial communications and cost effectiveness. Although technical cooperation is provided mainly for agricultural areas, Japanese descendant-experts should take a broader role in the terms of economic development that is broader than the medium and small enterprises development in the future.

3) Research cooperation

There are many qualified researchers in the South American countries. Not only are they involved in ongoing academic research but frequently come and go in the administration or business world. Consequently, it is extremely effective to support policies through collaboration with such researchers. The United Nations ECLAC (Economic Commission for Latin America and the Caribbean) which has its base in Santiago is especially noteworthy. Since the ECLAC has long-term experience and an independently critical mind (problem consciousness) as a research institution, they have a wide network across the Central and South America. “Creation of export dynamism” is a theme emphasized through research

cooperation. The South American export promotion in the 1990s in accordance with the Washington Consensus contributed to the survival (persistence) of a system dependent on primary products rather than the advancement of an industrial system. Japan and many other East Asian nations have made advancements in their industrial system with exports as the lever (means). Accordingly, recommendations should be made by each nation with respect to the incorporated promotion and creation of a new export industry, export infrastructure development and information exchange between the private and public sectors through joint research between South American and Asian research institutions.

Chapter 14 Country-Specific Assistance Tasks

14−1 Bolivia

14−1−1 General Development Trend

(1) Economic Characteristics in Bolivia

One of economic features of Bolivia is that its GDP growth is greatly affected by a rise in international prices of hydrocarbons or mineral resources which are major exports, rather than simply growth in the export industry. The structure depending on natural gas, petroleum and mineral resources which are referred to as primary products and traditional exported products which do not change very much over long periods of time.

Although the 2005 provisional value structurally indicates 25,935,070 million bolivianos at 131.7% in a 1996 GDP of 19,700,704 million bolivianos[128], the ratio of each sector of the total GDP was 15.2% in 1996 → 14.6% in 2005 (agriculture, livestock farming and fisheries) and 17.1% in 1996 → 16.6% in 2005 (manufacturing), which tends to be a slight decrease; whereas, the ratio of the petroleum and natural gas sector increased 4.0% in 1996 → 6.8% in 2005. In terms of export value, petroleum, natural gas and mineral resources only accounting for 10% of the GDP holds 67.1% of the 2005 exports. In particular, the value of natural gas accounts for 35% and other hydrocarbons accounts for 12.7%, so these two produce almost half the exports. Other exported products include coffee, sugar, leather, wood products, soybeans and jewels, etc. Although soybeans accounts for 13.3% of total exports, others account for 2 to 3% which is insignificant[129].

That is to say, although the Bolivian economy appears to be favorable in recent years, this is mainly a result of expansion in exports of hydrocarbon and a rise in international prices for mineral resources. As long as natural resources are the primary export, the ripple effect on the entire national economy is small. Accordingly, if the DGP increases from a state point of view, revenue per capita will not increase easily.

Since the domestic market is small, it is important to increase exportation by improving added value in order to develop the economy. However, in addition to low productivity in each industry, the inter-industry relationship is weak so that the division of labor (specialization) and cooperation are not being taken among companies. Therefore, industrial clusters cannot be so easily formed to reinforce the competitiveness in the international market.

In addition, nearly 90% of all micro and small enterprises and medium enterprises[130], which are regarded to cover 83 to 85% of employment, fall within the so-called informal sector and are not officially registered; so it is difficult to grasp the actual conditions. This group of enterprises which do not pay taxes and products entered from neighboring countries through the black market, and since it is a landlocked nation, has helped to intensify competition in the domestic market, thus creating a vicious cycle hindering corporate cultivation[131].

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[128] Comparison with 1990 values: Data by the Bolivian National Statistics Institute

[129] Bolivian National Statistics Institute (INE: *Instituto Nacional de Estadistica*) Homepage (http://www.ine.gov.bo)

[130] In Bolivia, enterprises with 4 employees or less are micro, those with 5 to 14 employees are small enterprises, and those with 50 or more are large enterprises.

[131] Simultaneously, Bolivian companies sell products on the black market in neighboring nations.

The informal sector which is considered to have expanded since the 1970s is a so-called survival business. Once they have dealt with handicrafts, they shift to the textile industry if they feel like textile-related business; whereas, if they discover that they can make money in other fields, they move to those fields. Such behavioral traits can be observed.

(2) Basic policies of the new administration

Although the former administration advocated poverty reduction based on neo-liberalism for such an economic structure, as the result of the indiscriminate reducing of custom duties, the domestic light manufacturing industry was severely damaged. On the other hand, as the result of serious consideration of exports, the exports of primary products has increased, particularly due to preferential tariffs in accordance with the Andean Trade Promotion and Drug Eradication Act (ATPDEA)[132] in the United States upon the condition of cocaine eradication, textiles, leather, log processing and jewel industries which have increased mainly in El Alto on the outskirts of La Paz, the capital. However, it is difficult to say that infrastructure for industrialization has been developed.

For this, in June 2006 the present administration publicly announced the new national development plan in order to realize "*Vivir Bien"* (a quality life)" and manifested serious consideration on the formation of cross-racial fusion and community spirit by escaping colonial rule and neo-liberalism.

There are 4 strategies in the national development plan, "Bolivian productivity national strategy", "Bolivian national dignity strategy (promotion of community social development and social protection project)", "Bolivian sovereign state strategy (nationalization of resources and tax imposition on resources development)" and "Bolivian democratic national strategy (social inclusion or indigenous communities to realize an equal society)"[133].

Of these, the most related industrial development is the "Bolivian productivity national strategy", which (i) the surplus funds obtained from natural gas and oil, mineral resources, electricity, forest resources, water and biological diversity will be effectively utilized by promoting the nationalization of resources, (ii) employment will be promoted by developing manufacturing industry, tourism, agriculture, housing construction, transportation, finance and services industry, (iii) production infrastructure such as telecommunications, roads, railway, electricity, water supply and gas will be improved and (iv) the *Banco de Tecnología* (technology bank) or the *Banco de Fomento para el Desarrollo* (development bank) will be established and production services such as irrigation, science and technology, plants and animals quarantine, information and communications will be provided[134].

With respect to the nationalization of resources, in the campaign promise of the MAS Party which is the present party in power, although acquisition of natural gas-related companies,

[132] Although the preferential tariffs will expire this year, it was heard that the new administration has finally started negotiations on its extension by dispatching the vice president to the United States. However, the US side appears to have no intension of extending.

[133] In addition to local governments at the departmental level, discussions on revising the Constitution in due consideration of self-government by aborigines are being held. If the Constitution is revised, the social framework including ownership of assets might be changed significantly, so special attention should be taken.

[134] As of September 2006, in response to the new national development plan, relevant ministries and agencies are formulating a concrete action plan.

reacquisition of two refineries of the Brazilian state-owned Petrobras corporation or acquisition of 51% stock were incorporated in the policies. At the present time, their tome has softened slightly, stating "although the ownership will be exercised as the Bolivian state, multinational corporations will not be taken over". However, the existing allocation of natural gas profits at 18% for the state and at 82% for the corporate side was changed to an allocation of 82% for the state and at 18% for the corporate side through presidential decree without officially resorting to Diet deliberation. In addition, an increase in natural gas prices toward Brazil and Argentina was declared. Therefore, as of September 2006, rigorous discussions are being taken between interested nations such as Brazil and Argentina and related domestic companies. It is understood that government personnel, in particular, the vice president or the concerned personnel at Bolivian embassy stationed in each country are also pressed to explain the president's intentions and policy.

