

ECONOMIC COOPERATION AND INTEGRATION BETWEEN
ARGENTINA AND BRAZIL, 1939-92

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ABSTRACT

The thesis discusses the determinants of economic cooperation and integration between Argentina and Brazil since 1939. The work is organised in three parts. Part I presents the theoretical framework. Drawing on international relations and development theory, it is suggested that perceptions on constraints and opportunities in the international system, along with the progress of industrialisation, shaped the incentives for cooperation. In addition, the role of ideas in shaping policies and institutions is emphasised. Special consideration is given to the ideas of the Economic Commission for Latin America (ECLA), which were especially influential in the fifties.

Part II offers an account of economic cooperation and integration between 1939 and 1960. It is suggested that after 1955 there was a strong convergence of views in Argentina and Brazil about the advantages of bilateral cooperation. This was associated with the end of the 'special relationship' Brazil-USA, growing friction in the Inter-American system and dissatisfaction with the working of the Bretton Woods institutions. In addition, structural change in the industry increased the costs of protection and the gains from trade. As a result, the proposal of a regional free trade area became more attractive.

Part III concerns itself with the evolution of cooperation after the creation of the Latin American Free Trade Association (LAFTA) in 1960. It is argued that LAFTA provided an outlet for industrial exports in a context largely dominated by highly inward-looking trade and industrialisation policies (import-substituting industrialisation). The gradual maturation of the industrial sector and growing industrial exports sustained the interest in the regional market. Finally, the creation of the Common Market of the South (MERCOSUR) is analyzed. The challenge of the consolidation of the MERCOSUR is discussed in the light of the new international context and the past experience on economic integration in Latin America.

To My Parents and My Wife

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INTRODUCTION

The project for Latin American economic integration was revived in the mid-eighties and impressive progress has been obtained since then. There is a sense of optimism which contrasts with negative views of previous attempts at integration. Past efforts for integration are now seen as an archaic legacy out of which Latin America is now emerging, in her quest for modernisation and a dynamic insertion in the international economy.

However, if it is politically convenient and sometimes necessary to stress the future rather than the past in order to encourage change¹, an understanding of recent progress in regional integration would benefit from the adoption of an historical perspective. This thesis analyses the variables that shaped cooperation and integration in the 1939-1992 period. These variables will be examined within a 'evolutionary' framework that draws on recent theoretical contributions from development economics and international relations. There is a growing awareness among economists, political scientists and historians that institutions and ideas can provide a key missing link between the analytic precision of formal models and actual decision making in conditions of bounded rationality. These theories are reviewed in Part I which sets out the research hypotheses.

Part II studies the evolution of cooperation and

¹ Cf. M.V. Benevides, 'O Governo Kubitschek: A Esperança Como Fator de Desenvolvimento', in A. de Castro Gomes (org.), O Brasil de JK (Rio de Janeiro, 1991), p. 21.

integration between Argentina and Brazil in the 1939-60 period. This period is significant as it witnessed the creation of the Latin American Free Trade Association (LAFTA), the first integration initiative that achieved some progress, after the failure of the initiatives of 1939-40 (Pinedo-Aranha) and 1953-54 (Perón-Vargas). It should be observed that the systematic study of the Argentine-Brazilian economic relations in the 1939-60 period, and especially from 1939 to 1955, has been largely neglected in the existing literature. While there are important works on the political relations between Argentina and Brazil, and on the economic and political relations of both countries with the central economies, much less attention has so far been given to the role of economic and political factors in regional trade and to the frustrated attempts at integration launched before 1960. This thesis aims to make a contribution in this area. It will be argued that when closer attention is given to trade relations in the 1939-55 period, a more qualified view of the role played by regional rivalry emerges, as both countries sought to cooperate in order to secure the gains from trade and this cushioned the impact of power competition and mutual suspicions. After 1955, structural change in the domestic economy increased the gains from trade while the evolution of the international economy fostered convergent views of development in Argentina and Brazil. These factors would lead to closer cooperation and the creation of LAFTA in 1960.

Part III considers the rise and fall of LAFTA, and its substitution by a new generation of bilateral agreements, which culminated with the formation of the Southern Common Market (MERCOSUR) in 1990. While changes in international conditions favoured divergent perceptions and unilateral development policies in Argentina and Brazil in the 1960-80 period, it will be demonstrated that the 'maturation' of the industrial structure and the system of preferences provided by LAFTA reinforced an interest in cooperation among policy-makers and entrepreneurs in both countries. New evidence is provided to show that LAFTA played a significant role in sustaining regional trade in the 1960s and 1970s. The feeling of failure that haunted LAFTA, stemming from its inability to progress towards a free trade area, should not obscure its contribution to the expansion of trade, the intensification of regional contacts and the accumulation of experience in trade negotiations. Additional evidence in favour of this argument is presented in the shape of an index of trade intensity. Finally, the factors underpinning the creation of the MERCOSUR are addressed and the prospects for progress considered in the light of the long term variables presented in previous chapters.

PART I. ECONOMIC COOPERATION AND INTEGRATION: THEORETICAL
ASPECTS

CHAPTER I. A FRAMEWORK FOR THE STUDY OF EXTERNAL ECONOMIC POLICY

INTRODUCTION

This chapter aims to offer a general theoretical framework for the study of economic cooperation and integration. Section I concerns itself with the determinants of external economic policy. The recent debate on the role of structures, ideas and institutions in international relations theory is briefly reviewed in sub-section I.1. It is suggested that the 'institutionalist' or 'modified structural' school of thought offers significant contributions to 'system-centred' analysis. In sub-section I.2 the modified structural approach is expanded into an 'evolutionary' model in which structures, institutions and performance/outcomes interact. The nature of these interactions is analyzed in section sub-section I.3. The concepts of 'learning' and 'adaptation' are used to describe the links between structures and policy decisions.

Section II concerns itself with the structural variables that determine the costs and benefits of economic cooperation and integration in peripheral economies and particularly in Latin America. Sub-section II.1. discusses the conditions of the international system that can be expected to lead to higher levels of cooperation and

integration. Sub-section II.2. addresses the influence of the domestic economic structure on integration. Sub-section II.3 summarizes the conclusions of the chapter.

I. THE GENERAL FRAMEWORK: AN 'EVOLUTIONARY' PERSPECTIVE

I.1. Structures, Actors and Institutions

A fruitful debate has been taking place in recent years in the theory of international relations. The debate addresses the role of structural and institutional variables in shaping foreign economic policy ¹. From one side, the system-centred or neo-realist approach suggests that state decisions and international outcomes can be derived from the structure of the international system, defined in terms of the distribution of economic and military capabilities ². States are regarded as indivisible units capable of delivering an unique, rational response to systemic inducements. This offers a parsimonious, elegant framework in which the distribution of power determines specific

¹ A review of different schools of thought in international relations can be found in R. Gilpin, The Political Economy of International Relations (New Jersey, 1987), chapter 2 and J.G. Ikenberry et al, 'Introduction: Approaches to Explaining American Foreign Economic Policy', in J.G. Ikenberry, D.A. Lake and M. Mastanduno (eds.), The State and American Foreign Economic Policy (Ithaca, 1988), pp. 3-7.

² The system-centred approach is rigorously presented by K. Waltz, Theory of International Politics (Reading, 1979). See also I. Wallerstein, The Modern World System (London, 1974).

patterns of behaviour and change ¹. But other authors argue that system-centred approaches leave many relevant variables outside the scope of analysis. It has been observed that frequently states behave differently from ways predicted in system-centred analysis ². The same systemic conditions can elicit different responses from national states ³. Systemic constraints and opportunities are therefore considered to be only a subset - although, clearly, a critical one - of the relevant explanatory variables in foreign economic policy. This has led to the search of a more encompassing theoretical framework for the study of international political economy. The so-called 'modified structural' school has sought to fill in the gaps left by the system-

¹ From a neo-realist perspective, the structure of the international system can be defined on the basis of three elements: (i) the existence of "anarchy", in the sense that in the international system there is no central authority with the power to coordinate state decisions and establish a hierarchy of states; (ii) the 'functional equivalence' of states, in the sense that all states play similar functions; (iii) the specific distribution of power among the units that form the international system. As the first two elements are constant, it is the distribution of power that can explain differences in behaviour and outcomes. Cf. K. Waltz, 'Reductionist and Systemic Theories', in R. Keohane (ed.), Neorealism and its Critics (New York, 1986 a), pp. 55-68.

² Cf. R. Keohane, 'Realism, Neorealism and the Study of World Politics', in R. Keohane (ed.), Neorealism and its Critics, pp. 1-26.

³ This point is convincingly made by Katzenstein and supported by comparative studies on the foreign economic policy of industrial countries. Cf. P.J. Katzenstein, 'Introduction: Domestic and International Forces and Strategies of Foreign Economic Policy', in P.J. Katzenstein (ed.), Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States (Wisconsin, 1978), p. 4.

centred approach ¹. This school accepts the premise that there are systemic constraints on actors' behaviour and that the position of the country in the international system largely shapes its policy options. However, the modified structural approach also reserves a significant place for (a) the role of institutions, (b) the role of ideas and (c) the role of 'non-state' actors in the international economy ². In addition, this school also emphasizes the need of a more disaggregated level of analysis in the study of the relevant structural variables. These three dimensions of the modified structural approach are now considered.

¹ The label "modified structuralism" was coined by S.D. Krasner, 'Structural Causes and Regime Consequences: Regimes as Intervening Variables', in S.D. Krasner (ed.), International Regimes (Ithaca, 1983), p. 6. The modified structural approach has also been labelled 'neo-liberal institutionalism' by R. Keohane, International Institutions and State Power (Boulder, 1989), p. 10. Keohane uses this designation in order to emphasise the importance of political processes and human-created institutions in affecting behaviour. However, the term 'neo-liberal' has a specific meaning in economics which is different from that in international relations. Therefore, the term 'modified structuralism' will be used for the sake of precision. A pioneer discussion of the relations between institutions and systemic theory is offered by E.B. Haas, Beyond the Nation State: Functionalism and International Organisation (Stanford, 1964), especially pp. 62-86.

² If the concern with ideas and institutions is not a new one among social scientists, only recently research in this field has attracted more attention from mainstream theorists. For an assessment of the revival of institutionalism and a comparison of the 'old' and 'new' institutionalist schools see J. Harris, J. Hunter and C.M. Lewis, 'Introduction: Development and Significance of New Institutional Economics', unpubl. paper, Conference on Public Choice and Development, University of London, London 16-18 September 1993.

(a) The Role of Institutions

Uncertainty is inherent to systems in which there exist interdependence among actors' decisions and in which these decisions are not coordinated by any central mechanism. In this context, institutions emerge as an instrument to diminish uncertainty and provide a more controlled, stable and predictable pattern of behaviour. They shape interactions and facilitate decision-making¹. Institutions are defined as 'persistent and connected sets of rules (formal and informal) that prescribe behavioral roles, constrain activity and shape expectations'². In doing so, institutions help to reduce transactions costs and increase the production of public goods³. In some cases, they are devised just to inhibit certain type of behaviour. For instance, rules may be designed so as to avoid the initiation of a trade war. In other cases, they consist of an elaborated framework that facilitates the celebration of agreements in several areas and establish positive norms of

¹ In the words of D.C. North, 'The New Institutional Economics and Development', unpubl. paper, Conference on Public Choice and Development, University of London, London 16-18 September 1993, p. 2, institutions 'impose constraints on human interaction in order to structure exchange'.

² Cf. R. Keohane, International Institutions, p. 3.

³ Cf. R. Keohane, 'The Demand for International Regimes', in S.D. Krasner (ed.), International Regimes, pp. 153-54.

behaviour¹. In general, institutions are deeply embedded in human transactions. Even systems that seem to work "spontaneously", like a perfect competitive market, are rooted in a set of elaborated institutional arrangements².

Clearly, institutions cannot be merely seen as a "technical" solution for managing interdependence and even less one that necessarily conforms to a certain criterium of optimum. Institutions reflect the distribution of power among actors and are value-laden, as has been convincingly argued by Susan Strange³. They are the result of past negotiations in which power was exercised. They imply an asymmetrical distribution of the costs and benefits of interdependence. Institutions are deeply embedded in politics and it is in this light that they should be studied⁴. However, the relative autonomy of institutions does not allow to directly derive behaviour and outcomes from power. The mediation of institutions has to be considered for an

¹ Cf. R. Keohane, 'The Demand for International Regimes', p. 155, and A.A. Stein, 'Coordination and Collaboration: Regimes in an Anarchic World', in S.D. Krasner (ed.), International Regimes, p. 125.

² Cf. G.M. Hodgson, Economics and Institutions: A manifesto for a Modern Institutional Economics (Oxford, 1988), p. 174.

³ Cf. S. Strange, 'Cave! Hic Dragones: A Critique of Regime Analysis', in S.D. Krasner (ed.), International Regimes, p. 344, and S. Strange, States and Markets: An introduction to International Political Economy (London, 1988), p.22.

⁴ The argument has been developed by R.H. Bates, 'Social Dilemmas and Institutions: An Assessment of the New Institutionalism', unpubl. paper, Conference on Public Choice and Development, University of London, London 16-18 September 1993, pp. 27-28.

adequate understanding of decision-making in foreign economic policy.

This thesis concerns itself with a specific set of institutions, namely international regimes. Regimes are formally defined as 'principles, norms, rules and decision making procedures around which actor expectations converge in a given issue-area' in international relations ¹. International regimes set a framework for negotiations and for the formulation of policies in certain areas of the international economy, where they articulate the conflict of interests. As institutions, regimes have a close association with structural variables but also some degree of relative autonomy. Regimes appear as both a 'dependent' and an 'intervening' variable between structures and outcomes in the international system ². They reflect structures and at the same time exert a specific, relatively autonomous influence on actors' behaviour.

(b) The Role of Ideas

Actors' perceptions are a significant variable in shaping institutions and behaviour. Actors' bounded rationality is grounded on a specific set of theories and beliefs about how the real world functions. Interests are only intelligible in the light of actors' past experiences and theoretical ideas - even if those are not explicitly

¹ Cf. S.D. Krasner, 'Structural Causes', p. 1.

² Ibid., p. 359.

articulated ¹. Therefore, understanding the evolution of relevant ideas and their diffusion among policy-makers is a necessary condition for understanding the formulation of external economic policy. This clearly challenges the assumption of 'instrumental rationality', implicit in the neo-realist approach ².

(c) Relevant Actors in the International System

The modified structural approach emphasises that interactions are not confined solely to the level of national governments as in the system-centred approach. R. Keohane and J. Nye have distinguished between two different ways by which non-governmental actors can play a role in the international system ³. One is by means of their participation in domestic political coalitions that control or influence governmental policies. In this case, non-

¹ E. Haas, When Knowledge is Power (Berkeley, 1989), p. 12, points that 'power is normally used to translate knowledge-informed interests into policy and programs'. J. Nye, 'Neorealism and Neoliberalism', World Politics, vol. XL, no. 2 (1988), p. 239, observes that 'to say that states act in their self-interest is merely tautological (...) unless we have a reasonable account of how such interests are perceived and redefined'.

² For a critique of the 'instrumental rationality' assumption see D.C. North, 'The New Institutional Economics', p. 2. This assumption implies that the rational behaviour of actors can be deduced from their contextual conditions as observed by the analyst. For an earlier critique see R. Nelson and S. Winter, An Evolutionary Theory of Economic Change (Cambridge, Mass., 1982), p. 63-71.

³ Cf. R. Keohane and J. Nye, Power and Interdependence (New York, 1989), p. xiii.

governmental actors interact through the mediation of inter-state or inter-governmental agencies. These are called 'international interactions'. It should be observed that domestic politics may influence foreign policy in directions which cannot be directly deduced from the position of the country in the international system. Conversely, non-governmental actors may bypass national governments and establish direct exchange with other governments or private actors. When interactions involve at least one non-governmental actor it is spoken of 'transnational interactions'. The growing importance of transnational corporations, non-governmental organisations and the international flow of information have in effect qualified to a significant extent the capacity of states to determine the shape and nature of international relations. Even though the state remains a crucial protagonist of the international system, analysts have become increasingly attentive to reciprocal influences and 'bargaining networks' that develop outside the realm of traditional inter-state relations ¹.

(d) An Issue-Area Definition of Structures

Neorealism emphasizes the distribution of power as the critical structure in international relations. Structures are in turn defined in terms of the distribution of economic and military capabilities. These capabilities are assumed to be perfectly fungible so as to make up an unique, highly

¹ Cf. S. Strange, States and Markets, p. 21.

aggregated structure of power in international relations. However, a definition too aggregate of power tends to miss the fact that the relevant structures shaping actors' behaviour are specific to the issue-area under consideration. Modified structuralism emphasizes this specific nature of the relevant structural variables ¹. This school of thought argues that power resources cannot be easily transferred from one issue-area to another ². Thus, it is necessary to adopt a more disaggregated level of analysis and to identify the relevant structures shaping policy decisions in a specific issue-area.

(e) Conclusions

The modified structural approach seeks to complement the system-centred one by making room for the role of institutions, a knowledge-based definition of interests and policies (ideas), a broader set of actors (including domestic political coalitions and transnational interactions) and an issue-specific definition of the relevant structures (disaggregated analysis). It should be emphasised, however, that this does not dismiss system-centred analysis. It is admitted that some general, useful insights on the behaviour of international actors can be

¹ Cf. R. Keohane, International Institutions, pp. 53-59.

² Ibid., pp. 56-57. For instance, despite of the key role that the USA plays in the security structure of the Western World, she has been unable to oblige Japan to adopt expansionary macroeconomic policies in order to reduce Japan's trade surplus.

obtained from the analysis of systemic constraints and opportunities. But these insights need to be subsequently enriched with other variables which mediate between structures and performances. In the following section, this approach to the study of the international political economy is more formally developed in terms of an evolutionary model of structural and institutional change.

I.2. An Evolutionary Model of Structural and Institutional Change

Models in international relations have been frequently inspired by the theory of oligopolistic competition and industrial organisation. These have offered an attractive metaphor and useful tools for the study of problems which involve uncertainty, incomplete information, transactions costs and multiple equilibria, within a setting of complex interdependence. In its simplest form, the modified structural approach can be compared to the conventional 'structure - behaviour - performance' model in industrial organisation, as shown in figure 1:

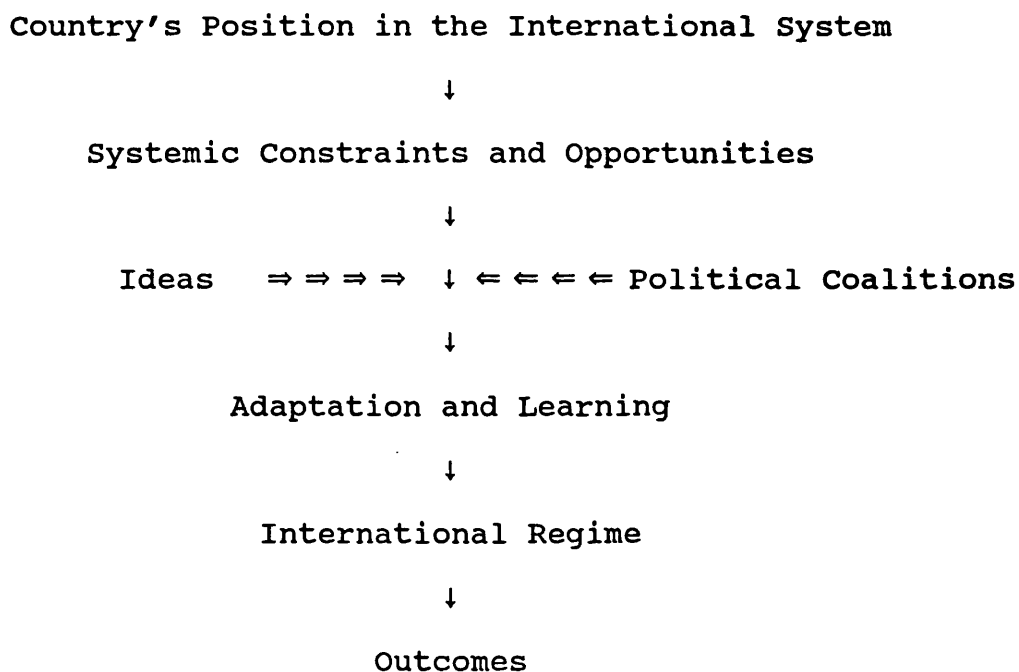
Figure I. The Simple Modified Structural Model

Structural Variables \Rightarrow Regimes (Institutions) \Rightarrow Outcomes

Source: S.D. Krasner, 'Structural Causes and Regime Consequences: Regimes as Intervening Variables', in S.D. Krasner, International Regimes (Ithaca, 1983), p.5.

This model can be made more specific if the links between structures and outcomes are more explicitly presented, as in figure 2. The inclusion of feed-back among the different variables permits to address policy change in the analysis.

Figure 2. The Expanded Evolutionary Model



In the expanded model of figure 2, systemic variables define actors' constraints and opportunities and hence the boundaries of policy-making. Institutions contribute to define the actual policy followed within the sub-set of policies allowed by the structural context. Institutions reflect past negotiations, the knowledge-based preferences of actors and the domestic political alliances that influence foreign policy making. In turn, actors modify

ideas and institutions as they analyze new pieces of information and the structural context is transformed ¹. An evolutionary path in the way described by Nelson and Winter and Axelrod then emerges from the feed-back between structures and institutions ². This feed-back is the subject of the following section.

I.3. Learning, Adaptation and Regime Dynamics

(a) Adaptation and Learning

When the various feed-backs that shape the evolution of structures, ideas, regimes and outcomes are considered it is then necessary to study how they create tensions that stimulate change. More specifically, the question is how actors change their behaviour as a result of the signals

¹ A similar proposal had been previously set forth by Ernst Haas in his quest of an 'useful' systemic theory. In Haas' words: '(A)ny system that specifies a number of components, in the context of transition, calling attention to the conduct of certain actors, systemic feed-backs on the actors, and actor feed-backs on the system, and manage to do so without being platitudinous or tautological will have gone a long way towards satisfying our criterion of usefulness'. Cf. E. Haas, Beyond the Nation State, p. 62.

² Cf. R. Nelson and S. Winter, An Evolutionary Theory, pp. 209-18 and R. Axelrod, The Evolution of Cooperation (New York, 1984), pp. 10-24. The term 'evolution' will not be used in this work in the sense of progress towards more efficient or perfect institutions. It just imply a process of change in successive time periods. For a critique of the 'panglossian' use of the term evolution in biology and economics, see G.M. Hodgson, 'Evolution and Institutional Change: On the Nature of Selection in Biology and Economics', in U. Maki, B. Gustafsson and C. Knusden, Rationality, Institutions and Economic Methodology (London, 1993), pp. 225-28.

sent by evolving structures (which constrain behaviour) and outcomes (which provide information about actual consequences of previous decisions). Haas suggests that actors can react to changing external conditions through adaptation and learning^{1 2}. Learning implies a broad reformulation of the consensual basis upon which a system works. This leads to a new shared perception of the nature of the problem and of the structure of the cause-effect relationships among the variables that the regime intends to affect or control. Adaptation, on the other hand, reflects a gradual increase in experience and understanding which does not involve a fully-fledged reformulation of problems and instruments³. Adaptation can take place in two different settings. The first, labelled 'incremental growth', is based on the extension of the tasks handled by the international regime in a relatively stable environment, characterised by the convergence of actors' demands. The second, labelled 'turbulent non-growth', is characterised by a weakening of coherence between means and ends, contradictory objectives and the weakening of the internal consensus that sustain the regime in a context of environmental instability.

¹ Cf. E. Haas, When Knowledge is Power, chapter 2. These concepts play the same role as the concepts of selection and learning used by Nelson and Winter, namely linking structural change and actors' decisions.

² I am grateful to José R. Chiappim, who suggested me the idea of applying the concepts of adaptation and learning, originally developed by Haas for international organisations, to the study of the dynamics of international regimes.

³ Cf. E. Haas, When knowledge is Power, pp. 3-5.

More formally, learning amounts to a change of regime through the reformulation of the principles and norms organising behaviour. Adaptation leads to changes within a certain regime through the reformulation of rules and decision making procedures. These concepts are defined as follows: ¹

(i) principles are 'beliefs of facts, causation and rectitude';

(ii) norms refer to 'standards of behaviour defined in terms of general rights and obligations';

(iii) rules are 'more specific prescriptions and proscriptions regarding behaviour';

(iv) Decision-making procedures are 'the prevailing practices for making and implementing collective choices'.

This set of definitions goes from the general to the particular. A change of regime is associated with alterations in the general basis that informs actors' views and behaviour, namely learning. Changes within a regime are related to the more specific, detailed application of this basis, namely adaptation.

(b) Sources of Change

A change of regime can be provoked by external or internal pressure. Structures and outcomes can be reshaped by factors from outside the issue-area regulated by the

¹ Cf. J.A. Finlayson and M.W. Zacher, 'The GATT and the Regulation of Trade Barriers: Regime Dynamics and Functions', in S.D. Krasner, International Regimes, p. 275.

regime, prompting a re-negotiation of the current regime. Current regimes may no longer be compatible with developments in other areas and will have to adjust. In other cases, it is the very working of the regime that undermines its foundations. Regimes may lead to outcomes that challenge prevailing principles and norms. Contradiction among the various components of a regime may become apparent as the external environment changes ¹. In addition, the generation of new theoretical ideas may also represent a source of change if they become consensual knowledge among relevant actors. Changes in shared perspectives are very important in the formation and change of regimes ². An increase in the actors' capacity to formulate problems and policies makes easier to establish a common basis for defining interests, to assess the impact of decisions and to conduct negotiations. In this process, 'epistemic communities' offering new ideas can play a critical role.

The lack of a consensual basis for regime change may imply a discontinuity in the process of adjusting behaviour to changing structures. When the mismatch between expected and actual outcomes and/or between regime and power become too conspicuous, there will be a stimulus for a broad redefinition of policies. But if actors do not share a common perspective this stimulus for change may just lead

¹ See on this point O.R. Young, 'Regime Dynamics: The Rise and Fall of International Regimes', in S.D. Krasner, International Regimes, pp. 107-110.

² Cf. E. Haas, When Knowledge is Power, pp. 20-28.

turbulent non-growth or declination. Moreover, if the structure of incentives is such that dominant actors have a significant interest in preserving the regime in its original form, advances in knowledge may reinforce the intensity of conflict rather than contribute to a change of the regime ¹. In this case, links among institutions, structures and outcomes will be reasserted in the long term through the collapse of the regime or its progressive loss of ability to restrain behaviour in the international economy.

(c) Conclusions

In this section, the relationship between structural change and institutional change was defined in terms of learning and adaptation. These concepts describe the way in which actors change their behaviour as a result of structural change and of the influence of new ideas. Learning leads to a change in principles and norms underpinning an international regime and hence to a change of regime. Adaptation leads to a change in rules and decision-making procedures and hence modifies behaviour within the same regime.

¹ Cf. Ibid., p. 118. See also North, 'The New Institutional Economics', p. 8.

I.4. Conclusions: A Restatement of the Problem

The objective of the theses is to study the determinants of economic cooperation between Argentina and Brazil in the period 1939-93. This can be restated as a set of questions framed in the theoretical approach presented above:

- which structural variables are associated with a change of regime, or more specifically, with a move towards regimes of higher cooperation and economic integration between the two countries;

- how has change in structural variables reshaped actors' patterns of behaviour - through learning and adaptation - and which has been the role of ideas in the move towards cooperation;

- which has been the influence of regimes, if any, on the actual patterns of bilateral trade?

The modified structural approach in its dynamic form provides an useful framework for the study of the evolution of cooperation. This framework will be applied to the economic relations between Argentina and Brazil in the past fifty years. But nothing has yet been said about which structural variables are relevant for the historical research. A set of more specific hypotheses linking structural and institutional variables is thus necessary. This is the subject of the following section.

II. The Political economy of Economic Cooperation

II.1. Introduction

A group of countries can achieve different levels of cooperation in their effort to manage economic interdependence ¹. The exchange of information on economic policy is the simplest form of cooperation. Countries retain full sovereignty but uncertainty is reduced by facilitating the flow of information. In turn, higher levels of cooperation demand some degree of 'shared sovereignty', in the sense that countries assume a commitment not to adopt unilateral decisions in certain areas. This may adopt the form of preferential arrangements in which reciprocal imports are exempted from trade barriers ². When preferences embrace most of bilateral trade a free trade area (FTA) results. When, in addition to trade liberalisation, countries accept to adopt a common external barrier vis-a-vis the rest of the world, a customs union (CU) is formed. A common market (CM) represents a still higher level of cooperation. Liberalisation is extended to factors of production which will cross borders freely in search of

¹ Cf. Economic Commission for Latin America and the Caribbean (ECLAC), Ensayos Sobre Coordinación de Políticas Macroeconómicas (Santiago, 1992e), pp. 159-67.

² Cf. J. De Melo et al, 'The New Regionalism: A Country Perspective', in J. De Melo and A. Panagariya, New Dimensions in Regional Integration (Cambridge, 1992), pp. 160-61.

higher rewards. When countries forming a CM adopt a common currency then the agreement is an economic union. Finally, the adoption of common political authorities in an economic union brings about political union. Separate national sovereignty disappears as the countries now form a new single political entity ¹. In practice, these forms of cooperation do not appear in pure form. A combination of them is most frequently found in the real world. However, it is useful to retain the pure models in order to assess the political and economic costs and benefits associated with different forms of cooperation.

From the point of view of policy-makers, the political costs of cooperation are related to the loss of sovereignty that cooperation entails. Moving towards higher levels of cooperation means giving up the use of certain instruments and transferring decisions to supra-national bodies. Clearly, national states prefer to retain full control over economic policy, which provides them with flexibility to pursue internal and external goals. This will be particularly important in a context of mutual suspicion, namely when countries fear political or economic dominance or when they are rivals in the quest for an hegemonic position. In addition, some domestic groups will be hurt by trade liberalisation and will demand protection. If these

¹ Cf. B. Balassa, 'Hacia Una Teoría de la Integración Económica', in M.S. Wyonczek, Integración de la América Latina: Experiencias y Perspectivas (Mexico, 1964), pp. 7-8 and El-Agraa, 'International Economic Integration', in D. Greenaway, Current Issues in International Trade: Theory and Policy (London, 1985), pp. 183-84.

groups influence policy, cooperation can be limited. On the other hand, governments may accept sharing sovereignty if this helps them to achieve certain political and economic objectives, for example, higher rates of growth, higher levels of industrialisation ¹, macroeconomic stability ² and a stronger position in international and domestic negotiations ³. The conditions that can tilt the balance either in favour or against cooperation will be briefly considered now ⁴.

II.2. Structural Variables: Constraints and Opportunities in the International Economy

(a) Integration and External Constraints on Growth

It is a well established point in standard economic theory that an open, multilateral trading system is the most favourable international environment for growth and trade ⁵.

¹ Cf. C.A. Cooper and B.F. Massel, 'Towards a General Theory of Customs Union for Developing Countries', Journal of Political Economy, vol. LXIII, no. 5 (1965), pp. 461-76.

² ECLAC, Ensayos, p.161.

³ Cf. J. de Melo et al (1992), 'The New Regionalism', p. 177.

⁴ The presentation that follows is only referred to cooperation and integration among periphery economies, that occupy a subordinated position within the international system. No references will thus be made to the determinants of cooperation among advanced industrial states.

⁵ Cf. J. Bhagwati, 'Regionalism and Multilateralism: An Overview', in J. De Melo and J. Panagariya, New Dimensions in Regional Integration, p. 29.

In such a context, free trade areas and customs unions in both developing and developed regions cannot find a proper justification ¹. However, in practice, the international context usually differs from this ideal. If A and B face barriers to the expansion of their exports to C, a regional trade agreement between A and B can lead to better outcomes than unilateral liberalisation ². The gains from integration will be higher the greater the barriers in C against exports from A and B. If the total amount of imports from C does not fall after integration, economic integration will be unambiguously welfare-enhancing. External constraints on growth may also be associated with competitive asymmetries that prevent A or B from exporting to C. Technology-based trade models illustrate this type of constraint. A higher rate of technological innovation in C than the rate of

¹ The place of economic integration in standard theory is in the realm of 'second-best' policies, only justifiable when the 'first best' cannot be applied for political or institutional reasons. See on this point W.M. Corden, 'The Normative Theory of International Trade', in R.W. Jones and P.B. Kenen, Handbook of International Economics, vol. I (North Holland, 1984), pp. 113-14. However, in two cases economic integration can be considered a first best policy from an economic point of view. Firstly, when forming a customs union leads to an improvement in the terms of trade. In this case the 'small country' assumption of standard theory no longer applies. Secondly, when there exist external economies that are not limited to national boundaries and therefore unilateral policies cannot represent an appropriate response. Economic integration is then an adequate policy to produce these externalities. In both cases, as what is being maximised is joint-welfare, the willingness of the partners to reach distributive and compensatory agreements becomes crucial to the success of the union. Cf. El Agra, 'International Economic Integration', pp. 205-6.

² This point is formally demonstrated by de Melo et al, 'The New Regionalism', pp. 168-69.

technology diffusion in A and B, in association with increasing returns, may lead to recurrent external disequilibrium¹. This will provide an incentive for A and B to grant each other preferences and restore equilibrium.