If viewed from another angle, it is important for Bolivia to maintain a favorable relationship with neighbor countries due to its landlocked nature in terms of trade; so its relationship with member nations of the CSN including Brazil which has become the largest exporting country due to its expansion in natural gas exportation, and Venezuela, Colombia and Peru which account for nearly 30% of recent exports is especially important. However, if we observe the movement of the new administration, they prefer to direct their eyes to domestic affairs observed in the nationalization of natural gas, so the relationship with Brazil and Argentina seems to be deteriorated. Although the Bolivian government also endeavored to restore its relationship by dispatching its vice president, it is difficult to forecast its future in what manner. In addition to this, the President Morales agreed with the *Alternativa Bolivariana para las Americas* (ALBA) advocated by the Venezuelan President Chávez, together with Castro, President of the Council of State of the Republic of Cuba, so that the three countries could resist US imperialism and its control of Central and South America; it was confirmed to be strengthening its political, economic and social integration and collaboration. As the result of the agreement, Bolivia will receive a group of doctors and teachers from Cuba and a preferential supply of energy from Venezuela. In addition, both nations signed the agreement to abolish custom tariffs on Bolivian products. In such a manner, Bolivia is also greatly changing its direction on regional integration.

Furthermore, the present administration set forth a policy to directly support micro and small producers and enterprises. Enterprises will be registered and legalized, and social guarantee for those employers will be substantiated; on the other hand, the idea of a development bank has been set forth. A development bank is regarded to pooling the funds of all donors in addition to a surplus of funds obtained from natural gas, etc. and to "directly provide financing to micro producers and enterprises at low interest"[135].

14-1-2 Industrial Development Issues and Trends in Assistance

(1) Industrial Development Issues

The concrete policies and action plan by the new administration are unclear at the present

[135] However, as of September 2006, the content and details are vague.

time. At the time of election, they said that “they would take measures to expand the market mainly for Europe, and at the same time, take measures toward industrial promotion for preferential tariff items which have not yet been effectively utilized”. However, following the election, they revised their remarks stating “the possibility of an FTA conclusion with the United States will not be eliminated”. Although it is important to secure the export market for textiles, timber, jewels and ornaments, we will try to negotiate in order to reduce the impact on the weakest products and the economic sector in our country.” The conditions are changeable due to pressure from the industrial world or each nation.

However, basic issues for industrial development confirmed by the study, examination and a field survey conducted by the JICA are nearly the same, which can be improved as follows.

- Reinforcement of governance on an investment and economic development basis and improvement in the stability of the organizational system
- Improvement in productivity: introduction of technology, training for managers and workers
- Export market development: conversion from exportation of natural resources or primary products with low processing level to exportation of products with value added
- Industrial cluster formation: quality improvement and security of quantity through specialization among enterprises and collaboration, improvement in international competitiveness
- Access to low-interest financing

Essentially the present government tends to deny policies set forth by the former government and intends to reform them entirely. However, many of the new policies remain at a conceptual level at the present time so that the contents remain vague.

Although the present administration changed the name to “production cluster”, the “production chain” used by the former administration, in other words, activities to create an inter-industrial relationship from small-scale producers to the market for exportation and to develop necessary related services appear to be continued, of the above-mentioned issues, improvement in productivity, export market development and industrial cluster formation are included.

With respect to the targeted sectors, the potential for agriculture, livestock farming and forestry with a diversified ecosystem from the Andes highlands to basins and lowland as a background is pointed out. In particular, farming products cultivated in Altiplano in the Andes highlands such as maca and quinoa are cultivated in only a few nations in the world. Maca has already attracted public attention as a health food; whereas, quinoa contains no gluten despite of it being a cereal, so it is expected to be attractive to people who cannot eat wheat, etc. and who are allergic to gluten. It is also deemed to be suitable for organic farming, so organic onions, etc. have been already exported to other countries. The potential sectors are textiles, log processing, leather, handicrafts and jewels in addition to agriculture. Especially for textiles, traditional woven fabric skills are handed over mainly to aborigines in the Andes, so this has attracted public attention. Although other donors have already supported the sectors by paying attention

to the production chain in many cases, these donors continue to support activities subject to specific areas and items, so many sectors and areas needing assistance still remain. For example, one of the problems is that it is hard for the handicrafts sector, etc. to obtain good quality materials domestically because the relative large companies exporting materials as they are.

In the case of considering such production chain for landlocked Bolivia, transportation-related infrastructure is important for promoting exportation. On the road from Cochabamba to Santa Cruz, the ground in the middle of the road is so bad that it is closed to traffic and a bridge has been washed away. In due consideration of the present traffic volume, few people appear to oppose road improvement. One problem they face is that, of the two airline companies in Bolivia, only LAB Airlines which provides air cargo service has gone bankrupt, so it is difficult to send air cargo. As a result, this has had an influence on exportation especially to the United States which is its second largest customer. With respect to exportation from Arica Port in Chile, due to the privatization of the said port, terminal charges, etc. have increased remarkably so that an increase in export cost has become a problem.

However, even if a production chain is developed, in the case of Bolivia, there is a big problem from a governance point of view. Under the present MAS administration, all vice ministers and directors have been replaced and scholars and leaders of organizations, etc. who do not have experience in governmental positions have been appointed. In turn, persons with no knowledge in related fields have taken important positions. To make matters worse, since 50% of the wages for members of both the upper and lower houses, ministries, vice ministers and directors were cut[136], superior staff left, so it is apprehended that the organizational capacity of the government will fall dramatically.

One problem often being pointed out is that some companies do not trust and cooperate mutually. This is therefore deemed to be one of the largest obstacles in creating the division of labor (specialization), cooperation and industrial cluster.

(2) JICA programs and projects

Presently the JICA has set forth three poles in a country-specific project implementation plan: “social development”, “support for production improvement” and “institution and governance”. If “social development” is understood to be two wheels with economic development through which safety for the socially weak will be guaranteed by improving social overhead capital and by substantiating education, health and medical services and basic social services and a society which is the basis of economic development is bottomed up[137], “support for production improvement” and “institution and governance” are related to industrial development itself.

When taking the conformity with development strategies of the present administration into account, social development and support for production improvement conforms to “productivity strategy” and “dignity strategy”. The institution and governance is regarded to be a

136 Of public employees, wages of lower-grade public employees were left as they were. Secret service expenses were also cut in a full-scale manner. However, the portion of wages and secret service cost cuts will be allotted to the expenditures for educational and health service field.

137 In the present administration, the nationalization and free education including universities, health and medical services such as socialism are being discussed.

cross-sectional theme in the national development plan.

(3) Trend in other aid-giving nations and aid provided by other donors

With respect to the trend in other aid-giving nations and aid provided by other donors, in response to the formulation of the PRSP (Poverty reduction Strategy Paper) in 2001 as described earlier, of the social infrastructure services, the ratios of support for basic education, in particular water supply and public sanitation have increased.

Speaking about industry development, although each aid-giving nation tends to support the promoting of exportation subject to some items and areas which fall under a production chain; in the case of viewing the aid amount in total, this does not reach even 10%. The aid method covers the organization of small-scale producers and short courses and training on exportation procedures and marketing, etc.

As a notable event, several donors have cooperated with governmental organizations for several years, as the consequence, they have concluded that it was more effective to directly cooperate with the private sector. They then changed their policies to carry out activities and to cooperate directly with the chamber of commerce, etc. subject to specific areas and products[138].

Following a new administration with strong anti-US sentiment, although some donors like the USAID are in a substantially suspended state, no donor draws off or some donors increase budget like the donors in North Europe.

14-1-3 Direction of future assistance in industrial development

In addition to the infrastructure development of rural electrification, railway, resources development, bridge, airport and rural roads, the JICA has provided technical cooperation in terms of beef cattle improvement projects and technical improvement of small-scale livestock farming. In the 2KR (Grand Aid for Increased Food Production), agriculture has also received assistance. JICA cooperation has been evaluated. For example, the Bolivian industrial association says that “JICA does not want to stand out but they provide a substantial amount of important aid”. With respect to road networks, the JICA intends to continuously provide cooperation as it is deemed to be the basis of regional economic activities. This field appears to be important in the future in the sense of social and economic infrastructure, regardless of a change in the administration.

In terms of economic development, in addition to the improving project on agricultural skills, although a study on industrial promotion is being carried out by dispatching professional investigators, the full-scale cooperation is not provided at the present time.

Then, what to do in the future, under a situation in which most of vice ministers and directors in the government were replaced and many incomers who have no professional knowledge are included. It is shifting in a direction very different from the past administration. However, in the case of objectively considering that the policies still show conceptual nuance and do not connect to concrete and systematic policies and an action plan, it appears that the

[138] Judged that it is difficult to directly support for micro and small enterprises, some private organizations tend to support medium to large companies to create a substantial inter-industrial relationship through these companies effectively utilize micro and small enterprises as subcontracting.

formulation of strategies is most important for Bolivia through a study on economic development.

However, based on the experience of JICA and each donor that we visited at this time, instead of carrying out a study on economic development for several years at least, it is better to take a more substantial approach for the following reasons.

- Although a number of studies on economic development were carried out by not only the central government but also the chambers of commerce, etc. in the past, there are little effects due to the replacement of substantial responsible personnel in the central government resulting from a change in administration and accumulation of impractical reports.
- The sustainability of an economic development survey as the personnel of governmental ministries and agencies is directly the counterpart (C/P) (as government strategy) is questionable in Bolivia where the tendency is to replace key personnel at every change of administration and new responsible personnel totally deny the policies of the former administration. Preferably, the long-term perspective and sustainability can be expected in the case of counterparts from private organizations, etc.
- Although the governance issue is extremely important, it is so difficult to promote the improvement in governance. Preferably, as the result of improving awareness of the private sector, citizens and social power, if power between the government and the private sector[139] become balanced, the situation will be difficult to change.
- In due consideration of the existence of indigenous people who have their own sense of values, it is necessary to jointly apply social developmental, community developmental approaches in economic development.

As mentioned above, one of current feasible approaches is as follows. In the case of Bolivia (under the present situation at least), "how to approach" is rather important than "which field should be covered" in order to obtain substantial effects. There is room to examine the fields in due consideration of discussions with a recipient government or organization to be a potential counterpart (including private organization).

（Project Image）

- Selection of one to several production clusters recognized by the Bolivian side by being aware of demarcation with other donors
- Dispatch of experts who will provide strategic advice and coordinate a project in total with local chambers of commerce, etc. regarded to be the counterpart
- Involvement of micro and small enterprises as suppliers based on (some) medium enterprises to be key
- Implementation of substantial and practical seminars and courses (management and technology) covering marketing, product development, production control fundamentals, certification, brand creation, exportation procedures and human

[139] In addition, if the academic sector taking the role to judge objectively and professionally things and the mass media are not cultivated, the balance as a state cannot be established.

resources development, etc.

- Dispatch of senior volunteers and Japan overseas cooperation volunteers (JOCV) who ensure quality improvement for exportation, etc. by visiting companies, in order to ease mutual distrust and to form industrial clusters

The above proposals can be positioned in the ongoing JICA Country Program as follows:

Relationship between proposals made by the study team and the JICA Country Program for Bolivia

JICA's Priority Areas	JICA's Programs	Proposals by the Study Team
Social development	Strengthening regional health network (reproductive health)	
	Water supply in poverty area	
	Support program for the people with disabilities	
	Improving the quality of educations	
	Sustainable livelihood for indigenous people	(Although proposals are not specified only to the indigenous people, the supports for production clusters might include many of them.)
Supports for production improvements	**Production chain/ regional development**	1. Supports for production clusters (chains) developments : Forming industrial clusters by making medium-sized companies as cores and including micro/small companies as suppliers 2. Implementation of practical seminars and trainings 3. Alleviations of mutual distrustfulness between companies
	Transportation networks development	
Institutional arrangements/ governance	**Supports for the preparation of national development strategy and implementation structures**	
	Reinforcements of regional governance	Experts dispatches to Chambers of Commerce etc., (It is necessary to create good power balance between public and private sectors by increasing political awareness and power of private sectors.)

Note: Broad characters indicate the programs in relation to economic development.

14-2 Ecuador

14-2-1 General Development Trend

(1) Current Economic Trend

The Ecuadorian economy is fed by petroleum exportation and agricultural production. The petroleum industry accounted for 25.2% of the GDP and 60% of exports (2004) is highest ranking, and agricultural, livestock farming and the fishing industries accounting for 10.5% of GDP, 22.7% of exports being mainly bananas, coffee, cacao, livestock, fish meal and shrimp. In the manufacturing sector, almost half are food processing and beverages based on farming and marine products and account for approximately three quarters (3/4) of the total amount of manufactured products together with textiles and leather and wood products. In such a manner, an excessive dependence on primary products has helped to create a fragile economic institution which is easily controlled by international prices or weather conditions. The government reduced inflation by injecting dollars into circulation in 2000, and since then the economy has recovered. However, this is mainly a result of an increase in oil prices; so an economic institution that is sensitive to external economic change has still not changed structurally. Moreover, unemployment has yet to be improved because the manufacturing sector where the employment effects are high cannot be developed. Reform to the industrial structure is being requested by improving competitiveness in the processing industry for farming products which has a traditional economic infrastructure.

The basis of Ecuadorian economic activities is divided into two provinces, Guayas province which has the port city, Guayaquil, and Pichincha province in which the capital, Quito, is situated, which accounts for approximately 30% and 25% in GDP respectively, aside from the petroleum sector. Other major economic zones in clued Manabi province (farming and marine products), Azuay province (ceramics, furniture and tire, etc.) and Esmeraldas province (oil refining and timber).

(2) Industrial Development Issues

Although the per capita GDP in Ecuador exceeds 2,000 dollars, the average income of the poor who account for the majority of the population of 13 million people is low, so the market scale is generally small. In addition, since the domestic distribution system has not yet been developed for geographical reasons, this has been a problem which has lead to local disparity in the domestic market development and economy. In addition, the causes hindering industrial development include a low level of basic education, insufficient physical science education, insufficient capital and technical skills, high investment risks resulting from an unstable and corrupt government, etc. Problems with a breach in the oil production agreement with the Occidental Petroleum occurred this year, and a revision of the Hydrocarbons Act and withdrawal of the Japan-Chile joint venture planting project, etc. have contributed to breeding international distrust in the relevant government and hindering the encouragement of direct overseas investment.

(3) Development Potential

Although Ecuador has many political and economic issues, the state itself has high development potential from the viewpoint of resources. Although its territory is located right on the equator, its geography is varied in altitude and it has a diversified climate, boasting natural environmental conditions that are the most biological diversified in the world. So it is extremely suitable for agricultural, livestock and forestry products. In addition, to the west is the Pacific Ocean which is rich in fishery resources brought by ocean current and seaports. Moreover, the Amazon has petroleum and gas resources, so an increase in output can be anticipated in the future.

14-2-2 Economic Development Guidelines

(1) Policy issues and basic policies of the current political power

After the dismissal of former president Gutiérrez vice-president Palacio took office and largely continued with the policies of the previous administration. The following five basic issues under a long-term plan (government plan extending from 2003 to 2007) are priority.