In sum, in an open, multilateral international economy incentives for regional integration will be reduced. Conversely, the further the actual system departs from this ideal type the higher the stimulus for integration will be. One of the hypotheses to be explored in the theses is that economic cooperation between Argentina and Brazil increased with the perception that the international system imposed constraints on the rates of growth they could achieve. Conversely, when the international economy was seen as conducive for trade and growth, the incentive for cooperation decreased.

The perception of the existence of external constraints on growth can be reinforced by the presence of formal or informal trading blocs. Trading blocs imply a loss of bargaining power for countries that are not part of any of them. A fragmented international trade system then provides an incentive to establish new regional trade agreements². But it may happen that A or B can choose between forming a

¹ Cf. for instance G. Amendola et al, 'The Dynamics of International Competitiveness', Weltwirtschaftliches Archiv, vol. 129, no. 1 (1993), pp. 453-57. A similar argument (based on the social costs of idle resources) is proposed by R. Ffrench-Davis, "Distorsiones del Mercado y Teoría de las Uniones Aduaneras", Integración Económica, vol. 14, no. 142 (1980), pp. 41-8.

² Cf. Bhagwati, 'Regionalism and Multilateralism', p. 30.

bloc or participating in an extra-regional bloc (C). If the externalities that A can obtain from integration with C are higher than with B, A will seek an alliance with C. A critical factor is therefore whether A and B share a common perspective on opportunities and constraints in the international system. It will be argued that divergent views hindered cooperation between Argentina and Brazil in certain periods. The nature of these countries' relationship with the USA played a large (but not exclusive) role in shaping views of opportunities and constraints in the international system. Another variable to be considered is the possibility of retaliation from countries that do not belong to the FTA or CU. Peripheral economies are particularly sensitive to pressure from centre countries, with which they usually have their most significant economic relations. The degree of tolerance of the international system to preferential arrangements and the international commitments regarding the principle of the most favoured nation clause affected Argentina and Brazil's disposition to closer cooperation.

II.3. Structural Variables: The Transformation of the Domestic Economy

In addition to international variables, domestic economic structures shape the political economy of economic cooperation and integration. Two set of variables are especially relevant: (a) the degree in which the economies are competitive or complementary; (b) the importance of

increasing returns to scale and of intra-industry trade.

(a) Complementary and Competitive Domestic Structures

Economic complementarity between two countries favours cooperation because it enhances trade. But this is not enough for sustaining a process of economic integration. From a standard economics' point of view, the static effects of economic integration depend on the relative importance of trade creation and trade diversion ¹. Trade creation is the substitution of cheaper imports from members countries for more expensive local production and is therefore welfare-enhancing. Trade diversion is the substitution of cheaper imports from third countries by more expensive imports from member countries and therefore reduces welfare ². If in balance trade creation outstrips trade diversion then economic integration increases welfare and can be considered a rational policy ³. The balance depends on certain features of the economic and trade structures. Trade creation is more likely to occur when (i) the economies of the member countries are more competitive; (ii) the initial barriers to trade are high; (iii) the final common barriers are low;

¹ Cf. J. Viner, The Customs Union Issue (New York, 1950), pp. 45-48.

² Cf. P. Robson, The Economics of International Integration (London, 3rd edition, 1987), chapter 2.

³ It has already been mentioned that the common external tariff of a CU can be set at a level in which trade diversion is avoided. If this condition is fulfilled, economic integration is always welfare-enhancing.

(iv) the initial volume of trade relative to production in each country is small; and (v) the initial participation of custom union members in total trade is low ¹. Condition (i) suggests that economies highly specialised in primary production will benefit less from integration than economies that have achieved industrial diversification. Supply constraints limit the scope of competition and hence the gains from integration. Conditions (ii) and (iii) suggests that economies that industrialise under high trade barriers can obtain large benefits from integration if the FTA or CU adopts low external tariffs.

It will be argued that the progress of industrialisation in the forties and fifties created conditions similar to those defined in points (i) to (iii) above. Argentina and Brazil achieved industrial diversification behind high barriers and therefore (from a welfare point of view) a strong incentive existed to integrate the economies, as duly observed by contemporary analysts. But if gains from trade could be high, so was the resistance posed by those favoured by protection. The tension between gains from trade and vested interests was qualified by the subsequent diversification of exports and the increase of intra-industry trade in regional trade. This is analyzed in the following section.

¹ Cf. T.A. Jaber, 'The Relevance of Traditional Integration Theory for Less Developed Countries', Journal of Common Market Studies, vol. 9, no. 3 (1970), pp. 261-64; S. Linder, Trade and Policy for Development (New York, 1967), p. 128; P. Robson, The Economics of International Integration, pp. 144-45.

(b) Increasing Returns and Intra-Industry Trade

Gains from trade are higher in the presence of increasing returns ¹ and this makes the case for cooperation and integration stronger ². Moreover, when increasing returns are associated with product differentiation, intra-industry trade emerges and this carries key implications for the political economy of integration ³. Intra-industry trade qualifies the link between gains from trade and the

¹ Increasing returns mean that productivity rises with the expansion of production. Increasing returns are related to static and dynamic economies of scale. Static economies of scale arise from the dilution of fixed costs in production and distribution and also from savings in the purchase of inputs. Dynamic increasing returns result from growing experience in production, research and investment. Cf. H. Helpman, 'Increasing Returns, Imperfect Markets and Trade Theory', in R.W. Jones and P.K. Kenen, Handbook of International Economics, vol. I, pp. 227-29.

² J. De Melo et al, 'New Regionalism', pp. 170-71.

³ Intra-industry trade is the international exchange of goods that belong to the same industry, this defined at a certain level of statistical aggregation. Intra-industry trade is usually measured through the Grubel and Lloyd Index, defined as $B_i = [(X_i + M_i) - |X_i - M_i|] \cdot 100 / (X_i + M_i)$, where X_i are M_i are exports and imports of the sector i , respectively. The association between intra-industry trade, increasing return and product differentiation is discussed by D. Greenaway, 'Intra-Industry Trade, Intra-Firm Trade and European Integration: Evidence, Gains and Policy Aspects', Journal of Common Market Studies, vol. 26, no. 2 (1987), p. 155. The presence of increasing returns boosts the gains from trade, while political incentives to liberalise depend on whether inter- or intra-industry trade prevails. When increasing returns are associated with product differentiation, intra-industry trade becomes more significant and higher gains from trade are compatible with less political friction.

political cost of trade liberalisation¹. The reallocation of factors will be less traumatic if trade leads to specialisation on different branches of the same industry rather than on different industries. It is easier to transfer labour and capital to activities that demand similar skills and technical capabilities². The greater the levels of intra-industry trade among a group of countries, the lesser the political resistance that economic integration will elicit from domestic interests.

Another implication of the type of adjustment to economic integration has to do with the concern of the military with regional hegemony. It is less likely that intra-industry trade changes relative power. Trade within the same industry implies that both countries will preserve

¹ See, for example, P. Krugman, 'Trade in Differentiated products and the Political Economy of Trade Liberalisation', in J. Bhagwati, Import Competition and Response (Chicago, 1982), for valuable insights on the theory of trade liberalisation under imperfect competition. D. Greenaway and R. Hine, 'Intra-Industry Specialisation, Trade Expansion and Adjustment in the European Economic Space', Journal of Common Market Studies, vol. 29, no. 6 (1991), pp. 604-7, offer a review of empirical research on intra-industry trade and costs of adjustment in Europe. D. Tussie, The Less Developed Countries and the World Trading System: A Challenge to the GATT (London, 1987), provides a comprehensive account of the impact of intra-industry and inter-industry trade on the economic relations of peripheral and central economies.

² The costs of adjustment in terms of frictional unemployment, retraining of labour and investment in new physical capital will be lower in the case of intra-industry trade. Theory indeed suggests that intra-industry trade does not depend on different intensities in the use of factors of production and therefore the impact of trade on factors' income should be reduced. Cf. W.M. Corden, 'Intra-Industry Trade and Factor Proportions Theory', in H. Giersch, On the Economics of Intra-Industry Trade: Symposium 1978 (Tubingen, 1978).

production in this industry, although they will specialise on specific branches. For instance, producing either cars or trucks will not make difference for a country which is interested in preserving metal-mechanical production. Conversely, inter-industry trade may lead to the suppression of an industry envisaged as 'strategic' by power concerned actors in the government. If inter-industry trade predominates, opposition to liberalise trade will rise. In competing for hegemony, what matters are relative capabilities and power concerned actors will react to an imbalance in industrial capabilities ¹.

This argument can be presented through the concepts of **sensitivity** and **vulnerability**, suggested by Keohane and Nye ². Sensitivity is defined as a situation in which unilateral decisions on trade taken by A can harm B. However, by adopting new policies and reallocating resources, B can overcome the consequences of a disruption of trade. Vulnerability, on the other hand, implies that B will not be able to replace the goods provided by A, except in the long term and at a heavy cost. Ceteris paribus, intra-industry trade leads to high sensitivity but low vulnerability. This occurs because if intra-industry trade is discontinued by A, it would be easier for B to transfer resources and produce the goods previously obtained from A. On the other hand,

¹ The pioneer, classical work on the role of trade in the pursuit of political power is A. Hirschman, National Power and the Structure of Foreign Trade (Berkeley, 1945), especially pp. 17-33.

² Cf. R. Keohane and J. Nye, Power and Interdependence (New York, 1989), pp. 11-19.

when trade is based on different industries, the adjustment to a fall in trade will be more difficult ¹. Inter-industry trade thus implies higher vulnerability. From the point of view of power competition, this is bound to create more concern than a situation of sensitivity .

The theses will argue that the implantation of the modern chemical and metal-mechanical industries in Argentina and Brazil by the late fifties entailed a qualitative change in the evolution of regional cooperation. Increasing returns then became a significant feature in industrial growth ². From the late fifties the upgrading of industrial capabilities led to growing industrial exports and intra-industry trade. A process of gradual 'maturation' of the industrial structure occurred, in which the scope for trade and inter-dependence was enlarged. Although slow and idiosyncratic, industrial learning reshaped regional trade in Latin America ³. Moreover, the pattern of industrial

¹ It is assumed that it is difficult to transfer resources between industries and that no convenient alternative source of imports exists in the short term.

² The importance acquired by increasing returns and intra-industry trade are associated with the higher capital and technological intensity displayed by the industries established by the spurt of new foreign investment from 1955.

³ The idea of a gradual upgrading of industrial capabilities - following a somewhat idiosyncratic path associated with the specific conditions of the Latin American markets - emerged from a series of case studies on the export performance of Latin American firms from the mid-seventies. See, in particular, J. Katz, 'From Infant Industry to Technology Exports: The Argentine Experience in the International Sale of Industrial Plants and Engineering Works', Inter-American Development Bank (IDB)-ECLAC, Working Paper no. 14 (1976); J.Katz and E. Ablin, Tecnología y Exportaciones Industriales: Un Análisis Microeconómico de la

transformation converged in Argentina and Brazil and this enhanced common interests and perspectives. In this context, the gains from trade increased and political resistance was reduced (though clearly not eliminated). Industrial convergence and the diversification of exports played a relevant role in sustaining the interest in regional trade in the sixties and seventies, despite the less favourable conditions for integration that the international economy and regional rivalry posed in this period.

II.4. Conclusions

1. This section reviewed the literature on the structural variables shaping the political economy of

Experiencia Argentina Reciente (Buenos Aires, 1976); J. Tavares de Araujo, 'Mudança Tecnológica e a Competitividade das Exportações Brasileiras de Manufaturados', Universidade Federal de Rio de Janeiro-Instituto de Economia Industrial, Texto para Discussão, no. 8 (1982); S. Teitel and F.C. Sercovich, 'Exportación de Tecnología Latinoamericana', El Trimestre Económico, vol. LI, no. 204, pp. 811-41. The new competitive advantages of the Latin American firms also allowed them to invest in foreign countries, especially in other peripheral countries, a phenomena which attracted the attention of researchers in the early eighties. Cf. S. Lall et al, Les Multinationals Multinationales Originaires du Tiers Monde (Geneve: IRM/PUF, 1983) and L.T. Wells, Third World Multinationals: The Rise of Foreign Direct Investment From Developing Countries (Cambridge, Mass: The MIT Press). Empirical research was followed by an effort to rethink the theory of industrial exports from the region. For a review of this literature see F. Fransman, 'Conceptualising Technical Change in the Third World in the 1980s: An Interpretative Survey', Journal of Development Studies, vol. 21, no. 4 (1984), pp. 572-651; B. Herbert-Copley, 'Technical Change in Latin America Manufacturing Firms: Review and Syntheses', World Development, vol. 18, no. 11 (1990), pp. 1457-69; and L. Haguener, 'Competitividade: Uma Resenha da Bibliografia Recente Com Ênfase no Caso Brasileiro', Pensamiento Iberoamericano, no. 17 (1990), pp. 327-336.

cooperation and integration. At the international level, stimuli for integration arise when governments consider that the international economy is moving away from the theoretical ideal of a multilateral, open trade system. Shared perceptions on the existence of external constraints on growth will trigger defensive responses and encourage cooperation. Conversely, the perception that the international system allows for sustained growth makes governments less keen to share sovereignty and they will therefore prefer flexibility. The move towards cooperation can be either reinforced by the formation of other trading blocs or curbed if retaliation by third countries is likely.

2. The diversification of the economy, industrial convergence and growing intra-industry trade boost the interest in regional cooperation. They imply more trade and (relatively) less resistance to integration from both, entrepreneurs and military concerned with the vulnerability that inter-industry trade provokes. Structural change in Argentina and Brazil since the late fifties created more favourable conditions for cooperation. The upgrading of industrial capabilities and the diversification of production and exports enhanced the role of increasing returns and intra-industry trade.

3. These hypotheses linking institutional and structural change give some guidance for the study of cooperation between Argentina and Brazil. They will be tested and re-elaborated in the historical research presented in Part II. Still, the links between cooperation

and structural change are mediated by ideas. It is thus necessary to previously review the ideas that have been influential in policy-making and economic integration in Latin America. This is the subject of the next chapter.

CHAPTER II. ECLA AND ECONOMIC INTEGRATION IN LATIN AMERICAINTRODUCTION.

In chapter I it was suggested that actors' perceptions were a significant variable in shaping international regimes. The generation of new theoretical insights on certain problems can have a large influence on the design of policies and institutions. This chapter offers an account of the ideas associated with the Economic Commission for Latin America (ECLA), and in particular with its first Executive Secretary, the Argentine economist Raúl Prebisch. ECLA proposals were very influential in Latin American economic integration in the late fifties. ECLA played the role that Haas attributes to 'epistemic communities' in international organisations¹. It acted as a catalyst in the first wave of integration efforts. It was a source of technical capabilities (at that time, a very scarce resource in Latin America), studies and information on industrialisation and regional trade.

In particular, ECLA's centre - periphery conception succeeded in setting up a new articulated framework to study the specific problems of industrial development in backward countries. Within this approach, proposals for regional integration became coherent and gained more support from

¹ Cf. E. Haas, When Knowledge is Power, pp. 40-46.

policy-makers. However, some observers attribute to ECLA ideas a negative influence on Latin American development for being 'inward-looking' and biased against international trade. This chapter argues that this perception is invalid and that there is little evidence to support it in the major theoretical works of ECLA. Clearly, indiscriminate protection in Latin America had a negative influence on industrial efficiency and economic integration¹. But it is incorrect to attribute to ECLA the responsibility for these policies. The analysis of ECLA ideas in this chapter will permit a clearer distinction between the role of ideas and the role of structural and political constraints on policy-making.

Finally, ECLA ideas are revisited in the light of more recent theories of international trade, growth and public goods in the international system. It is suggested that these theories offer some support to early ECLA concerns and allows for a clearer identification of the problems at stake in international negotiations than conventional trade theory.

¹ Industrial and trade policies in the period are briefly reviewed in Part II.