- Anti-corruption measures
- Poverty banishment
- Improvement in public peace and order
- Economic revitalization and improvement of competitiveness
- Political reform

Of these, "poverty banishment" is an original task of other priority issues and is listed as a strategy to overcome poverty reduction through economic development and as a related issue to reinforce the competitiveness and to improve productivity. In other words, the poverty problem in Ecuador is a concentration of wealth to the class controlling the economy and an economic and social development disparity between urban and rural areas (including Amazon, etc.) in a similar manner as with other South American nations since the Conquistadors. So the number of poor exceeds the majority of population as a whole. In particular, the majority of poor and the poorest are concentrated in rural areas. Against the backdrop of extreme populism rising in recent years, the "anti-poverty measures" are the issue of highest priority; consequently, economic development strategies to address this problem are requested.

Furthermore, the Palacio administration publicly announced the following six items as supplementation and revision of a long-term program as a national reconstruction project.

- Reconstruction of political system
- Economic policies (Investment expansion and employment increase by effectively utilizing surplus funds from oil exportation)
- Infrastructure development (Appropriation of funds for basic infrastructure development and reinforcement, investment project promotion in the hydrocarbon sector through the IESS financing)
- Human resources reinforcement (Reinforcement of the health and educational sectors, investment to the science and technology sector, vocation ability development)
- Legislation reinforcement and improvement in public peace and order

・ Foreign policy (Support for concept of setting up the South America Community of Nations: CSN)

(2) Development direction for major industries

Primary industries in Ecuador are the petroleum industry, agriculture, forestry and fisheries. The petroleum industry intends to move forward in development investment under the new Hydrocarbons Act while obtaining technical cooperation from oil-producing countries such as Brazil, Mexico, Venezuela and Malaysia, etc. Although the petroleum industry is a capital-intensive industry and does not always lead to alleviating poverty, regional development by returning profits to the oil development area (Amazon) is expected. In addition, in future stages of expansion oil production, added value is expected to be improved through the development of the downstream sector such as expansion in oil manufacture capacity for foreign markets, petrochemical industry development and development of various derivative products industries. Positioning as an important base in Ecuadorian economy and industry may not change.

The agricultural, forestry and fisheries sector are fields in which income redistribution and the effects of employment promotion are expected as anti-poverty measures. However, with respect to the situation in agriculture, forestry and fisheries, the exportation of primary products having a low rate of added value remains in the mainstream, so that the processing level is the lowest among South American nations. Improvement in the added value, productivity and international competitiveness of products will become a key in leaping the sector. In addition, domestic market development will lead to income improvements in small farm households by improving the domestic distribution infrastructure, in turn becoming an opportunity to breed the desire to enter into the export industry.

(3) Small and micro enterprises development

The so-called medium and small enterprises problems in South American nations are treated as small and micro enterprises problems. As a matter of course, although small and micro enterprises development is understood as policy to encourage the growth of medium and small enterprises, it is realistically subject to the informal sector where side businesses of the poor such as the household industry comprised of small farm households account for the majority; so many enterprises cannot reach an “enterprise” level from a technical and managerial point of view. For the future outlook, through the support represented by “small-scale financing programs for craftsmen in the fragile resident group and micro enterprises (program taken by the present administration)”, including care for the socially weak, an aid package for upgrading small and micro enterprises (such as financing, technical guidance, business guidance, information provision, guidance on market development and distribution support) should be expanded.

14-2-3 Direction of Future Assistance

(1) Present level of assistance

Assistance from international organizations, bilateral assistance and assistance by NGOs is

generally provided. Anti-poverty measures and environmental conservation are fields in which assistance is provided the most, followed by basic education, health and medical services, good governance and agricultural support. Agricultural support includes guidance on agricultural skills, farming products processing and improvement in the competitiveness (UNIDO) in addition to irrigation; whereas, other industrial fields include micro finance, vocational training, support for starting up business, cluster formation and support for productivity improvement. Other than these, support for developing specific areas such as development for border areas, poor areas and comprehensive rural community development can be often observed.

(2) JICA cooperation priority areas

In accordance with policy consultations of July 2005, the following development tasks for three priority areas (anti-poverty measures, environmental conservation and disaster prevention) set up by the JICA are established.

Anti-poverty measures:

- Basic infrastructure (water supply and sewerage, health and medical services, education, etc.)
- Industrial development and employment creation (human resources development)
- Support for poor farmers
- Encouragement of community development

Environmental conservation:

- Conservation of natural environment and ecosystem
- Anti-environmental pollution measures

Disaster prevention:

- Reducing vulnerability to natural disasters

In addition, support for Peruvian border areas, mountainous areas in the South and the Colombian border areas in the north are listed as items to be addressed.

JICA has introduced the following programs in due consideration of the above.

- Improvement in health and sanitation
- Educational improvement
- Appropriate application and improvement of water resources
- Micro enterprises development
- Development for agriculture and rural communities
- Ecosystem maintenance and nature conservation
- Environmental conservation mainly for water resources
- Improvement of disaster prevention control

(3) Expected direction of assistance

- According to the present forecast prior to the presidential election in October of this year, for example, representative by aboriginal groups has been excluded, and it is said there is little possibility of any dramatic policy change. In any case, support for themes that focus eyes on economically important issues such as the problems of poverty, agriculture, rural

communities and farmers should be selected.

- There appears to be no objection to the addressing of "poverty reduction" as an overall goal necessary for economic development in the relevant country. In addition, as far as the exportation-oriented industrial development is evolved in cross-sectional themes generally associated with economic development, "reinforcement of the competitiveness and improvement of productivity" is a crucial strategy. These two items cover economy-related and two developmental tasks of five basic policies advocated by the present government.
- As an assistance keyword for these goals, firstly, supporting themes associated with "poverty reduction" and economic development include employment promotion, encouragement for starting up business, rural development, support for agricultural skills, support for reinforcing a financial system, vocational training, rural distribution infrastructure development, market development for rural cities, support for traditional handicrafts development, eco tourism and tourism development, etc. Secondly, themes associated with "reinforcement of the competitiveness and improvement of productivity" include support for processing skills in the agriculture, forestry and fisheries, support for industrialization in agriculture, intensification of agriculture, creation of a production chain, rationalization of physical distribution, export market development, support for disseminating industrial information, support for export market information, support for standardization of exported products, new product development, support for R & D, preparation of a quality inspection system and institution, support for improving productivity, vocational training for quality control skills, etc. can be listed.
- As the above-mentioned economic development-related supporting themes indicate, although alternative solutions for many supporting projects can be considered, assuming that poor districts in rural areas or rural cities, local industries, agriculture, livestock farming, forestry, industries related to agriculture, livestock farming and forestry are subject to assistance, in due consideration of special features of areas subject to the relevant project and local needs toward projects through local governments, organizations, private companies, farmers, residents and NGOs, etc., it is necessary to apply an implementation method through which the further effects can be expected.
- For example, as an aid package incorporating anti-poverty measures and regional development, it is desirable to implement medium and long-term assistance through setting the poor rural communities or distribution center of a targeted group, so that the beneficiary effects will emerge directly. For example, successful samples should be accumulated by implementing regional development over a period of 5 years based on village revitalization in specific areas or industrial development in model districts. In addition, many NGOs participate in this type of cooperation, so the long-pending follow-up is possible in a project through collaboration with an NGO with accumulated knowledge in the relevant area.
- Other than the above, as aid expected throughout the study at this time, financial support can be taken into account. In particular, the Ministry of Finance and Public Credit is hoping for the creation of a guarantee financing system for medium and small enterprises.