I. THE CENTRE-PERIPHERY THEORY

I.1. Centre and Periphery

In the late forties Raúl Prebisch presented his classical work about the international insertion of Latin America and the specific characteristics assumed by industrialisation in the Periphery¹. This and other works associated with ECLA (subsequently the Economic Commission for Latin American and the Caribbean, ECLAC) would come to have an enduring influence on Latin American economic thought and on development economics. The key concern of the

¹ The reader can consult the vast literature produced by ECLA and Prebisch himself. The 1949 Prebisch's 'manifesto' is a significant hallmark in the development of the centre - periphery theory. The 'manifesto' is reprinted in R. Prebisch, 'The Economic Development of Latin America and its Principal Problems', Economic Bulletin for Latin America, vol. VII, no. 1 (1962), pp. 1-51. Prebisch further developed his ideas in subsequent works. See in particular R. Prebisch, International Cooperation in Latin American Development Policy (New York, 1954); R. Prebisch, 'Desarrollo Económico, Planeamiento y Cooperación Internacional', in ECLA, En Torno a las Ideas de la CEPAL: Problemas de la Industrialización en América Latina (Santiago, 1977). ECLA, Economic Survey of Latin America (Santiago, 1949), especially part I, pp. 3-85, remains a classical early presentation of the theory. In a late work, R. Prebisch, 'Notes on Trade From the Standpoint of the Periphery', CEPAL Review, no. 28 (April 1986), pp. 203-14, summarised with clarity many of the basic tenets of the original contributions. A penetrating account of the beginnings of ECLA and the Centre - Periphery theory can be found in C. Furtado, A Fantasia Organizada (Rio de Janeiro, 1985). O. Rodríguez, La Teoría del Subdesarrollo de la CEPAL (Mexico, 1981) offers a highly rigorous presentation of ECLA development theory. This section draws largely on Rodríguez's work. R. Bielschowsky, Pensamento Econômico Brasileiro: O Ciclo Ideológico do Desenvolvimentismo (Rio de Janeiro, 1988) analyzes in detail the impact of ECLA ideas on the Brazilian debate on economic development in the forties and fifties.

theory is with the characteristics assumed by the diffusion of technology in centre and periphery countries. Economic development in the periphery is regarded as 'one more stage in the worldwide spread of new forms of productive techniques' ¹. Yet development adopts different forms in centre and periphery out of the specific features that singularise their economic structures. That of the periphery is specialised in primary production and heterogeneous - in the sense that comprises sectors with contrasting labour productivity, as technical progress is confined to the export sector. Conversely, the economic structure of the centre is diversified and homogeneous, i.e., more uniformly permeated by technical change. These differences had their origin in an earlier start of industrialisation in the centre. The structural features of both types of economies were forged during the period of 'outward-looking growth' ('crecimiento hacia afuera'), and to a large extent reproduced during the period of 'inward-looking growth' ('crecimiento hacia adentro') in the periphery. Centre and periphery were thus two poles of a system that dynamically tended to recreate, in relative terms, the original asymmetry. This implies that technical progress and productivity growth in the periphery will recurrently lag behind the centre. The different characteristics of the economic structures of centre and periphery generate three basic trends which are specific to periphery: (a) the tendency towards external imbalance; (b) the tendency

¹ Cf. ECLA, Economic Survey, p. 3.

towards structural unemployment; (c) the tendency towards the deterioration of the terms of trade.

(a) *External imbalance.* The existence of a structural tendency towards external disequilibrium is attached to differing demand elasticities for primary and industrial products and to the effects of technical change upon the demand for primary products. First, as income increases, demand for industrial goods grows faster than that for primary goods. Secondly, technical change in the centre increasingly substitutes industrial for primary goods. As a result, growth in the periphery expands imports from the centre at higher rates than the centre expands its imports of peripheral products. This imbalance places a limit to economic growth in the periphery, which is proportional to the difference in the elasticity of demand for primary and industrial products - or between peripheral exports and imports.

(b) *Structural unemployment.* A set of distinctive features are suggested to be found in the periphery that are responsible for the tendency towards structural unemployment: (i) the large reserves of labour available in low-productivity activities; (ii) the use of capital-intensive technologies, that reduces demand for labour and leads to technological unemployment, particularly in backward agricultural sectors; (iii) the feeble capacity to save and invest (see also sub-section c).

(c) *Terms of trade.* The divergent effects of the diffusion of technical change in centre and periphery leads

to the erosion of the peripheral terms of trade. Productivity increases in the centre are not entirely translated into lower prices. This is explained by (i) the competition process, based on product differentiation and not in lower prices and (ii) the power of labour unions which capture a share of the gains from technical change. Thus, the fruits of technical progress are retained in the centre as oligopoly rents and/or higher wages. Conversely, these mechanisms are not present in the periphery. Technical change in the primary sector expands production but as this faces an inelastic demand then prices fall. Moreover, as workers displaced by technical progress in the primary sector cannot find employment in the industry (given, as mentioned, the specialised economic structure of the periphery), wages fall as well and so do prices. Therefore, neither oligopoly rents nor higher wages sustain the price of primary goods and thereby contribute to retain the fruits of technical progress in the periphery ¹.

The deterioration of the terms of trade is suggested to occur during different phases of international economic cycles. In periods of recession the price of periphery goods will fall more than that of industrial goods. In periods of

¹ ECLA's conclusions reverse those suggested by David Ricardo. This author expected an improvement in the terms of trade for the agricultural sector as the expansion of industrial demand would lead to cultivate less fertile land, thereby raising the price of agriculture goods. The hypotheses that the terms of trade for the periphery deteriorated in the long term gave rise to a complex empirical debate. Cf. J. Spraos, 'The Statistical Debate on the Net Barter Terms of Trade Between Primary Commodities and Manufactures', Economic Journal, vol. XL, no. 1 (1980), pp. 107-28.

international expansion the price of periphery goods will increase without achieving its former levels. This shapes a long-term trend in which at the end of each successive cycle the structure of relative prices has moved against the periphery.

I.2. Investment and Growth

ECLA identified a set of forces constraining capital accumulation and growth in the periphery. Some of them are related to the tendencies already mentioned. If exports are bound to increase at slower rates than imports, external bottlenecks set a limit to economic growth. In turn, the deterioration of the terms of trade reduces the surplus available for investment. These factors are compounded by payments of royalties, technology and interests to the centre, which further contracts the investible surplus¹. Yet surplus losses are not confined only to the external sector. Income distribution is heavily concentrated in the periphery and this induces a premature imitation of the patterns of consumption of the centre. Funds are thus diverted from investment, the domestic market is contracted and effective demand channelled towards expensive imported goods².

Problems of insufficient accumulation are aggravated by the use of capital-intensive technologies. While the

¹ See Prebisch, 'Notes on Trade', p. 205.

² This point is already made by Prebisch in the 1949 'manifesto'. See R. Prebisch, 'The Economic Development of Latin America', p. 7.

development of these technologies accompanied the gradual growth of incomes and savings in the centre, the periphery had to adopt them in a much shorter period of time, mobilise resources out of smaller income levels, and use large scale technologies to serve reduced internal markets. Hence, financial constraints are particularly stringent for industrial investment in the periphery. This factor reinforces the negative consequences of the misallocation of resources in the process of capital accumulation.

I.3. Policy Implications: Industrialisation and Planning

Industrialisation emerges as the core strategy to spread technology and retain the fruits of technical progress in the Periphery. Only industry can internalise the stimulus for growth and provide employment for the labour force released from the agricultural sector and thereby prevent the deterioration of the terms of trade ¹. In turn, the existence of marked differences in productivity levels with respect to the centre makes protection a necessary

¹ ECLA, The Latin American Common Market (New York, 1959), p. 9, observes that 'first and foremost it should be recalled that, from the standpoint of the labour force, industry, like other urban activities, has the dynamic function of absorbing the manpower which technical progress releases from agriculture and other primary activities, from artisan industries and from pre-capitalist occupations with very low productivity'.

condition for industrial growth in the periphery ¹. Alternative policies, like the reduction of wages and devaluations, are not supported by ECLA. Besides its social and political implications, ECLA points out that falling wages will bring about a fall in the terms of trade by reducing the price of exports ². Protection is thus seen as more adequate to promote industrial growth in the periphery.

Moreover, planning is deemed necessary to assure steady growth in the industry. There is an ideal pattern of reference to which industrialisation should conform in order to avoid domestic and external disequilibrium ³. In this pattern, the rates of investment and growth in different sectors (export and imports, agriculture and industry) and in different industrial branches (capital, intermediate and consumer goods) should keep a certain technical proportionality. Otherwise, industrial growth would be hindered. The role of planning is to channel investment so as to conform to this pattern of balanced growth ⁴.

¹ In Prebisch's words: 'the principal justification for protection lays on the differences in productivity between the centre and periphery. These differences are basically explained by the great disparity of capital per worker and technical capabilities'. Cf. Prebisch, International Cooperation, p. 16.

² Ibid., p. 16.

³ Cf. O. Rodríguez, La Teoría del Subdesarrollo, p. 271. A significant contribution to this argument was made by R. Nurkse, Equilibrium and Growth in the World Economy (Cambridge, Mass., 1961), especially pp. 241-258, who proposed a strategy of 'balanced growth'.

⁴ Cf. ECLA, 'Desarrollo Económico, Planeamiento', p. 35.

While highlighting the role of the state in periphery industrialisation, ECLA gave little attention to the study of the state itself and to whether the institutional capabilities and the political will required by the ambitious ECLA programme were in place. In the early sixties ECLA became increasingly involved in the promotion of social and economic reform in Latin America, a move away from the industrialist emphases of the fifties. This revealed a concern by ECLA in more directly assessing the so called 'structural obstacles' to development ¹. However, the change in the political climate with the rise of military governments in Argentina and Brazil and the heyday of counter-insurgency ² would lead to the steady loss of influence of ECLA ideas and the reverse of the timid efforts at economic and political reform. Concurrently, ECLA was challenged in the theoretical field as well, and lost its intellectual appeal. Criticisms took shape in both dependency and neoclassical theories. While dependency gained momentum in the sixties by placing politics in the centre of the development debate ³, neoclassical critics

¹ Cf. O. Rodriguez, La Teoría del Subdesarrollo, p. 280.

² At the beginning of the sixties, the idea of planning and the emphases on the solution of social problems benefited from the support received by the Alliance for Progress and by the fact that democratic governments were still in power. But these objectives were set aside in the second half of the sixties as the Cold War strategy predominated and the military governments sought legitimacy in rapid growth. Cf. J.S. Tulchin, Argentina and the United States: A Conflicted Relationship (Boston, 1990), p. 123.

³ To a certain extent, dependency was an outgrowth of ECLA. The work of F.H. Cardoso and E. Faletto, Dependencia y Desarrollo en América Latina (Mexico, 1967), was written

offered a more articulated challenge in economics by pointing out the distortions generated by interventionist policies ¹. By the mid-sixties ECLA no longer offered a bases for 'shared knowledge' to Latin American técnicos nor did it play an active role in shaping policy-making.

I.4. Export pessimism, Import Substitution and The Political Economy of International Trade

ECLA's basic objective was industrialisation and this could be attained through import substitution or the diversification of exports. Both alternatives are compatible with ECLA theory ². This view can be easily found in ECLA

in the early sixties with a view to providing political content to ECLA periodisation of Latin American development. Cf. F.H. Cardoso, 'The Originality of the Copy: CEPAL and the Idea of Development', Cepal Review, no. 4 (1977), pp. 7-41. But dependency literature quickly moved to challenge the idea that the periphery could develop within the international capitalist system. Thereby, dependency challenged the reformist hopes of ECLA. For an analysis of the dependency debate, see G. Palma, 'Dependency: A Formal Theory of Underdevelopment or a Methodology for the Analysis of Concrete Situations of Dependency', World Development, vol. 6, no. 7-8 (1978), pp. 881-924.

¹ Cf. I.M.D. Little, Economic Development: Theory, Policies and International Relations (New York, 1982), and J. Bhagwati, Foreign Trade Regimes and Economic Development (Cambridge, Mass., 1978). Although many of ECLA ideas are somehow now incorporated to the new mainstream theories of trade and growth (see section III), these 'new wave' of economic thinking arrived when the influence of ECLA in Latin America had been buried a long time ago.

² Norberto González observed that in ECLA formative years the term 'import-substitution' was in fact used as an euphemism for industrialisation, since the deliberate promotion of industry faced strong opposition at that time. Industrialisation, and not import substitution, was the core of ECLA ideas. Cf. Norberto González, former Executive Secretary of ECLA, *interview*, Buenos Aires, 27 October 1993.

works ¹. ECLA acknowledged that import-substitution implied a cost in terms of efficiency and that this policy was only justifiable to the extent that exports could not be expanded ². Efforts to expand industrial exports were preferable to import-substitution ³. However, ECLA and other authors ⁴ adopted a rather pessimistic view regarding opportunities for Latin American exports in the post-war period. ECLA assumed that trade could no longer represent the 'engine of

¹ It is interesting to recall how Prebisch (1961), 'Desarrollo Económico, Planeamiento', p. 5, criticised indiscriminate protection: '(T)he need for import substitution and, consequently, for the protection of substitutive activities, has been unavoidable. But there has been a failure to boost exports to the same extent. There has been a discrimination in favour of industrial substitution and against exports, particularly the industrial ones. The ideal policy would have been to promote exports in order to place them on an equal footing with substitution activities' (author's translation).

² Cf. R. Prebisch, International Cooperation, pp. 20-22.

³ Prebisch called attention to the fact that industrial exports could sustain growth at a much lower cost in terms of public support than import substitution. Cf. R. Prebisch, 'Desarrollo Económico, Planeamiento', p. 28. In a similar vein, ECLA, The Latin American Common Market, p. 9, observes that 'given a specific rate of economic growth in Latin America, the development of industrial exports would reduce the scale on which import-substitution had to be promoted'.

⁴ Cf., for example, R. Nurkse, Equilibrium and Growth in the World Economy, pp. 304-24. In promoting development in Latin America, Prebisch, 'The Economic Development of Latin America', p. 50, observed that 'the most obvious possibility would have been to increase export earnings. The difficulty was that, in each period, the total sales of primary products depended on the needs of the industrial countries (and) discrimination by France and the UK in favour of suppliers in the franc and sterling areas, together with the heavy subsidies and protection given by the industrial countries to their own primary producers limited what could be done in this respect.'

growth' that it had represented in the past. This was related to the change of principal cyclical centre of the international economy in the inter-war period, with the rise of the United States of America (USA) and the decline of the United Kingdom (UK). As the USA displayed a more reduced import coefficient than the UK, it was suggested that she would not be able to impart enough dynamism to the rest of the world. Stimulus to growth coming from higher exports by the centre would be retransmitted to the Periphery with a too large temporal lag, straining the international trade and payments system ¹. This, in combination with the lack of external financing for Latin America ², implied that little stimulus for growth would come from the international economy. These negative trends had imposed, as a matter of facts rather than options, import-substituting policies in order to sustain high rates of growth in the periphery.

Clearly, the assessment of the prospects of international trade in the late forties and fifties proved not to be valid for the sixties. However, this does not represent an anti-trade bias implicit in ECLA theory. A virtuous link with centre technology, investments and markets was regarded as a fundamental factor in peripheral development. But for ECLA this convergence of interests was not spontaneous. ECLA understood that international trade involved complex issues of political economy as the

¹ This argument has been recently revisited by C. Furtado, 'The Nature of the Principal Centre', CEPAL Review, no. 42 (1990), pp. 11-15.

² This will be analyzed in the next chapter.

industrialisation of the periphery entailed a complementary change in the economic structure of the centre. Mutual adjustments in both poles of the system were required. The successful management of this transformation would have to be negotiated and agreed, demanding new institutions to promote structural change and adjustment. This can be seen as the international counterpart of ECLA favourable view on domestic planning and industrialisation. Deliberate inter-governmental action was deemed necessary at the international level in order to correct the disequilibria arising from a purely market-led process. In both the domestic and international economy an ideal pattern of transformation was conceived, based on a balanced or complementary growth with which the actual patterns were compared ¹.

In sum, ECLA considered that a convergence of interests of centre and periphery existed in the long term. But this convergence would not automatically emerge from free trade. It had to be constructed through international cooperation with a view to promote mutual adjustments in the economic structure of the poles of the system. ECLA established a link between structural change and the politics of international cooperation, a link at that time absent in mainstream theory.

¹ There was an implicit idea of 'articulated industrialisation' in centre and periphery ('industrialización mancomunada'), in the sense that structural change had to be complementary in the poles of the system. Cf. Octavio Rodríguez, former ECLA economist, interview, Montevideo, June 1993.

II. ECLA AND THE ROLE OF ECONOMIC INTEGRATION

In ECLA's perspective, economic integration appears as a significant instrument for fostering industrialisation¹. Economic integration was expected to increase the scope and efficiency of import-substitution, based on economies of scale. Increased efficiency would subsequently permit the expansion of exports of industrial goods to the centre². This would reshape the form in which policy-makers view the costs and benefits of integration.

First, static gains in efficiency were considered a significant but not exclusive objective of regional integration. The emphasis was on expected effects on rates of growth, investment and technological diffusion. Secondly, trade diversion was not considered always negative. In some cases this could be an objective to be pursued. Trade diversion would result in foreign exchange savings that

¹ The principal work summarising ECLA ideas on economic integration is ECLA, The Latin American Common Market, especially pp.5-9. Important contributions within a similar approach can be found in S. Dell, Problemas de un Mercado Común en América Latina (Mexico, 1959) and V. Urquidi, 'The Common Market as a Tool of Latin American Economic Development: A Comment', in A. Hirschman, Latin American Issues: Essays and Comments (New York, sixth edition 1967).

² In Prebisch's words: 'The development of industrial exports among LA countries will lead to a reduction in the costs of production and provide certain industries with the possibility of exporting to the rest of the world. A policy of encouragement and cooperation in the centres would permit to accelerate this movement'. Cf. R. Prebisch, 'Economic Development and Monetary Stability: The False Dilemma', Economic Bulletin For Latin America, vol. 6, no. 1 (1961), p. 34.

could be used to sustain capital goods imports and hence growth. The meaning of 'trade diversion' was blurred in this context, since total trade with the rest of the world would increase, now made up of different goods. Thirdly, lower protective barriers at regional level did not need to constitute an objective for *all sectors*, although a fall in average barriers was expected. In certain cases, integration would permit to establish import-substituting industries that were not feasible before and tariffs would persist in these emerging industries. But gains in efficiency would allow to reduce protection in established industries ¹. Fourthly, improving the efficiency of ISI and expanding exports to the rest of the world were complementary and mutually reinforcing strategies ². In turn, more regional

¹ As will be discussed in Part II, indiscriminate protectionism was rampant in the early fifties. ECLA indeed compared the welfare consequences of integration with the actual situation at that time and not with the ideal situation of multilateral free trade.

² This point is forcefully argued in ECLA (1959), The Latin American Common Market, pp. 8-9: 'It must be acknowledged that hitherto domestic markets facilities created by import substitution policy have not given rise to any impressive undertakings in the field of industrial exports to the rest of the world. Moreover, since in many cases protectionist policy, in the shape of very severe import restrictions, if not bans, has been carried too far, the atmosphere of competition in the internal market has become appreciable less intense. The return to the customs tariff as an instrument of protection, the lowering of intra-regional duties in some cases and their abolition in others would do much to restore the spirit of competition, greatly to the benefit of industrialisation policy. In this new environment, the gradual development of a flow of industrial exports to the rest of the world might be one of the objectives of Latin American trade policy'.

competition would permit to increase exports to centre markets and reduce the stimulus for import-substitution ¹

III. TRADE, GROWTH AND PUBLIC GOODS: A RETROSPECTIVE VIEW OF ECLA

From the late seventies, new developments in trade theory have identified technology and imperfect competition as a key variable shaping trade flows and gains from trade. Increasing returns, product differentiation and 'strategic' policies have increasingly attracted the attention of economic theorists ². Something similar has happened in growth theory, where 'endogenous growth' and externalities associated with technology form a growing field of theoretical and applied research ³. The significant role attributed to technological learning in the new trade and growth theories have large implications for thinking

¹ Ibid., p. 10.

² Cf. P. Krugman, Rethinking International Trade (Cambridge Mass., 1991), especially chapter 1. For an 'evolutionary' approach to technology and trade see G. Dosi, K. Pavitt and L. Soete, The Economics of Technical Change and International Trade (Hemel Hempstead, 1990), pp. 3-20.

³ Cf. P. Romer, 'Increasing Returns and Long-run Growth', Journal of Political Economy, vol. 94, no. 5 (1986), pp.1002-37. Recently, this author has observed that 'the economics profession is undergoing a substantial change in how we think about international trade, development, economic growth and economic geography. In each of these areas we have gone from a progression that starts with models based on perfect competition, moves to price taking with external increasing returns and finishes with explicit models of imperfect competition'. Cf. P. Romer, 'The Origins of Endogenous Growth', Journal of Economic Perspectives, vol. 8, no. 1 (1994), p. 20.

international cooperation. The potential scope for state intervention is expanded in these theories. 'Strategic' sectors can be targeted by governments in order to increase market shares in industries that generate larger externalities and oligopoly profits¹. Subsidies to R&D may constitute in certain cases an adequate policy to promote competitiveness and growth. In a world of increasing returns and imperfect competition, in which market shares are affected by strategic decisions of governments and oligopoly firms, trade friction can be very large. Thus, as one moves away from perfect competition towards strategic interactions, political economy cannot be ignored.

In a pure Heckscher-Ohlin world countries are receptacles of different factor endowments. Any intervention on trade - given the small country assumption - harms the country that applies it. Political economy is confined to the control of vested domestic interests that resist free trade within each country. No friction can arise in the international system, since all will gain from specialisation in accordance with the principle of comparative advantages. However, when specialisation is somewhat arbitrary (i.e., it can be affected by state policies and history²) and adjustments are not automatic

¹ Cf. J.A. Brander, 'Rationale for Strategic Trade and Industrial Policy', in P. Krugman (ed.), Strategic Trade Policy and the New International Economics (Cambridge, Mass., 1986), pp. 23-46.

² If there are economies of scale in an industry, initial state subsidies or just an earlier start in production may lead to oligopoly positions which are not based in comparative advantages. Trade is in this sense

(i.e., resources can remain unemployed for a long period, particularly if patterns of trade are rapidly changing) international political economy asserts its relevance ¹. The new trade theory shows that gains from trade are still higher in the presence of increasing return, but relative gains can be critically affected by policy. The world now resembles that described by early ECLA ideas and by the modified structuralist school of international relations. Room needs to be made for institutions and negotiations in order to constrain behaviour and make policy decisions compatible. 'Governance' and the production of public goods in the international trade system become major themes in foreign economic policy ².

In this respect, ECLA early insights seem to have been confirmed by later theoretical developments. Imperfect competition and interactions among non atomistic actors describe the context in which international efforts for coordination take place. Policy coordination can be seen as a public good that contributes to sustain trade by avoiding a war of subsidies and protection. ECLA proposals for international cooperation can be interpreted in the light of Kindleberger's concern with the production of public goods in the international system. International coordination, for

path-dependent and 'history matters'. Cf. P. Krugman, Geography and Trade (Leuven, 1993).

¹ On this point see Kindleberger, Government and International Trade (New Jersey, 1978).

² Cf. C.P. Kindleberger, 'International Public Goods Without International Government', American Economic Review, vol. 76, no, 1 (1986), pp. 1-12.

ECLA, is required to promote mutual adjustment in centre and periphery as industrialisation advances in the periphery. Clearly, the fact that there is room for government coordination in order to provide a public good does not imply that governments will act accordingly¹. But a clearer identification of the problems at stake - as that provided in the fifties/early sixties by ECLA and more recently by the new theories - can contribute to guide political analysis.

IV. CONCLUSIONS

1. By offering a new theoretical framework which put together industrialisation, international trade and economic integration, ECLA contributed to shape economic policies in Latin America and played the role of a catalyst in the move towards economic integration of the late fifties.

¹ This reverts the discussion to the analysis of the state and state policies which have received growing attention by theorists. If frequently public choice theories are highly sceptical about the role of the state, a more balanced view seems to be emerging, as argued by Evans, based on the concept of relative autonomy of the state and on the analysis of the type of relation that state and civil society maintain. Cf. P. Evans, 'The State as a Problem and Solution: Predation, Embedded Autonomy and Structural Change', in S. Haggard and R. Kaufman (ed.), The Politics of Economic Adjustment: International Constraints, Distributive Conflicts and the State (Princeton, 1992), pp. 139-181. See also C. Anglade and C. Fortín, 'The State and Capital Accumulation in Latin America: A Conceptual and Historical Introduction', in C. Anglade and C. Fortín, The State and Capital Accumulation in Latin America, vol. I (London, 1989). For a recent review and critique of public choice theories, see H. Streeton and L. Orchard, Public Goods, Public Enterprises and Public Choice: Theoretical Foundations of the Contemporary Attack on Government (New York, 1994).

2. Industrialisation in the periphery was seen by ECLA as driven by external constraints on growth. But 'spontaneous' import-substitution in the past was plagued with inefficiency and disequilibrium. These problems could be reduced through planning, economic integration and international cooperation.

3. Planning would permit to adjust the actual pattern of structural change to an ideal pattern of balanced growth and thereby avoid disequilibrium. Regional economic integration, in turn, would raise the efficiency of import substitution, curb the move towards indiscriminate protection and encourage industrial exports to regional and world markets. Last but not least, international cooperation would assure that the transformation of the structure of exports and imports in the periphery was matched by a corresponding transformation in the centre.

4. ECLA theory made room for the role of the state and policy cooperation although ECLA itself did not analyze which factors actually shaped state policies. In the early sixties ECLA became more concerned with political and economic reform. But this move was cut by the polarisation of the political and intellectual climate in the mid-sixties. Still, some of ECLA insights were confirmed and developed in more recent theories. They contribute to explain why actors' interests can diverge and when international cooperation is required. In doing so, more rigorous questions can be addressed in the study of the international political economy.

PART II. FROM BILATERAL AGREEMENTS TO LAFTA, 1939-60

CHAPTER III. STRUCTURAL CHANGE AND ECONOMIC COOPERATION
BETWEEN ARGENTINA AND BRAZIL, 1939-55

INTRODUCTION

This part of the thesis discusses the determinants of cooperation and integration between Argentina and Brazil in the period 1939-60. In previous chapters a general framework for studying economic cooperation was proposed and a set of hypotheses linking structural variables and economic integration suggested. The relevance of these hypotheses will now be examined through an historical study of the origins of the Latin American Free Trade Association (LAFTA). This chapter will discuss the impact on regional cooperation of structural change in the international system and in the domestic economy in the period 1939-55. Chapter IV will address these variables in the period 1955-60. Finally, Chapter V studies the change in the bilateral trade regime, namely the shift from 'restrained bilateralism' towards the attempt at creation of a free trade area (LAFTA).

Economic relations between Argentina and Brazil in the period 1939-55 combined cooperation and rivalry. On the one hand, these countries competed for a more influential position in Latin America. Brazil's foreign policy in most

of the period was based on a 'special relationship' with the United States of America (USA), stemming in part from a common interest in counterbalancing the Argentine influence in Latin America. On the other hand, there also existed significant forces fostering cooperation between Argentina and Brazil, despite the limits posed by geopolitical suspicions. The major stimulus for closer cooperation stemmed from both the benefits that the two countries could derive from trade and the possibility of strengthening their position in international affairs. In the case of Argentina, the situation of relative international isolation in which the country was placed in the period prompted her to seek closer relations with her Latin American neighbours, and Brazil in particular. From the Brazilian point of view, Argentina was more than a valuable commercial partner. A larger role for Brazil in regional and hemispheric affairs was deemed to require some support from her Southern neighbour. This encouraged the quest for cooperation and qualified the influence of rivalry in regional foreign policy.

The variables that shaped these contending forces of cooperation and rivalry will be addressed in this chapter. Section I discusses the impact of change in the international system upon Argentine policy towards Brazil. Section II analyzes this impact in the case of Brazil's policy towards Argentina. Section III addresses the influence of trade and industrialisation on regional

cooperation. Section IV presents the conclusions of the chapter.

I. ARGENTINA: IN SEARCH OF A PLACE IN THE INTERNATIONAL ECONOMY, 1939-55

The consequences of the inter-war World Depression in Latin America should be briefly recalled in order to assess the context in which the bilateral economic relations of Argentina and Brazil developed in 1939-55. The crisis had a large impact on the objectives and instruments of foreign economic policy. Far-reaching disequilibrium in the external front encouraged the promotion of industry and a larger economic role for the state. Protection in the central economies was matched with the expansion of controls over the external sector in the periphery ¹. State activism in Argentina and Brazil was not confined to defensive measures aimed at stopping the drain of foreign exchange. Governments also set out to negotiate bilateral agreements with a view to preserve export markets and diversify their international trade partners. In this respect, Argentina and Brazil were

¹ These trends had indeed significant antecedents before 1930, but they were reinforced in the thirties and gained momentum in the forties. Cf. C. Díaz-Alejandro 'Latin America in the Thirties', in R. Thorp, Latin America in the Thirties: The Role of the Periphery in World Crisis (Oxford, 1984), pp. 17-49; C.M. Lewis, 'Industry in Latin America Before 1930', in L. Bethel (ed.), Cambridge History of Latin America, vol. IV (Cambridge, 1986), pp. 269-319; W. Suzigan, Industrialização Brasileira: Origem e Desenvolvimento (São Paulo, 1986).

placed in different positions by the end of the thirties. This would play a significant role in shaping Argentina and Brazil's views of bilateral cooperation.

I.1. Looking for New Partners: From the 'Roca-Runciman Agreement' to the 'Pinedo Plan'

The international front looked particularly gloomy in the case of Argentina. The advantages of Argentina's traditional close economic and political ties with the UK shrank in the thirties as the UK sought to reduce the impact of the crisis on the British economy¹. In May 1933 Argentina signed the 'Roca-Runciman Agreement' with the UK by which she sought to protect her position in the British market, then threatened by the preferences that the UK had granted to the British Dominions by the Ottawa Treaty of 1932. Argentina agreed to offer preferential treatment to UK exports and investments in exchange for an import quota for

¹ Cf. M.P. Abreu, 'Argentina and Brazil During the Thirties: The Impact of British and American International Economic Policies', R. Thorp (ed.), Latin America in the Thirties, pp. 144-62; M.P. Abreu, 'Anglo-Brazilian Economic Relations and the Consolidation of American Pre-eminence in Brazil, 1930-45', in C. Abel and C.M. Lewis (eds.), Latin America, Economic Imperialism and the State: The Political Economy of the External Connection from the Independence to the Present (London, 1985), pp. 379-93; R. Gravil, 'A Time of Acute Dependence: Argentina in the Thirties', The Journal of European Economic History, vol. 7, no. 2 and 3 (1978), pp. 337-378.

Argentine meat and other tariff concessions ¹. However, the terms of the agreement meant only a partial relief for Argentine difficulties ². Argentina's position in the international system had become remarkably weak. Argentina had no promising substitute as regards the UK place in her foreign trade. This can be seen in table III.1.A.

¹ The UK promised to consult Argentina in case she needed to apply further restrictions on imports from this country. UK restrictions on imports of chilled beef from Argentina should not exceed 10% of the imports of the period June 1931 - July 1932. For frozen meat and mutton, progressive restrictions would be imposed, from 10% to 35%. In turn, Argentina was expected to apply the sterling gains in buying British goods and paying dividends and interests to British capital in the country - after the deduction of debt charges owed to other governments. Further concessions to the UK were granted at the moment of renewal of the Treaty in 1936.

² The Roca-Runciman Agreement aroused strong criticisms in Argentina. It was considered that too many concessions had been given to the UK in order to defend a group of exporters (basically, the exporters of chilled beef) which in practice accounted for a relatively small part of Argentine total exports. Some authors have pointed out that the Agreement was the price that the government had to pay for preserving the so-called 'concordancia', the political coalition that backed the conservative governments of the thirties. Cf. J. Fodor and A. O'Connell, 'La Argentina y la Economía Atlántica en la Primera Mitad del Siglo XX', Desarrollo Económico, vol. 13, no. 49 (1973), pp. 3-65. See also Gravil, 'A Time of Acute Dependence'. Conversely, Alhadeff has argued that the Agreement was instrumental for economic recovery after 1933, as the Roca Funding Loan made it possible to finance a price support programme for the agricultural sector. The expansion of public debt also had an stimulating effect while the fund boosted consumers and business confidence by reducing interest rates. Cf. P Alhadeff, 'Dependency, Historiography and Objections to the Roca Runciman Pact', in C. Abel and C.M. Lewis (eds.), Latin America, Economic Imperialism and the State, pp. 367-93.

TABLE III.1.AARGENTINA: MAIN TRADE PARTNERS, 1934-55

(In percentage)

Period	S.A.	Brazil	USA	Europe	UK	Germ	Fran

1934-39							
Average X	8.6	5.4	10.5	76.5	34.3	7.5	5.0
M	10	5.7	15.2	62.0	22.9	9.5	4.8

1940-45							
Average X	17.8	7.1	25.3	48.3	34.5	-	-
M	28.7	20.2	24.1	31.3	16.6	0.3	0.5

1946-50							
Average X	13.1	6.4	13.1	66.4	24.1	2.4	6.8
M	15.9	9.7	28.4	43.1	12.3	0.5	6.2

1951-55							
Average X	18.5	11.2	17.0	56.6	18.1	6.5	5.4
M	21.7	10.4	16.5	43.0	6.8	8.4	5.9

X = Exports to country or region of destination/total exports.

M = Imports from country or region of origin/total imports.

SA = South America.

Source: República Argentina. Dirección General de Estadísticas y Censos, Anuario de Comercio Exterior (Buenos Aires, various years).