The above proposals can be positioned in the ongoing JICA Country Program as follows:

Relationship between proposals made by the study team
and the JICA Country Program for Ecuador

JICA's Priority Areas	JICA's Programs	Proposals by the Study Team
Poverty reduction	Upgrading of Health Service	
	Support for micro scale enterprises	Multiple model programs for poverty alleviation at specific region 1. Advisory service program for improvement of micro enterprise operation (Consulting service program) 2. Entrepreneurship promotion program in the model region (Business diversification program) 3. Development assistance of organizing bazaar and wholesale market in the cities of the region (Modernization program of regional micro retailers and distributors) 4. Improvement program of transportation infrastructures around the region
	Agricultural development and rural development	1. Multiple development programs for specific rural village (1) Organizing movement for product development and boost economy projects in the frontier area or poor peasant area (2) Vitalization of markets in the regional cities and improvement and development of regional transportation infrastructures between rural areas and cities (3) Circuit technical consultation service for farmers in the regional villages 2. Strengthening of agricultural products' competitiveness, up-grading of agro-based processing industries, development of international market for regional products (1) Promotion plan for agro-based processing industries (2) Strategy planning to access international market for indigenous agricultural products in the region (3) Promotion plan for standardization of Agricultural Products (4) Measures for degraded soils and research & development of eligible products in the area (5) Establishing an institution of guarantee financing for small and

		medium scale agro-based processing industries
Environmental conservation	**Ecological and nature conservation**	A package plan of "development" and "environmental conservation" (1) Natural environment conservation plan with development of eco-tourism industries (2) Measures to prevent ecocides and pollutions caused by exploitation of oil, natural gas and mining of minerals.
	Environmental protection on water resource and surrounding areas	
Disaster prevention	Improvement of disaster prevention management	

Note: Broad characters indicate the programs in relation to economic development.

14-3 Paraguay

14-3-1 General Development Trend

Of the four least developed countries, both GDP and population in Paraguay are smallest, as shown in Chapter 11 (11-1), the ratio of the agricultural sector of the GDP is overwhelmingly high in South America and the 2004 ratio was 26%. Since they are not blessed with abundant mineral resources, etc. they have the characteristics of a purely farming nation. The manufacturing industry accounts for only approximately 15% of the GDP and mainly includes food processing and beverages, textiles and timber. Aside for a few of these, the majority are small-scale production for domestic consumption. Exportation greatly depends on primary farming and livestock farming products such as soybeans, beef, cotton and leather, so the former two items accounted for 49% of the total exports in 2005. If soybean processed food such as soybean oil or soybean cake are included, the dependency becomes greater. Consequently, the Paraguayan economy appears to show a single-type economic structure in which primary products are extremely limited to soybeans and beef in the agricultural and livestock farming sectors.

The present Duarte administration has been successful in stabilizing a macro economy; on the other hand, economic growth is relatively lower than surrounding nations despite maintaining a plus, which has greatly resulted from such an economic structure. In other words, traditional and minority exported products pull national economic growth in general due to a rise in international prices or an increase in demand; on the other hand, the manufacturing industry except for textile products is stagnant or indicates a slight growth. In addition, producers of soybeans or beef are mainly rich large-scale land owners, so the ripple effects on the national economy are also limited. Consequently, this does not especially lead to income improvements by the poor, so the unemployment rate is 10% (urban areas in 2004: ECLAC data) and does not show a remarkable improvement.

In maintaining such a fragile industrial structure as a background, development issues in general in Paraguay, in particular, problems rooted in the social and economic structures which are the basis for the way of the state or people's lifestyles over a long period of time seem to have a significant affect. To put it concretely, there is preservation of disparity in the domestic economy, a lack of education and human resources development, unattended (non-improved) legislation and uncertain application and problems pertaining to governance by the government and the administration (such as structural corruption and a concession system). For example, if only rich large-scale producers expand exports as mentioned earlier, the disparity of the domestic economy expands more than preservation. If legislation on foreign investment has been prepared and procedures are taken by a responsible person at his own discretion and the quality of workers is low, they are not even listed up as potential place to investment in compassion with other nations. Based on the hearing of the Study, improvement in the basic social infrastructure is widely recognized by the stakeholders (especially in the private sector and donors) as a role of the government in the case of promoting long-term and sustainable development.

Such recognition is also backed up by basic principles on development in the government.

The present administration advocates the slogan "poverty and corruption eradication" in its basic principles for development; in consonance with this, the "fair economic growth plan" setting forth 6 priority areas in the policies was formulated (Refer to 11-2).

14-3-2 Issues on Industrial Development and Trend in Assistance

(1) Industrial development issues

A major obstacle in the industrial development in Paraguay is its disadvantageous position in MERCOSUR. Since it is a member of MERCOSUR and is geographically landlocked, Paraguay is greatly affected by the economic trends and policies of Brazil and Argentina, its two strong South American neighbors. In fact, MERCOSUR accounts for more than 50% of the trade in the said country. Due to reduction and abolition of customs duties, Brazilian and Argentina products flow in, 400 manufacturers couldn't compete and appear to be going into bankruptcy. In the competition of both the regional market and extra territorial market, farming products or light industrial products produced in Paraguay do not have the competitiveness because the large-scale production with reasonable prices in both Brazil and Argentina. For example, companies producing organic sugar which are deemed to be relatively competitive cannot obtain sufficient profits only through domestic sales in Paraguay and export to Europe[140]. Accordingly, domestic parties concerned almost all comment that "we cannot gain any economic profits from MERCOSUR and only obtain a loss or damage."

Furthermore, in the case of accessing markets from Paraguay into Brazil and Argentina or passing by both countries on the way of transporting to extra territorial countries, since they face non-tariff barriers (NTB) in both nations, generally speaking, it is recognized that Paraguay is in a more disadvantageous situation. As described in Chapter 11 (11-2), this mainly refers to customs clearance, importation quarantine, inspection and importation permission, etc. A clear example of this is one recent case brought up by Paraguay to the consultation mechanism of the trade committee of MERCOSUR. There was discriminatory treatment of inland duty imposing imported natural juice (toward Uruguay), regulations on importation, sales and transit of genetic recombined soybeans (toward Brazil) and uncertainness in the case of applying the inspection regulations at the time of transit of natural juice (toward Brazil)[141]. The image of Paraguayan products is not very good from the Brazilian and Argentinean viewpoint due to the preconception (perceptual cues) that "the products are bad and do not satisfy certain standards". It is heard they are often treated very badly. However, Paraguay not only regards MERCOSUR to be politically meaningful but also recognizes the importance of membership more than other member nations because Paraguay, as a landlocked nation[142], has no choice but to rely on its economic relationship with Brazil and Argentina. In addition, Paraguay also faces a problem of non-tariff barriers. Accordingly, it is important for the government and companies to take stable and realistic measures in accordance with their role.

On the other hand, in order for Paraguay to accomplish substantial growth in the future, although the expansion and diversification (increase in the number of leading exported items) of

[140] Based on the hearing to the GTZ Paraguay office
[141] Report B by the consultant: 26 to 30 pages
[142] Based on the hearing to Industrial Union of Paraguay and the ministry of Finance

exports are deemed to be indispensable, after overcoming the above-mentioned disadvantageous competitiveness in MERCOSUR, in the case of promoting exports including extra territorial exports, there are many issues. The government has also proposed diversified policies such as support for small farmers or micro enterprises, export development and promotion, simplification of exportation procedures and investment promotion through the cooperation with donors. For example, the Investment and Export Network (REDIEX), an affiliated organization of the Ministry of Industry and Commerce to formulate exportation strategies and support for export companies by promoting the selection and examination of sectors with export potential through collaboration with the government, the private sector and research institutions. Export market development is taken by the PROPARAGUAY which is an export promotion agency under the cooperation with REDIEX. In order to realistically establish an insistent flow from exported product development to production development, procurement, distribution and sales, and access to foreign markets, not only is support for skills and funds for producers essential, but also institutional development to reinforce the supporting system of the government, to promote exports and investment, and to back up the infrastructure. In other words, a basic framework for industrial development should be steadily constructed in order to create export dynamism.

As mentioned above, major issues in the industrial development can be outlined as follows.

- Technical measures for non-tariff barrier (plant and animal quarantine, technical standards and standardization, certification)
- Establishment of a production chain (especially for value-added products development, technical improvement of micro, medium and small enterprises and human resources development, reinforcement of a domestic inter-industrial relationship and reinforcement of the government supporting system)
- Economic infrastructure development (roads, telecommunication, electricity) for efficiency of economic activities and investment promotion
- Social infrastructure development including governance and institution

(2) Assistance trend

In due consideration of the direction of the Duarte administration, in the country-specific project implementation plan (August 2005), JICA established 5 priority fields: (i) substantiality of social services for the poor to maintain and improve incomes, (ii) relaxation of disproportion under MERCOSUR and reinforcement of economic competitiveness to promote economic growth, (iii) environmental conservation and sustainable development of natural resources, (iv) administrative organization and institutional development (good governance), and (v) viewpoint and method for cross-sectional cooperation in priority fields; 15 programs in total under those fields.

In particular, although six programs were provided for priority field 2 “reinforcement of economic competitiveness” in the economic development, before anything else, this intends to establish a production chain in order to achieve export access and corresponds to the above-mentioned industrial development issues. Six programs, in other words, as stated in Chapter 11 (11-3), these refer to “support for production of major agricultural products such as

soy beans", "support for human resources development of micro, medium and small enterprises", "support for technical improvement of animal inspection, industrial standards inspection and certification and institutional development", "support for institutional development for enforcing domestic industries and promoting exports and investment", "support for specific industries development" and "support for basic infrastructure development for industrial activities and improvement of maintenance and management capacity". In addition to the implementation of an economic development study, JICA has performed a leading role in pest and disease control vocational training, mass inspections and testing, livestock sanitation, export and investment policies and encouragement of industrial cluster formation.

In addition, the JBIC deems economic infrastructure in the IIRSA project to be a top priority; one part is a loan for the Iguazu hydraulic power plant which was decided in February this year. JETRO has provided cooperation in organic farming and specialty products development and sales promotion.

On the other hand, many donors have set export promotion and reinforcement of economic competitiveness as priority fields. Several donors such as the IDB and the USAID implement direct assistance for individual companies in specific areas (such as support for management, export and sales, providing of loans to technical development). As a backdrop, recent assistance tends to place an emphasis on governance by the government and anti-corruption measures overall. Therefore, this could mean that direct support for companies and private organizations is more effective (Refer to 11-3). Although assistance from the EU has tended to fall behind as scheduled, they have expressed a policy mainly for promoting and diversifying exportation (such as certification and inspection institution development, human resources development and upgrading of negotiation ability) in the future.

14-3-3 Future Direction of Assistance

Generally speaking, it is important to diversify exported products. However, with the direction that Paraguay is heading, it is natural to establish a domestic inter-industrial relationship mainly for promoting value-added exportation of agricultural and livestock farming products at first. Agricultural and livestock farming products include, the advancement of processed goods derived from soybeans, cotton and edible meats which are leading products and the added value of non-traditional products which are minor but promising. For example, sesame, peanut, organic sugar, mate tea and stevia can be considered.

From the viewpoint of assistance, firstly, the problem that a production chain is created to some extent but actual exports become bottlenecked should be addressed. At the same time, relatively superior product development and security of stable access to international markets should be supported. In order to create a sturdy production "chain", it is important to respectively create a strong chain in rural communities that produce and supply materials and support the local economy. In this sense, in the case of improvement of production at a small farm level, organization, development and added-value of local industries, this leads to the reinforcement of a production chain. At the same time, it is also important to reduce poverty and to correct domestic disparity.

From the medium and long-term point of view, it is necessary to create a framework to

effectively utilize future economic opportunities for Paraguay by steadily taking measures to improve the basic production framework such as institution and infrastructure. For example, if non-tariff barriers with Brazil and Argentina are removed to a considerable level, it will be possible for foreign investors to effectively utilize the favorable geographical location of Paraguay as a supply base in MERCOSUR. However, at that time, if the factors of infrastructure, institution and administrative transparency are not improved, this cannot be realized. In addition, as described in Chapter 3 (3-1), while the trend of escaping the industrial locality of Sao Paulo, Brazil and to extend to the surrounding areas progresses, for Paraguay to effectively utilize the opportunity in the future, workers with certain qualities should be at hand. That means, needless to say, human resources development including basic education is important.

The following actual examples can be considered, in consideration for their relative priorities.

(1) In the short and medium term: support for resolving export bottlenecks and reinforcing the system for formulating production chains

- Animal and plant quarantine, standards inspection and certification system, institutional development (corresponding to non-tariff barrier): For these problems, it is necessary to examine improvement in appropriate institution and technology in relationship with partner countries and areas which are especially important for trade in Paraguay. In this sense, implementation can be considered by effectively utilizing a third-country expert from Brazil or Argentina. For both institutional and organizational development, pilot measures can be taken into account through the selection of sectors and products.
- Support for institutional and organizational reinforcement for export and investment promotion: By supporting the establishment of autonomous operation of governmental organizations to promote exports and investment, an institution to back up export efforts of individual enterprises is strengthened.

(2) In the medium and long term: support for establishing production chains to create export dynamism and seizing future economic opportunities

- Support for production skills corresponding to export needs, production and quality control, and security of production amount in micro, medium and small enterprises. For example, in addition to technical cooperation provided directly to individual enterprises, human resources are developed through private company associations and the chamber of commerce.
- Reinforcement of domestic and local economies (improvement in local distribution systems, human resources development by the local government and private sector): The combination of the above-mentioned enterprise support could be considered.
- Support for starting up businesses: Technical cooperation and advice is provided with the collaboration of private organizations such as the chamber of commerce.
- Infrastructure development (roads, telecommunications and electricity), corresponding to inefficient transmission and distribution power and insufficient capacity: For the

latter, a development study and dispatch of experts including effectively utilization of electricity revenue under the collaboration of JBIC could be considered.

The above proposals can be positioned in the ongoing JICA Country Program as follows:

Relationship between proposals made by the study team and the JICA Country Program for Paraguay

JICA's Priority Areas	JICA's Programs	Proposals by the Study Team
Enriching of social services to the poor and maintenance and increase of their income	Support for improving basic education	
	Support for improving health and medical service	
	Support for promoting local industries and productions	For the purpose of poverty reduction and correction of economic gap in the country by establishing production chains:- ・ Strengthening local economies (improvement of distribution systems, human resource development of municipal and private organizations) ・ Support for developing local and value-added products ・ Developing production technology of small farmers and supporting organization of them
	Support for promoting independence of small farmers	
Easing of imbalance among MERCOSUR countries and strengthening of economic competitiveness to promote economic growth	**Support for producing major agricultural products such as soybeans**	
	Support for developing human resources in micro and small and medium enterprises	For the purpose of establishing production chains to create export dynamism:- ・ Strengthening production and quality management technology for micro and SMEs ・ Providing technical cooperation to individual companies and developing human resources in cooperation with private organizations including chambers of commerce and industry ・ Developing human resources of private sector in provincial/rural areas
	Support for technical and institutional development of plant and animal quarantine, industrial standard inspection and certification	For the purpose of resolving export bottlenecks and establishing production chains:- ・ Removing non-tariff barriers by developing technology and systems of inspection and certification by utilizing third-country experts including Brazilians and Argentines
	Support for developing institutions for strengthening domestic industries and promoting export	For the purpose of establishing production chains to create export dynamism:- ・ Supporting autonomous management of export/investment promotion agencies and strengthening the institutional system