Table III.1.A shows that exports to the UK represented more than one third of total Argentina exports in 1934-39. The USA, on the other hand, absorbed less than 10 %. Moreover, Argentina's trade balance with the USA was chronically unbalanced. This became a central problem when the European currencies in general and sterling in particular became inconvertible and hence triangular trade was no longer possible. Between 1918 and 1940 Argentina obtained a surplus with the USA in only three years: 1935,

1936 and 1937. This changed during Second World War, but the dollar shortage was severely felt in the post-war years. Table III.2.A shows the substantial strain that trade with the USA placed on the Argentine total trade balance.

TABLE III.2.A

ARGENTINA: TRADE BALANCE, SELECTED YEARS
(In Thousands of Argentine pesos)

Year	SA	USA	Europe	Total
1937	52.2	44.3	743.8	753.3
1938	6.5	-136.1	213.5	-60.4
1942	10.5	113.1	399.7	514.6
1943	127.2	353.3	590.9	1250.2
1947	81.3	-1883.7	2168.3	156.4
1948	-110.3	-1749.4	1613.4	-647.9

Sources: Cf. Table III.1.A

Table III.2.A reflects the fact that the USA had reached a key position in the thirties as a source of manufactured goods and capital for Latin America but remained a closed market for Argentine exports, which were competitive with US domestic agricultural production ¹. Trade friction with the USA compelled the Argentines to cultivate

¹ In September 1927 the US prohibited imports of meat from countries affected by the foot-and-mouth disease, among which Argentina was included. The 1930 Howley-Smoot Act consolidated the protectionist stance of the US agricultural policy. Competing agricultural imports were all but completely banned by 1935. Cf. D. Rock, 'Argentina 1930-46', in L. Bethell, Cambridge History of latin America, vol. VIII (Cambridge, 1991), p. 45.

the UK connection. This policy displayed a singular continuity throughout the twenties and thirties, reflecting the narrow space in which the Argentine options were confined. This space was defined by her close but asymmetric association with the UK and by the 'closeness' of the US market to Argentina's main exports.

The outbreak of Second World War and the subsequent disruption of trade with Europe made it still more urgent for Argentina to develop and diversify her external relations. One obvious course of action was to reach a more favourable modus vivendi in trade matters with the USA. Another was to intensify trade links with neighbouring Latin American countries and in particular with Brazil. Both avenues were in fact considered in the 'Pinedo Plan', an innovative set of proposals presented to the Argentine Congress on the 14th of November of 1940 ¹. The Pinedo Plan distinguished three main areas of exchange: (a) the sterling

¹ Cf. 'El Plan de Desarrollo Económico Ante el Honorable Senado', reprinted in Desarrollo Económico, vol. 19, no. 75 (1979), pp. 403-26. An assessment of the challenges faced by the Argentine economy at that time was provided by Federico Pinedo in a lecture delivered in June 1942. He observed that 'it is unfounded the belief that a hungry and destroyed Europe means great prospects to countries which can produce the basic goods she would urgently need, since one cannot see how Europe can obtain in the short term the means of payments necessary to buy them' (author's translation). Cf. F. Pinedo, 'Relaciones Económicas Inter-Americanas', Revista de Economía Argentina, vol. 41, no. 290 (1942), p. 236. He also observed that after the war the international market would not be entirely open and this would harm Argentina if she had no connections 'with the big conglomerates of countries (...) whose economic prevalence in tomorrow's world is certain'. Cf. *ibidem.*, p. 237.

area, where Argentina obtained trade surpluses in non-convertible currency; (b) the US or dollar area, in which Argentina held a significant deficit in convertible currency; (c) the area comprised by neighbouring Latin America countries, regulated by various systems of exchange controls. The central concern of the Pinedo Plan was the expansion of trade with the USA and Latin America areas in order to compensate for the fall of Argentine exports to Europe. Regarding the USA, the Plan contemplated both selective import-substitution and the exploitation of potential export opportunities to be found in the US market¹. Interestingly enough, the creation of a special body in charge of promoting industrial rather than agricultural exports to the USA was proposed - as it was assumed that imports of agricultural goods would continue to be restricted. Such industrial exports should come from the 'natural industries', i.e., those related to the processing of agricultural goods.

As regards Latin America, emphasis was placed on increasing the then relatively modest levels of trade. The creation of a free trade area (FTA) would be the best way of attaining this objective. The Plan emphasized the role to be played by a FTA in achieving the economies of scale required by the process of industrialisation. The FTA should progress

¹ Cf. L. LLach, 'El Plan Pinedo, Su Significado Histórico y los Orígenes de la Economía Política del Peronismo', Desarrollo Económico, vol. 23, no. 92 (1984), pp. 515-57 and D. Rock, 'Argentina 1930-46', p. 43.

in a context of openness with the aim of encouraging intra-regional trade rather than hindering extra-regional imports¹. When the Pinedo Plan was presented, negotiations were already taking place with Brazil in order to liberalise bilateral trade. These negotiations continued after Pinedo's resignation (see below) and culminated with the signing of the November 1941 Agreement for Progressive Free Trade. This agreement represented a high point in bilateral cooperation and committed Argentina and Brazil not to apply trade barriers to activities yet not established in either country. As the process of industrialisation was at an early stage in both countries, the agreement was intended to forestall protectionist demands in the future. By assuring

¹ This clearly distinguishes this first attempt to economic integration from that of the late fifties, when import-substituting industrialisation became the dominant strategy. F. Pinedo, 'Relaciones Económicas', p. 238, emphasised that the efforts to form a custom union with Brazil should be seen as a step towards the integration of Argentina within the new international economy. He concluded that 'an economic union among few or many Latin American countries (...), to be fruitful, has to be aimed to the elimination of barriers in the region, and not to the exclusion of what is extra-continental' (author's translation). British observers in Buenos Aires, however, did not feel reassured by the promise of keeping the regional market open: 'the advantages which Brazil and Argentina agree to afford to each other are also left open (...) for inclusion in similar treaties with other neighbours. An extending area of Latin American free trade, coupled with preferences, if not tariffs, behind which are to be built up local manufacturing industry, is the clearly envisaged aim of both parties to the present treaty. Such, at least, has been the interpretation placed upon the treaty by the Argentine press, which has welcomed it also from the standpoint of Argentina's need of industrial development and increased self-sufficiency in the post-war period'. Cf. FO 461 1, 'Correspondence respecting America, Part I, January to March 1942', A 381/298/2, 10 January 1942.

a regional market for new industries, it was expected to have a large impact on trade. It sought to liberalise bilateral trade at the very moment in which international trade collapsed because of the war.

The proposal for a Latin American free trade area in the Pinedo Plan has received little attention in the literature. The Plan, however, suggests that policy-makers already understood the role of the regional market in industrialisation and the 1941 treaty represented a significant antecedent to the initiatives of the late fifties. Two arguments in favour of a free trade area were then set forth which would reappear later, namely the importance of economies of scale and the problem of the Most Favoured Nation Clause (MFN) ¹.

(i) *Economies of scale and parallel industrialisation in Argentina and Brazil.* During early negotiations with Brazil, Economic Minister Federico Pinedo observed that

'I have always understood that it would be ideal to progress towards a customs union - open, of course, to other neighbouring countries (...). Let's suppose that a policy in this direction would have been initiated many years ago. Instead of having in Brazil and Argentina parallel industries producing at high costs in different and all but

¹ The leading role of Raúl Prebisch in the formulation of both the Pinedo Plan and ECLA ideas may contribute to explain this continuity.

closed markets, we could have arrived at a profitable division of industrial work between the two nations (...) I am prepared to make most efforts in order to reach an understanding with Brazil as ample as possible"¹.

A similar point of view was held on the Brazilian side, where it was observed that a customs union 'will allow industrial development in one country to be supported by that in the other, instead of competing in identical and artificial manufactures'². Thus, policy makers in both countries realised the importance of the process of industrialisation taking place and sought to encourage specialisation in an early stage³.

(ii) *The problem of the Most Favoured Nation Clause.*

The initiative for progressive free trade between Argentina and Brazil could not ignore previous agreements in which the

¹ Pinedo to Berger, Archives of the Centro de Pesquisa e Documentação of Rio de Janeiro (therefrom CPDOC), Archive Souza Costa (therefrom SC) 4.09.12, Buenos Aires, 12 September 1940 (author's translation). Similar emphasis on the diversification of the structure of trade can be found in Pinedo's letter to the Brazilian Foreign Minister Osvaldo Aranha, CPDOC, Osvaldo Aranha Archive (therefrom OA), 40.01.23, Buenos Aires, 5 March 1940, in which he acknowledged the full-hearted support that the initiative received from Aranha.

² Letter from the Brazilian Ambassador in Buenos Aires, Rodrigues Alves, to Foreign Minister Osvaldo Aranha, CPDOC, Archive Osvaldo Aranha (therefrom OA), 40.01.23, Buenos Aires, 27 September 1940 (author's translation).

³ Clearly, the soundness of this proposal for taming sooner than later indiscriminate protection would be confirmed by the difficulties faced by trade liberalisation in the sixties.

MFN clause had been conceded to third parties. It was necessary to adopt an institutional framework allowing for an exemption to this clause. A way out was found in the creation of a free trade area or customs union ¹. This was a response to the pressure exerted by the USA and the UK, which tried to avoid discrimination in the markets of Argentina and Brazil ². Moreover, between 1939 and 1941 the international system became more permissive as regards trade arrangements ³. The war made it more difficult for the UK to place effective pressure on her partners. The USA, in turn, adopted a more positive outlook on import substitution and regional trade during the war, as she expected that this would contribute to ease supply constraints associated with

¹ A customs union was deemed to represent 'the way of avoiding that other countries, making use of the clauses of the Most Favoured Nation, take advantage of the benefits granted to neighbouring and friendly countries' (author's translation). Cf. Rodrigues Alves to Aranha, CPDOC OA 40.01.23, Buenos Aires, 27 September 1940.

² The Brazilian Ambassador in Buenos Aires reported that, in relation with UK pressures against the treaty with Brazil, the Argentine Foreign Minister Torriani was prepared to 'denounce the treaties with England if they compromise Argentine objectives in a moment in which the country goes through so great difficulties' (author's translation). Cf. letter from Rodrigues Alves to Aranha, CPDOC OA 40.01.23, Buenos Aires, 29 January 1941. Clearly, it is unlikely that Argentina would have taken such a bold step at that time. But Torriani's reaction is indicative of the interest in achieving a free trade agreement with Brazil.

³ In 1941 the Inter-American Economic Consultative Committee of Washington recognised the legitimacy of establishing preferential agreements among neighbouring countries. This possibility was explicitly mentioned in the trade agreements signed then by Argentina with the USA. Cf. Rodrigues Alves to Aranha, CPDOC OA 40.01.23, Buenos Aires, 25 October 1941, p. 3.

the war effort.

The move towards closer cooperation in 1939-41 was probably negatively affected by the decision of the Argentine congress, at the beginning of 1941, of not to ratify the Pinedo Plan. However, this seems not to have had a decisive effect in bilateral cooperation as far as negotiations with Brazil continued and the Treaty for Progressive Free Trade signed after Pinedo's resignation ¹. In effect, the conduction of the economic and foreign policy was not the main issue at stake in the Argentine political debate. During the discussions of the Pinedo Plan in congress the policy alternatives offered by the opposition were much similar to Pinedo's proposals. The reason why the Pinedo Plan was turned down by the Argentine Congress seems to have been essentially one of domestic politics ². Argentina faced in 1940 the challenge of political and economic reform ³. Political reform, aimed at liberalising

¹ The Pinedo Plan was ratified by the Senate Chamber but turned down by the Deputy Chamber, in which the opposition held majority. Still, some of the measures included in the Plan were implemented through executive decrees. Cf. D. Rock, 'Argentina, 1930-46', p. 43.

² This convergence of proposals was emphasised by Pinedo during the debates in the Senate Chamber on the 17 December 1940: 'either our plan is in the right direction to work out the problems or our adversaries have no imagination at all, because they have not raised alternative proposals. They have just limited themselves to offer the same proposals' (author's translation). The debate is reprinted in F. Pinedo, En Tiempos de la República (Buenos Aires, 1947), especially p. 270.

³ Cf. L. LLach, 'El Plan Pinedo', pp. 516-17.

the political regime, was necessary to obtain support for economic reform. Pinedo himself had previously set out to negotiate with the Radical Party a new political understanding which should create conditions for applying his policies ¹. This was frustrated by rigged elections in the provinces of Santa Fé and Mendoza which further strained the political climate in Argentina. As a result, the Plan was not ratified, prompting Pinedo's resignation.

Thus, the evidence suggests that the failure of congress to ratify the Pinedo Plan was not due to a hostile attitude in Argentina as regards cooperation with Brazil. Geopolitical rivalry had not yet become a dominant issue in regional relations nor a significant one in domestic politics ². On the other hand, the failure to reach a political agreement in Argentina, which could have permitted a more coherent and sustained approach towards regional and

¹ Pinedo started conversations with the opposition leader Marcelo de Alvear with the objective of reaching an agreement on economic and political reform, as expressed by Pinedo in an interview to the newspaper La Nación, 12 January 1941. In the interview, Pinedo argued that 'the objective is not only to reach an understanding so as to take care of these problems (the economic and financial problems of the country). Many of the measures waiting for Parliamentary decision are obviously of urgent necessity (...) But it is not a truce (...) what should be looked after, but a definitive peace' (author's translation).

² This situation was at variance with what would happen in 1953-54, when Perón launched his economic union proposals, to be discussed later. In the early fifties bilateral relations between Argentina and Brazil became a hotly debated and conflictive issue in Brazil's domestic politics which decisively contributed to curb economic cooperation.

hemispheric cooperation, was not inconsequential. This probably increased uncertainty over the implementation of the agreement in 1941 and certainly contributed to the reversal of cooperation in 1942. In particular, the deterioration of Argentina-USA relations and its impact on regional and hemispheric affairs contributed decisively to redefine interests in a centrifugal direction. This point is addressed in the following section.

In sum, the structural conditions of the period 1939-41 were particularly favourable for cooperation between Argentina and Brazil. The war had led to a convergence of perspectives on the need to increase regional trade. Hegemonic powers were less willing or less able to resist preferential arrangements. Geopolitical rivalry was not a stumbling block in the way to closer cooperation. In this context an agreement for 'progressive free trade' was possible. It represented a bold move to foster efficiency and growth which acknowledged the importance that industrial production had acquired.

I.2. Conflict With the USA

Reshaping commercial relations with the USA, as proposed in the Pinedo Plan, proved to be a sluggish, complicated process. Political and trade friction were a recurrent feature in Argentine-US relations. In effect, Argentina played a leading role at several Pan-American

Conferences in resisting the attempts of the USA to consolidate her political leadership in Latin America. Argentina's privileged association with Europe, and especially the UK, made for a position of strength and independence in hemispheric affairs, jealously defended by Argentine diplomacy¹. In addition, the competitive nature of agricultural production was a stumbling block in trade negotiations. If the proximity of war led the USA to seek a trade agreement with Argentina, the negotiations carried between June 1939 and January 1940 failed and this outcome was very much resented by the Argentines². This raised serious concerns in Argentina about the evolution of her foreign trade and contributed to set apart this country from the USA³. At the beginning of Second World War a

¹ Cf. A.C. Paz and G. Ferrari, Política Exterior Argentina, 1930-62 (Buenos Aires, 1964), pp. 57-63.

² President Cantilo severely condemned US protectionism as the USA only offered to reduce tariffs on meat and linseed up to a restricted quota. The British, whose bilateral practices were usually criticized by the USA, observed that 'negotiations (...) broke down because America was prepared to give away very little and wanted too much. Despite these lofty ideals about unhampered development of world trade they insisted upon a system of quotas with a corresponding obligation of Argentina to buy American goods'. Cf. FO 371 2416, 22 January 1940.

³ Reporting on a conversation with Pinedo, Ambassador Armour suggested that the basic point in Argentina-USA relationship was to open the US market to Argentine products. He pointed out that 'what Argentina needs is a minimum of economic security and an opportunity to sell more in the Western hemisphere.(...) The greater problem that will have to be faced eventually is the question of markets for wheat, meat and other products that the USA cannot absorb'. Cf. Armour to the Secretary of State, 611.531/1538 in Foreign Relations of the United States, 1940, vol. V

rapprochement eventually occurred between Argentina and the USA and a trade agreement signed in October 1941, the first since 1853. But this more cooperative disposition would not last. Bilateral relations steadily eroded after the hemispheric conference of Rio de Janeiro, where Argentina opposed the US initiative of severing diplomatic relations with the Axis powers ¹. From February 1942 the USA adopted a straightforward hostile approach towards Argentina, in the shape of an extensive economic boycott on the supply of intermediate and capital goods ². The USA also endeavoured to sever trade links between Argentina and her partners in Europe and Latin America. In effect, the economic boycott included the prohibition of using Marshall Plan dollars in Europe for buying Argentine goods until mid-1949 ³. In 1944 the USA made insistent demands on the UK asking for the cancellation of the latter's commercial agreement with Argentina, which provided for the importation of large quotas of Argentine meat. Between 1942-44 the USA tried to obstruct Argentine imports of rubber from Bolivia and

(Washington, 1961), pp. 462-3.