	and investment **Support for promoting specific industries (such as formulation of industrial clusters)**	• Supporting starting-up of businesses in cooperation with private organizations including chambers of commerce and industry • Strengthening local economies (improvement of distribution systems, human resource development of municipal and private organizations)
	Support for developing industrial infrastructures and capacity of operation and maintenance	For the purpose of seizing economic opportunities in the medium and long term:- • Developing infrastructures in road, telecommunication, and electricity • Supporting improvement of inefficient power transmission and distribution and lack of capacity, and supporting efficient utilization of power revenue
Environmental conservation and sustainable development of natural resources	Support for developing legal and administrative institutions for environmental conservation	
	Support for preventing deterioration of water resource environment	
Development of administrative organizations and institutions (Good governance)	Support for reforming administrative institutions	(In order to establishing production chains which enable long-term, sustainable development, improvement of governance including strengthening legal and administrative systems and increasing efficiency and transparency of operation of the systems, is indispensable.)
Cross sectoral cooperation	Revitalization of cooperation projects (Phoenix)	
	Support for Japanese descent society and regional development in cooperation with them	

Note: Broad characters indicate the programs in relation to economic development.

14-4 Peru

14-4-1 General Development Trend

The economy in Peru is relatively favorable from a macro point of view. The economy ate has maintained an annual growth rate of more than 4% since 2002 and exports have increased at a high average annual rate of 31%. Foreign investment is in a stage of recovery. The World Bank and the IDB are showing signs of favoring such economic performance and plan to expand financing. The following causes can be listed.

(1) Reserves of rich mineral resources such as copper, gold, molybdenum, zinc, lead and silver and flourishing international prices

(2) Diversified agricultural, forestry, livestock farming and fisheries resources such as sugarcane, cotton, rice, grapes, olive, fish, coffee, tea, cocoa and asparagus

(3) Firmly maintaining free and open-door economic policies, in which a mutual agreement has been reached by FTA with the United States; Early Harvest with Thailand and the FTA negotiations are underway with Singapore. In APEC, Peru is the member of the Central and South American side paralleling Mexico and Chile. To say nothing of nationalization, with respect to resources or key industries, an open-door policy has been firmly maintained even for foreign companies. These policies have been attracting investors not only from European nations but also Central and South American nations such as Panama and Chile.

(4) Continuity of administration and stabilization of macroeconomic finance: Political power has changed hands over the past 16 years with leaders such as President Fujimori, Toledo and Garcia. However, personnel, organization and policies in the administration continue which has become the basis for economic stability.

(5) Accumulation of certain-scale urban economy: Lima with 8 million people is the largest city on the Pacific coast of South America and is located in an area with a high concentration of non-agricultural work force. It is of a certain scale as a domestic consumption market. Not only is the textile industry in a favorable export relationship with the United States, but also the manufacturing industry, on the non-primary product basis, is showing favorable growth.

If the present satisfactory development continues, it is possible that Peru may become a major production base for United States and major South American countries.

However, extreme domestic disparity and the enormous number of poor people (50% of the population) are causes for political instability and a fragile economic institution. In particular, the following problems exist.

(1) The mining industry contributes to 55% of exports and 25% of tax revenue. On the other hand, the domestic inter-industrial relationship is weak. The non-mining sector has not yet been developed, so this is not the sector to create stable employment.

(2) The economy is concentrated only in Lima and so rural areas are falling considerably behind. For example, residents in mountainous regions are isolated from the market economy and basic social services such as education and health.

To cope with these problems, in June of this year the new administration inaugurated the following major policies: (1) to increase employment and reinforce the competitiveness of medium and small enterprises, (2) (2) to intensify public investment (especially in education, health and basic infrastructure), (3) to encourage exports from mountainous regions, and (4) decentralization.

14-4-2 Issues Facing Economic and Industrial Development and Trend in Assistance

Although industrial development taken by the new administration is underway, essentially the following two points can be summarized.

【Long-term Step】 Trade should be connected to poverty reduction. In particular, reinforcement of the competitiveness of medium and small enterprises and in agriculture (such as financing for farmers and micro enterprises, improvement in market information, dissemination, new product development and reinforcement of a quarantine system) and strengthening of the production chain (encouragement of collaboration between importers and production centers, improvement of transportation and distribution networks)

【Short-term Step】 Employment opportunities should be increased. In particular, support for micro enterprises, business start-ups and the non-informal sector (such as vocational training and credit granting)

JICA has responded to economic and industrial policies through assistance in priority fields (poverty reduction, social development, economic infrastructure development and environmental conservation) in Peru. (a) Support for medium and small enterprises (improvement in skills of vocational training instructors), (b) development of agriculture, forestry and fisheries (such as production development through fishing training for small-scale and micro-scale coastal fishermen and development for exportation of marine products) and (c) economic infrastructure development (such as transportation network, electricity network and telecommunications network) are considered to be the column of each program. Therefore, assistance is provided mainly for food control, sanitation of livestock farming, seeds quality, spinning and sewing, and marine products. “Economic infrastructure development” is different from “poverty reduction”, even in Peru. So this is deemed to be of the highest priority for poverty reduction. The JBIC also plans to increase financing mainly for infrastructure development which will contribute to regional economies, in principle. In accordance with the concept that trade will connect to production center development, JETRO has supported Andean products.

Other donors such as IDB, the EU, the GTZ, the USAID and Spain are providing support for industrial development. The purpose of assistance has tended to change from “reinforcement of production itself” to “trade connected to poverty reduction by connecting the markets to production”. Under such a trend, supporting models which specify a goal attract wide public attention rather than production capacity. For example, this includes quality improvement of agricultural products based on the need for market information in advanced nations and

reinforcement of the competitiveness of exports by medium and small enterprises for nations subject to the FTA, etc. In addition, as an assistance method, it generally works directly on the private sector rather than the central government ministries and agencies. For example, this covers introduction of buyers from advanced nations, quality improvement corresponding to concrete needs (USAID) or technical cooperation (GTZ) through collaboration between companies in advanced nations (such as the coffee industry) and aid organizations. The case (EU) of adopting an integrated approach for specific areas (for example, human resources development ― participatory planning ― support for industry association ― specialty products development ― collaboration with local administration) is also noteworthy.

14-4-3 Direction of Future Assistance

Macroeconomics and administration are relatively stable in Peru and the newly inaugurated Garcia administration is extremely pro-Japanese. Consequently, sustainable assistance is effective. Basically an aid program though country-specific planning by JICA also conforms to the policies of the new administration. Existing assistance such as support for medium and small enterprises and vocational training in line with this is therefore considered to be effective; so it is very important that it be continued. In addition, the Government of Peru's mental strategy obtained through the Study and the trend of other donors are taken into account, the following would appear to enhance the existing effects of assistance.

(1) Support for systematization of policies on medium and small enterprises

Medium and small enterprises policies are often implemented from a human (personnel), financial or institutional point of view. The majority of donors regard support for medium and small enterprises to be one of the aims. The Act for Medium and Small Enterprises Development was established in 2003 and an inter-ministerial council on medium and small enterprises was established. However, since systematic policies emphasizing medium and small enterprises have yet to be prepared, the Medium and Small Enterprises Bureau of the Ministry of Labor and Employment Promotion in Peru is showing signs of an impending crisis. It would appear to be a good time for Japan to provide assistance for the systematization of medium and small enterprise. In addition, Japanese accumulated experience in this issue is greater than that of other donors. The following issues are especially noticeable.

- Positioning of policies on medium and small enterprises: The position of the Medium and Small Enterprises Bureau is unclear between the Ministry of Labor and Employment Promotion and the Ministry of Production and should be clarified. While the economy has shown continuous growth, it is a good time to position policy on medium and small enterprises within various economic policies such as exportation, foreign investment, employment and regional economies.
- The Government of Peru is positive in expanding trade with the United States, the ASEAN nations and nations in Asia and Pacific region including China, so medium and small enterprises are regarded to be new leading figures. In relation to trade policy, it appears it will be very beneficial for Japan to support strengthening the competition of medium and small enterprises.

- Capacity building of the Medium and Small Enterprises Bureau in Peru: This includes an increase in the number of exchanges with medium and small enterprises policies-related personnel in Japan and South American nations.

(2) Reinforcement of production chain

The new administration is proclaiming exports of farming products from mountainous areas as an eye-catching strategy. Despite the political overtones, instead of dualism whether it be expansion of free trade or poverty reduction, each donor focuses on the idea of connecting trade to poverty reduction. Although exportation from the remote highlands is possible in the future, many areas have the potential for economic development through trading. JICA has also conventionally supported related issues, for example, training by area "Andes productivity training", the technical project "Regional Revitalization through the Shared Experiences of Municipalities" and the technical project "Support for Small Rural Communities in Outlying Urban Centers", etc. JICA's experience can be effectively utilized in the strategy of the new administration. In particular, taking into consideration the trend by other donors in recent years, attention should be paid to the following.

- Assistance should approach private companies whenever practical. For example, this includes training for manager of medium and small enterprises related to a specific production chain, capacity building of the local chamber of commerce, excavation and introduction of buyers in Japan or others and clarification of quality improvement needs through cooperation with buyers. Collaboration with Andean products supported by JETRO can be considered.
- Not only in-house improvement of medium and small enterprises or management consultations, but also productivity as a production chain (in other words, productivity outside plants and enterprises) should be taken into account. In particular, market needs should be conveyed to farm households, the agricultural sector and the farm product distribution industry; the business environment of micro enterprises (such as information and exchanges of experiences) and not only medium and small enterprises should be improved.

(3) Formation of base for local industry (northern coastal zone, for example)

A major cause of poverty in Peru is regional disparity. Approximately one third (1/3) of the population is concentrated in Lima, the capital, and other areas are falling far behind. This is the backdrop of the *Sierra Exportadora* (mountain exportation strategy). It is desirable to actualize this strategy more realistically and to form a base for local industries in order to promote the decentralization of Lima. Although other donors support economic development in underdeveloped areas by narrowing down areas to some extent, it seems effective to develop areas where the possibility of creating an industrial base for long-term poverty reduction exists. Even in the JICA's country-specific plan (Peru), the formulation of a regional development vision has been suggested.

Taking into consideration the intensions of the Ministry of Production and Ministry of Finance in Peru, the development effects along the coastal areas in the north (Piura region,

population 1.7 million) are immense. Piura is the center of the North and its development possibilities are extremely diversified and include surrounding agriculture, mining industry and tourism. In addition, it is an exit or Manus in Brazil to the Pacific Ocean; so it has the potential to become an international trading base in the future. Quayaquil, the largest economic center, is located near Piura in the north, and has the potential to become a bordering regional economic zone. Japanese aid projects for the Piura region include fisheries development and road improvement projects.

Instead of merely preparing the blueprint for the creation of a local industry base, this should be incorporated as a part of the decentralization of local finance and administration.

The ongoing JICA country program could well accommodate these recommendations as shown below:

Relationship between proposals made by the study team and the JICA Country Program for Peru

JICA's Priority Areas	JICA's Programs	Proposals by the Study Team
Fighting against poverty	**Livelyhood**	1. Strengthening productive chains through buyers' participation, and 2. Developing regional industrial bases, particularly in northern seaboard.
	Support of the socially vulnerable	
	Governance	(Local administrative and financial capabilities should be strengthened in connection with the regional industrial base development.)
Supporting social sectors	Education	
	Health and sanitation	
	Natural disaster control	
Strengthening economic infrastructures	**Support of SMEs**	1. Preparing an integrated policy for small and medium scale enterprises, and 2. Strengthening productive chains through buyers' participation
	Development of agriculture, forestry and fishing	
	Economic infrastructures	(Local economic infrastructures should be strengthened in connection with the regional industrial base development.)
Protecting environment	Environment	

Note: Broad characters indicate the programs in relation to economic development.

Chapter 15　Actions to be Taken for the Time Being

The direction for South American assistance in the area of economic development was described above. If the direction is taken into account, for the time being it should be important to begin the following activities.

(1) Project formulation study

With respect to the less developed countries in South America, a project formulation study on themes that are important to the start up of a new project or to develop a current project will be carried out. As much as possible, themes common to the four relevant nations should be efficiently established. For example, the following themes will be created. Reference to relevant experience in neighboring countries should often be useful regarding these topics. In connection with these four topics, a possibility exists in the economic development of a cross-border region. Therefore, south-south cooperation should be useful in this regard as well.

- Systematization of policies on medium and small enterprises in a country and reinforcement of human and organizational infrastructure
- Reinforcement of inspections and a certification system for agricultural and livestock farming products, quality of processed products and sanitary conditions
- Regional economy development (agriculture and medium and small enterprises) and industrial base development

(2) Preparation of business development on trade for poverty reduction

The incorporation of promotion and poverty reduction is the direction to which the least developed countries and many related donors intend to move. In this direction, cooperation between the private and public sectors becomes important to a recipient country and to donors. The following preparation will be taken.

- Arrangement of data on private organizations in each area (such as the chamber of commerce) and capacity analysis
- Sharing of information with other donors, assistance coordination
- Promotion of sharing information of the organizations concerned on the Japanese side and coordination (such as JICA, JETRO, import companies and dispatched experts)
- Utilization of experience and human resource (such as Japanese descents and participants in the past training) in JICA's technical cooperation with leading countries in this region (Argentina, Brazil and Chile) in the field of trade promotion, to formulate projects for the four concerning countries and to hold the third-country training
- Sharing of information and lessons learned between trade or industry promotion agencies in the ASEAN region with which JICA has been in cooperation and the counterparts in South American countries, by holding joint seminar or workshops
- Identifying "best practices" and organizing related information about efforts to promote trade and industries and the relationship of the government and private sector seen in South America. Such supports for research activities could be conducted by

setting up a trust fund in the related institutions such as ECLAC.

(3) Evaluation Study

For a country that is considered to need investment of a relatively large amount of assistance resources and continuing assistance, a specific evaluation study is carried out from the viewpoint of the "effects of economic development on poverty reduction", it is necessary to come to a common understanding on a medium-term assistance policy. For example, Bolivia, Paraguay and Peru, etc. could be considered.

(4) Formation of assistance strategies for South America

With respect to assistance for South America, in addition to the understanding of country-specific needs and readiness to receive assistance, it is important to have an assistance strategy toward South America from the viewpoint of its future socioeconomic relationship with East Asia, especially with Japan. The following preparation is taken in due consideration of this.

- Establishment of a society for South American assistance (such as ODA-related organizations, people of learning and experience, business circles)
- Review of development policies in South America and cooperation for research on strategy formulation (exceeding the Washington Consensus). For example, a think-tank stationed in South America such as the ECLAC is effectively utilized.
- Together with the above, dialogue and workshops on policies with Japanese ODA-related personnel and the stakeholders of least developed countries in South America (to be held in a third country convenient to both parties)