¹ Cf. J.S. Tulchin, Argentina and the United States: A Conflicted Relationship (Boston, 1990), p. 82.

² Cf. C. Escudé, Gran Bretaña, Los Estados Unidos y la Declinación Argentina (Buenos Aires, 1986), pp. 322-29; A. Lanús, De Chapultpec al Beagle: Política Exterior Argentina (Buenos Aires, 1984), pp. 24-32.

³ Cf. C. Escudé, Gran Bretaña, especially pp. 322-29.

Brazil, copper from Chile and tin from Bolivia ¹. Therefore, Argentine difficulties in the external front, already made acute by the war, were heavily reinforced by her conflict with the USA. Only in the early fifties did bilateral Argentine-US relations begin to normalize. The Eisenhower government privileged a Cold War strategy in which the re-incorporation of Argentina in the system of hemispheric security was crucial ². In addition, the economic policy adopted by Perón after 1952, and especially his favourable attitude towards US investments in the oil sector in Argentina, encouraged the rapprochement between this country and the USA ³. At the end of 1954 the Export-Import Bank (Eximbank) provided to Argentina a loan of US\$ 60 millions

¹ Cf. In January 1944 a Brazilian Commercial mission arrived at Buenos Aires in order to negotiate the supply of rubber tires to Argentina. The USA were reported 'to place every obstacle in the way of Argentina acquiring rubber supplies from Brazil'. Cf. FO 371 37723: AS 144, 7 January 1944. Commenting on the US-Chilean copper limitation agreement, Cordell Hull stated that 'perhaps the greatest advantage of the agreement from our point of view has been a voice in the control of copper exports to Argentina'. Cf. Secretary of State to Ambassador Bowens, Chile - 835.24/2445, Telegram, in Foreign Relations of the United States, 1944, V. VII (Washington, 1964), p. 706.

² On the foreign policy of the Eisenhower administration see S.G. Rabe, Eisenhower and Latin America: The Foreign Policy of Anti-Communism (London, 1988). The change in foreign policy already began in the late forties, when the objective of promoting democracy was gradually abandoned in favour of a policy based on security concerns. Cf. L. Bethell, 'From the Second World War to the Cold War', in A. Lowenthal (ed.), Exporting Democracy: The United States and Latin America (London, 1991), pp. 41-70.

³ Cf. 'Argentina Crisis: US Officials Favor Perón - But Largely for Business Reasons', The Wall Street Journal, 27 June 1955.

to build a new steel mill and the USA began to consider this country in her programmes of military assistance ¹. Still, for most of the period it was the conflict with the USA which dictated, to a significant degree, the evolution of Argentina's foreign policy.

I.3. Post-War Bilateralism and Regional Agreements

Post-war Argentine international and regional policies were dominated by her conflict with the USA and difficulties in sustaining essential imports. The experience of the forties reinforced this Argentine drive for autonomy and the diversification of trade. Moreover, the international context continued to look unpromising. Bilateral agreements were the basic instrument used by most countries to regulate trade and the 'dollar shortage' remained a central problem for Argentina and many Latin American countries, since most imports could only be supplied by the USA during the period of European reconstruction. The failure to return to full convertibility in Europe (and particularly in the UK) continued to pose the question of how to finance critical imports of capital and intermediate goods from the dollar area. The Argentine response to the constraints posed by the world's 'dollar shortage' was to deploy an intense

¹ Cf. S.G. Rabe, Eisenhower and Latin America, p. 38. See also J.C. Torre and L. de Riz, 'Argentina Since 1946', in L. Bethell (ed.), Cambridge History of Latin America, vol. VIII (Cambridge, 1991), p. 89.

diplomatic activity aimed at reaching bilateral trade and payments agreements with European and Latin America countries ¹. In this strategy, as in the Pinedo Plan, Latin America and particularly Brazil received considerable attention. Argentina thus played a leading role in encouraging regional trade in this period. Regional agreements were seen as a form of increasing trade without having to use hard currency. In addition, it was expected that they would provide for Argentina an instrument to extend her political influence in the region, and hence reduce her vulnerability in the international system. Argentine comparative higher development nourished aspirations of regional leadership ². The first half of the fifties witnessed several initiatives launched by President

¹ For a review of the 'dollar shortage' debate of the period see L.B. Yeager, International Monetary Relations: Theory, History and Policy (New York, 1966), especially the appendix to chapter 25). By the end of 1953 60 % of Argentine trade was covered by bilateral agreements. Cf. Bank of London and South America, Fortnightly Review, vol. 18, no. 448 (1953), p.789.

² On the Argentine aspiration to increase her influence in the region see FO 371 108793 AA 1021/1, 4 January 1954. US observers pointed out that 'Argentina's international aspiration includes a dominant position in Southern South America, a position of leadership in Latin America and a place in the world corresponding to somewhat inflated views of national capabilities. To reach these goals, Perón requires internal economic expansion, a free hand to assert Argentine influence over neighbouring countries and foreign support for Argentine pretensions in world affairs'. Cf. NIE-91-54, 9 March 1954, Secret, in Foreign Relations of the United States, 1952-55, vol IV (Washington, 1983), p. 462. See also section II for an analysis of the reactions generated by the Argentine initiatives for 'economic union' with smaller neighbours.

Perón with a view to promote economic integration with neighbouring countries, for which he sought to obtain the support of Brazil. Perón also expected to cooperate with Brazil in the defence of the price of common primary exports, like wool and leather¹. Thus, a series of 'economic union' treaties with smaller neighbours were signed by Argentina in 1953-4. In February 1953 the 'Santiago Act' between Chile and Argentina was signed, aimed at establishing a customs union². Subsequently, 'economic union' treaties were signed with Paraguay (August 1953), Ecuador (August 1953) and Bolivia (September 1954). These agreements represented an attempt by Argentina at diversifying economic and political relations in a context

¹ Cf. letter from Luzardo to Vargas, CPDOC, Archive Getúlio Vargas (therefrom GV) 52.01.14, 'Cartas' (8), Buenos Aires, 27 March 1952, pp. 4-5.

² The 1953 treaty was expected to (i) stimulate trade and industrialisation in both economies; (ii) gradually reduce tariffs and other trade barriers; (iii) simplify bilateral exchange controls; (iv) provide for the free transit of goods towards third countries; (v) develop the transport infrastructure. Cf. US State Department Central Files, 'Economic and Financial Review, Second Quarter of 1953', 855.00/7-1453, Desp. no. 38, 14 July 1953, in Argentina: Internal Affairs, Microfilm, Decimal Numbers 735, 835 and 935 (Maryland, 1987). Although the composition of trade between Chile and Argentina was basically made of primary products, some modest steps were given in order to promote industrial trade. A subsequent agreement signed on 19 July 1954 between metallurgic producers of Argentina and Brazil were elevated to the Commissions of the Economic Union Treaty with a view to including metallurgic products in the exchanges list. The results were largely disappointing, however, because obstacles remained in the concession of import permits. Cf. ECLA, Estudio del Comercio Inter-Latinoamericano en 1954 y 1955: Situación y Perspectivas en 1956 (New York, 1956b), pp. 16-17.

marked by geopolitical rivalry and the fragmentation of international trade.

II. BRAZIL IN THE INTERNATIONAL ECONOMY, 1939-55

II.1. The 'Special Relationship'

The situation of Brazil in the international system was in relative terms much more comfortable than that of Argentina. First, Brazil held her most intensive commercial links with the USA, which was the main market for coffee¹, Brazil's principal export commodity. Tables III.1.B and III.2.B show this more favourable position of Brazil.

¹ A 1935 commercial agreement allowed Brazilian coffee exports to enter free of taxes in the US market. Cf. ECLA, Estudio del Comercio Inter-Latinoamericano (New York, 1956a), p. 76.

TABLE III.1.B
BRAZIL: MAIN TRADE PARTNERS, 1934-55
(In percentage)

Period		S.A.	Arg	US	Europe	UK	Germ	Fran
1934-39								
Average	M	7.2	4.7	37.4	49.3	10.1	15.2	6.9
	X	14.6	12.7	25	52.9	12.1	21	3.1
1940-45								
Average	M	18.1	10.8	49.7	23.4	14.3	--	--
	X	21.7	16.7	56.1	12.5	5.9	--	--
1946-50								
Average	M	11.6	7.9	45.8	34.4	8.6	0.8	3
	X	11.4	8.4	49.7	28.6	10	0.5	2.4
1951-55								
Average	M	8.9	6.3	45.4	38.3	5.4	7.9	5.1
	X	14.1	6.9	34.9	37.6	4.6	8.1	5.6

X = Exports to country or region of destination/total exports.

M = Imports from country or region of origin/total imports.

SA = South America.

Average = Arithmetic average for the period .

Source: Ministério da Fazenda. Diretoria de Estatística Econômica e Financeira, Comércio Exterior do Brasil, Janeiro a Dezembro, 1934-38 (Rio de Janeiro, 1939); Instituto Brasileiro de Geografia e Estatística, Anuário Estatístico do Brasil (Rio de Janeiro, various years).

Clearly, in comparison with Argentina, the distribution of Brazil's exports and imports was favourable. Considering that between 1939 and 1955 the USA was the basic source of capital goods supplies, the fact that Brazil undertook most of her trade with the USA implied a higher potential for acquiring the equipment she needed to sustain investment and growth. The USA absorbed and supplied more than 40 % of total Brazil's exports and imports, respectively, since

1940. This percentage was less than 20 % in the case of Argentina. On the other hand, Table III.2.B shows that Brazil suffered too as a result of the post-war 'dollar shortage'. If this deficit was set at a relatively higher levels of imports from the USA than Argentina, they would still be regarded as a source of external disequilibrium and constraint on growth in post-war years.

TABLE III.2.B
BRAZIL: TRADE BALANCE, SELECTED YEARS
(In Thousands of Cruzeiros)

Year	SA	USA	Europe	Total
1937	-395.8	536.3	-152.0	-98.6
1938	-439.8	622.3	-328.3	-222.5
1942	688.4	429.3	1134.1	2851.1
1943	15.3	1025.5	1010.6	2335.4
1947	1142.8	-5761.1	2631.2	-1609.8
1948	776.9	-1489.0	1823.4	712.0

Source: Cf. Table III.1.B.

The more favourable position of Brazil was not restricted to trade matters. Brazil also developed friendly political ties with the rising hegemon along the lines of Baron of Rio Branco's 'unwritten alliance'¹. This had been instrumental by the turn of the century in the peaceful solution of disputes over the large Brazilian border with several Latin America countries. Brazil saw in the USA a

¹ The expression was coined by E.B. Burns, The Unwritten Alliance: Rio Branco and Brazilian-American Relations (New York, 1966).

natural ally in her attempts to balance British influence and contain Argentine aspirations of regional leadership in Latin America. Close links with the rising hegemon would yield substantial pay-offs for the Brazilian economy. In effect, the USA adopted in the thirties a more favourable stance towards with Brazil than that of the British with respect to Argentina. In particular, as observed by Abreu, the USA embraced a multilateral outlook on trade policy which relieved the Brazilians from having to offer preferential concessions ¹. As a British official at the Bank of England put it:

'In Brazil, (US officials argued that) their position was as dominating as ours in Argentina and they were pleased to point out that they had deliberately refrained from canalising trade and payments there as, they claim, we have done in Argentina' ².

US 'multilateralist' approach towards Brazil persisted despite the fact that Brazil was carrying out her trade with

¹ Cf. M.P. Abreu, 'Argentina and Brazil During the Thirties', especially pp. 150-51.

² Cf. FO 371 2416, 22 January 1940. However, as discussed, the enlightened hegemon view on US policy cannot be extrapolated to the case of Argentina. The USA adamantly resisted to liberalise imports of agricultural products which could harm agricultural producers in the USA, as was seen in the 1939-40 negotiations with Argentina. This qualification should also be kept in mind in order to understand conflict in the post-war trade system, especially in temperate agricultural goods and textiles.

Germany on a bilateral basis ¹. The June 1936 bilateral treaty for compensated trade with Germany permitted Brazil to obtain a market for her cotton exports - which the US market could not absorb - and diversify her sources of industrial goods and military equipment ².

In the forties, the basic thrust of Brazilian external

¹ It is a matter of debate whether US goodwill towards Brazil was secured by Vargas' ability to capitalise on certain strategic assets (such as the vulnerability of the Brazilian North East coast, during the war, the German efforts to enlarge her influence on Latin America and the Argentine enduring dispute with the USA) or was just the 'residual' consequence of US efforts to consolidate a long-term project of hegemony, cloaked in a multilateral approach to commercial relations. For S. Hilton, 'Brazilian Diplomacy and the Rio-Washington Axis During the World War Second Era', The Hispanic America Historical Review, vol. 59, no. 2 (1979), pp. 201-31, Vargas acted in a 'machiavellian' fashion giving false assurances to both, the USA and Germany, in order to keep a highly profitable double approach - bilateral and multilateral - to trade policy. G. Moura, Autonomia na Dependência: A Política Externa Brasileira de 1935 a 1942 (Rio de Janeiro, 1980), especially p. 63, highlights the ability of Vargas in maintaining a 'pragmatic equidistance' which allowed him to secure concessions from both rivals. M.P. Abreu, 'Anglo-Brazilian Economic Relations', suggests, on the contrary, that Vargas obtained in fact very little additional bargaining power from his German connection and emphasises instead the role played by the US long-term objective of consolidating multilateralism and containing Argentina.

² The tolerance of the USA with Brazil's German connection was resented by the opposition to Vargas. A former member of the Brazilian Treasury Delegation in the USA complained in a personal letter to Cordell Hull: 'From 1937 to 1940 the USA saw Germany leap to first place in the Brazilian market. (...) It saw Brazil buying arms and munitions in Berlin with the gold collected for coffee sold in New York. Impassably, the USA almost begged pardon to the Brazilian dictator for his provocations'. Cf. FO 371 37889 AS 4545/36/54/6, 26 August 1944. Cf. See also G. Moura, Autonomia na Dependência, pp. 91-91. Commercial links with Germany were subsequently terminated when the British imposed a naval blockade.

policy was to obtain US support for her process of economic development in exchange for cooperation with US strategic objectives, namely the war effort and the consolidation of the pan-American system ¹. The firm support given by Brazil to the USA during the war placed her in the position of privileged recipient of US economic and military aid. Priority in the supply of oil and capital goods, credits from the Eximbank for the construction of the Volta Redonda integrated steel mill, the favourable Inter-American Coffee Agreement of 1940, military support and financing for investments in infrastructure, were among the advantages that Brazil obtained from her wartime cooperation with the USA. In the mid-forties, Brazil obtained the same priority as the UK in the distribution of oil supplies. Volta Redonda received from the US government the same treatment regarding the provision of capital goods as that of new steel projects in the USA herself ².

The 'special relationship' with the USA and distant relations with the problematic Argentina was naturally the most convenient policy for Brazil in this context. This

¹ This cooperation included the construction of military basis with U.S. personnel in the North East (April 1942), the declaration of war to the axis (August 1942) and the dispatch of Brazilian troops to the Italian war theatre by the end of 1944.

² Cf. C. Escudé, La Argentina Versus las Grandes Potencias: El Precio del Desafío (Buenos Aires, 1986), pp. 158-82; A. Hurrell, 'The Quest for Autonomy: The Evolution of Brazil's Role in the International Economy', unpubl. PhD diss., University of Oxford, 1986, p. 31. (1986), p. 31.

policy persisted even after the transformation of the international conditions with the end of the war. After 1945 there was a decrease in the consideration that the USA had placed on Brazil and a reversal of the high expectations that Brazil held about her role in the new post-war international order ¹. The USA would adopt an increasingly less sympathetic appraisal to Brazil's requests for financial and political support. As a global power, facing military and economic demands in many other parts of the world, the USA placed Latin America in a low priority position in her agenda. Latin America appeared as a region in which US hegemony was uncontested. Yet this change in Brazil's position was not immediately perceived ². The Dutra administration (1946-1950) did not introduce relevant changes in the orientation of the earlier Vargas' policies (1930-1945) on the external front, assuming that Brazil continued to be a 'special case' in Latin America. It was believed that US support for Brazil would continue to come, stemming from a solid political association ³. These

¹ Cf. A. Hurrell, 'The Quest for Autonomy', p. 60.

² It has been argued by G. Moura, 'Brazilian Foreign Relations 1039-50: The Changing nature of Brazil-United States Relations During and After the Second World War', unpubl. PhD diss., University of London, 1984, that policy-makers suffered from a misperception of where Brazil's true international interests laied after the war.

³ Cf. P. Malan, 'Relações Econômicas Internacionais do Brasil, 1945-64', in B. Fausto (ed.), História Geral da Civilização Brasileira: O Brasil Republicano, Economia e Cultura, vol. III (São Paulo, 1984), p. 63.

expectations on the continuity of US support for Brazil's development were still entertained by Vargas at the beginning of his second presidency. They seemed to be confirmed by the installation of the Joint Brazil-USA Commission in July 1951¹, which should elaborate development projects to be financed with US support. However, no significant new funding became available. In 1953 the new Republican administration made it clear that it was not prepared to commit large sums of US public capital in development projects in Latin America. The Eisenhower government insisted instead on the role to be played by private foreign investments in Latin America. The USA believed that sound economic policies in Latin America would be discouraged by large inter-governmental loans. Thus, during his second presidency Vargas was confronted by a completely different situation to that of his first presidency. The 'special relationship' had been severely eroded². The outbreak of the Korean War did not lead to an

¹ The Joint Brazil-US Commission had been created in December 1950.

² This process was observed by US analysts with growing concern: 'In recent years, US-Brazilian relations have been impaired by growing Brazilian nationalism, which has produced friction in both economic and political-military affairs.(...) In particular, Brazil feels that the US economic and financial assistance to Brazil has not been commensurate with Brazil's past services and present strategic importance to the USA, and with Brazil's value to the USA as a moderating influence in Latin America and United Nations affairs'. Cf. 'National Intelligence Estimate', Secret, 86, 4 December 1954, in Foreign Relations of the United States, 1952-55, p. 643.

enlargement of Vargas' leverage with respect to the US - nor did it provide the enduring boost for primary exports that Perón had been anxiously awaiting. Brazil would expect much less from cooperation with the USA and the normalisation of Argentine-US relations made cooperation with Argentina less conflictive. This facilitated a convergence of interests by Argentina and Brazil after 1955, which would play a significant role in the integration efforts of the late fifties.

II.2. Brazil and Argentina

From a Brazilian standpoint, the relationship with Argentina was the resultant of two conflicting forces: (a) regional rivalry, alignment with the USA and domestic political opposition to collaboration with the Peronist regime worked in different moments to set the two countries apart; (b) Brazil's quest for strengthening her position in the hemispheric system and sustaining trade led her to seek cooperation with Argentina.

(a) Regional rivalry, alignment with the USA and domestic opposition to collaboration with Perón

Regional Rivalry. Argentina represented Brazil's principal rival in the quest for political and economic influence in Latin America. Although some diplomatic

initiatives had been taken earlier in the century to establish new bases of understanding between the two countries ¹, mutual suspicion and rivalry prevailed in the conflictive context of the forties ². First, Argentina regarded with suspicion the close cooperation between Brazil and the USA since she feared that this would shift the balance of power in Latin America in favour of Brazil. Such a concern was in fact a central issue in the letter that the Argentine Foreign Minister sent to Cordell Hull with a view to normalising Argentine-US relations ³.

Secondly, Argentine approaches to small neighbouring

¹ Saenz Peña paid a visit to Brazil in 1910 with the aim of establishing a 'Pacto de Cordial Inteligencia'. In 1915 the so-called 'ABC Treaty' was signed by Argentina, Brazil and Chile. This intended to set up a cooperative framework for dealing with international problems in the region. The Argentine Chamber of Deputies would subsequently fail to ratify the treaty. Cf. L. Moniz Bandeira, O Eixo Argentina-Brasil: O Processo de Integração na América Latina (Brasília, 1987), p. 20.

² Rivalry between the two countries began in the colonial times, in the shape of the struggle between the Spanish and Portuguese Empires in Latin America. A comprehensive study of Argentina and Brazil political relations is provided by L. Moniz Bandeira, Estado Nacional e Política Internacional na América Latina (Brasília, 1993). An account of the different moments of cooperation and rivalry in bilateral political relations can be found in H. Jaguaribe, 'Brasil-Argentina: Breve Análisis de las Relaciones de Conflicto y Cooperación', Estudios Internacionales, no. 57 (1982), pp. 152-3.

³ Storni asked in his letter for the 'urgent provision of airplanes, spare parts and machinery to restore Argentina to the position of equilibrium with respect to other Latin American countries'. Cf. R.A. Humphreys, Latin America and the Second World War, vol. II (London, 1982), pp. 152-3. On the arms embargo to Argentina, see R.A. Potash, The Army and Politics in Argentina, 1945-62: Perón to Frondizi (London, 1980), pp. 76-77.

countries were seen elsewhere as attempts to establish an hegemonic position in the region. From 1943 Brazil endeavoured to secure a more significant economic and political presence in the region, largely as a reaction to Argentine inroads in Latin America ¹. This was heightened by the Bolivian coup of December 1943, which seems to have counted on Argentine support ². In particular, hegemonic ambitions were attributed to the economic union treaties that Argentina had signed with Chile, Paraguay and Ecuador in 1953-54 ³. During the visit of the Chilean Foreign

¹ In May 1943 Brazil conceded important benefits to Paraguay which then had much closer ties with Argentina. Cooperation included a loan for public works in Paraguay. Paraguay and Bolivia were regarded as 'the diplomatic battle field between Argentina and Brazil'. Cf. Archives of the Ministry of Foreign Affairs of Uruguay, Biblioteca Artigas (therefrom MFA-BA), Ambassador Gutierrez to Foreign Minister, Box 61 - Brasil, Rio de Janeiro, 24 May 1943 (author's translation). See also Moniz Bandeira, Estado Nacional, p. 68.

² Cf. R.A. Humphreys, Latin America, p. 122.

³ Reactions in Brazil to the economic union treaties were 'of repudiation to the expansionist tendencies associated with the so-called doctrina justicialista'. Itamaraty was also expected to endeavour to 'limit the Argentine action in neighbouring countries and to persist in its pan-American policy' (author's translation). Cf. MFA-BA, Ambassador Pittaluga to Foreign Minister, Box 101 - Brasil, Section 1a, no. 5/53, C.9/953, Confidential, Rio de Janeiro, 4 March 1953. Uruguay - who faced a serious diplomatic conflict with Argentina at that time (see on this point chapter V) - was highlighted in a polemic speech delivered at by UDN senator Assiss de Chateaubriand, who suggested that Brazil should approach this country in order guarantee the 'sovereignty of the Uruguayan democracy, so much threatened by Argentina' (author's translation). Cf. MFA-BA, Box 101 - Brasil, Section 1a, N.4/53, 518/953, Ambassador Pittaluga to Foreign Minister, Rio de Janeiro, 17 August 1953.

Minister to Brazil in March 1953, Chilean diplomats hastened to emphasise that the economic union agreement with Argentina had only economic objectives and therefore it had not implied the formation of any kind of political bloc ¹.

Finally, power competition with Argentina strongly affected Brazil's views of bilateral trade relations. In particular, the opposition to Vargas maintained a vigilant attitude as regards trade with Argentina. In 1949, a secret report by UDN (National Democratic Union) senator from Alagoas, Arnon Collor de Mello, alleged that Brazil's trade with Argentina had contributed to strengthen Perón's position. In his view, by doing so Brazil had been unconsciously helping her likely enemy in a future war ². In sum, power competition shaped the hostile response that Argentina's initiatives at regional integration elicited from Brazil and the USA. Concurrently, Argentina regarded with suspicion Brazil's alliance with the USA and the anti-Argentine campaign sponsored by the UDN press. The

¹ In the words of the Chilean Ambassador in Rio de Janeiro: 'My country needs a commercial association with all these countries which could complement her economy with a view to enhancing progress and welfare. The recent visit of President Perón to Chile (...) had the objective of studying agreements of an exclusive economic nature. All that has been said denying this objective is completely baseless' (author's translation). Cf. Correio da Manhã, Rio de Janeiro, 12 March 1953.

² Cf. L. Moniz Bandeira, Estado nacional, p. 66. This behaviour corresponds to that predicted by A. Hirschman in a context of power competition, namely the effort to increase the influence over smaller neighbours and to reduce exposure to trade disruption by the hegemonic rival.

implications of this friction for bilateral cooperation will be addressed in more detail later, within the context of the conflict between Vargas and the UDN.

Brazil's alignment with the USA and US Policy Towards Argentina. Besides regional rivalry, Brazil's resistance to closer cooperation with Argentina was aimed at avoiding a clash with the USA. This was related to US opposition to regional economic integration in Latin America. The USA regarded with hostility Argentine initiatives at forming economic unions with other Latin American countries. For the USA, the brand of regionalism promoted by the Peronist regime could lead to a weakening of the pro-Western stance of Latin America - a fear that grew with Perón's 'third position' in the context of the Cold War ¹. In the case of Europe the USA encouraged the process of economic integration with a view to strengthening the economies of crucial allies, threatened by the Soviet Union. In Latin America, she had no compelling reasons for adopting a similar policy ². First, the Soviet challenge was perceived as less serious in Latin America. Secondly, economic integration in Latin America was being sponsored by a 'trouble-maker' (Argentina) whose intention, allegedly, was to create a 'Southern Bloc' opposed to the inter-American

¹ Cf. 611.35/6-2352, Secret, 1 March 1952, in Foreign Relations of the United States, 1952-54, vol. IV, p. 405.

² See on this point the interesting analyses of C. Escudé, El Precio del Desafío, pp. 133-412.

system ¹. Hence, political friction between the USA and Argentina created a negative climate for intra-Latin American cooperation.

The form in which financial aid was provided by the USA also affected the Latin American assessment of costs and benefits from regional cooperation. In Europe, US reconstruction aid was channelled through an inter-European body (the Organization for European Economic Cooperation, OEEC) which contributed to enhance regional economic coordination. The financial support provided by the USA to the constitution of the European Payments Union also encouraged regional trade. Conversely, aid to Latin America was provided on bilateral basis, thereby reinforcing competition among the Latin American countries for obtaining support for their own national development projects, with no regard to a regional dimension ². Already in June 1954, the Director of the Foreign Operations Administration of the USA observed that the

'Latin America countries want to move in a regional direction and have more regional relationships of an economic nature', and that 'our government has had a firm position against such a move. (...) Our discouraging such a

¹ Cf. FO 371 108793 AA 1021/1, 4 January 1954; and FO 371 108796 AA 1041/1, 20 January 1954.

² Cf. J. Grunwald et al, Latin American Integration and US Policy (Washington, 1972), p. 92.

development would create an unfavorable attitude because they know of the successful regional development in Europe on an economic basis' ¹.

US mainstream policy would continue to be that of providing bilateral finance to individual country's development plans, analyzed case by case. Only by the beginning of the sixties would US policy experience a change in favour of a more supportive approach.

It is then hardly surprising that Brazil assessed the costs of closer cooperation with Argentina as very high. To the extent that this could be seen as a departure from her alignment with the USA, this could alienate US support for Brazil. In addition, Argentine-US rivalry was favourable for her strategic interests. An alliance with the hegemonic power in order to contain a regional rival - which at that time displayed higher levels of economic development - looked naturally appealing for Brazil. The smooth working of this alliance required to confine, within narrow limits, the Latin American policy of Brazil, which should be subordinated to the inter-American approach ². This contributes to an understanding of why Brazil did not

¹ Cf. 'Minutes of the Meetings Held in the Executive Office Building', MSA-FUA, Director's files, FRC 56 A 632, Confidential MISC/RH-47, 21 June 1954, in Foreign Relations of the United States, 1952-54, p. 323.

² See on this point M. Hirst, O Pragmatismo Impossível: A Política Exterior do Segundo Governo Vargas (Rio de Janeiro, 1990), p.22-23.

sponsor any policy for regional integration of her own in the period before 1955.

Domestic Political Variables. Although a consensus in favour of economic cooperation with Argentina had never existed in Brazil, it became a central issue of debate between 1951 and 1954 ¹. The UDN, the main opposition party to President Vargas, regarded in Perón's Argentina the same type of authoritarian leadership and statist economic policies it was fighting at home. Vargas' Labour Minister João Goulart was considered the link between Labourist politicians in Argentina and Brazil. He was charged with the intention of coopting labour unions in order to follow in the steps of Perón. UDN leaders therefore firmly opposed cooperation between the two governments, which they considered would reinforce the anti-liberal features of the Vargas regime ². In addition, the various political compromises assumed by Vargas with a view to broaden his basis of support led to the coexistence of conflicting views within the government itself. This made it more difficult to

¹ Cf. M. Hirst, O Pragmatismo Impossível, p. 38, has observed that 'in no other moment in contemporary Brazilian history had the relations with Argentina generated such a great internal political mobilisation' as in the first months of 1954. 'Peronism was characterized as a major threaten which could distress both the internal order and the international commitments of Brazil' (author's translation).

² The UDN even accused Vargas of having received a funding from Perón for his electoral campaign. Meanwhile, the Peronist press in Argentina openly voiced its preference for Vargas candidacy. Cf. L. Moniz Bandeira, Estado Nacional, pp. 71-2.

implement any coherent foreign policy strategy ¹. Domestic feuds in Brazilian politics, within and outside the government, had left Vargas practically immobilized respecting a more open and firmer cooperation with Perón.

This point is clearly illustrated by the confused episode involving Vargas and Perón in relation with the Argentine-Chilean Treaty of Economic Union of October 1953 (the "Santiago Act"). The Treaty was criticised in Brazil on the grounds that it went against the idea of pan-American unity - in other words, it was seen as hostile with respect to the USA. In turn, in a confidential conference given at the Argentine National War School in November 1953, Perón reacted to these criticisms making a strong attack on Itamaraty and Vargas. Perón affirmed in his speech that Vargas had indeed privately given his support to a Southern economic union and had promised to join Argentina and Chile as soon as political conditions in Brazil were more propitious to the initiative ². The subsequent leaking and

¹ Thus, Vargas nominated Baptista Luzardo, a close friend of both Perón and Vargas, as Ambassador in Argentina. At the same time, he nominated João Neves da Fontoura, a political enemy of Luzardo and firmly opposed to cooperation with Argentina, as Foreign Minister. Luzardo's diplomatic activities in Buenos Aires were under continuous attack by those associated with Neves da Fontoura. Cf. for instance letter from Neves da Fontoura to Vargas, CPDOC GV, 'Correspondências' (15) 52.01.13/3, Rio de Janeiro, 17 March 1952 and letter from Luzardo to Vargas, CPDOC GV 52.08.22/2, Buenos Aires, 7 August 1952.

² It seems that Argentina did invite Brazil to participate in the economic union treaty with Chile, and this received a sympathetic consideration by Vargas. Contacts were carried in confidentiality through Ambassador

publication of this conference by Argentines exiles in Montevideo provoked a political storm against Vargas, for what was seen as his secret dealings with the Argentine foe¹. Particularly revealing was the so-called 'João Neves Accusation', an interview given by the former Minister João Neves to the O Globo newspaper of Rio de Janeiro². In the interview, Neves accused President Vargas of ambiguity in his foreign policy and stated that only his presence at the head of the Ministry had prevented Vargas from entering into a full understanding with Perón. It is also interesting to note that even Vargas' supporters limited their defence to just denying the existence of conversations between the two Presidents, without addressing the point of whether cooperation with Argentina could in fact be instrumental in furthering Brazil's interests in the international economy³.

Luzardo in Buenos aires, a personal friend of both Vargas and Perón. Cf. A. Lanús, De Chapultepec al Beagle, pp. 286-88.

¹ Anti-peronist feelings in Brazil were so strong that this alleged connection between Vargas and Perón was used again in September 1955 in an attempt to discredit Vargas' political heirs, Kubitschek and Goulart. Cf. FO 371 114027 A 1041/1, Confidential, 30 September 1955.

² O Globo, 4 April of 1954. João Neves left the Ministry of Foreign Relations in June 1953, when he was substituted by Vicente Rao. Vargas then also nominated João Goulart for the Ministry of Labour and Osvaldo Aranha for the Economic Ministry.

³ This point was made by H. Jaguaribe, 'A Denúncia de João Neves', Cadernos de Nosso Tempo, vol. 1, no. 2 (1954), pp. 83-100. In his remarkable analysis of the João Neves' 'accusation', Jaguaribe offered a broad discussion of the

These cleavages in Brazilian politics contributed to the cool reception that Perón's initiatives had in Brazil. Looking only at the structural variables it could have been expected that cooperation with Argentina had reached higher levels after 1953. By then it was already clear that Brazil's special relationship with the USA had come to an end. In addition, the rapprochement between Argentina and the USA after 1952 weakened the basis of Brazil's former foreign policy. Cooperation in the early fifties would have been much less costly than in the forties. Systemic constraints had been eased while mounting economic difficulties made cooperation more attractive. However, the internal dynamics of Brazilian politics made cooperation with Argentina problematic. Bilateral relations had become a significant internal political issue because domestic opposition to Vargas associated cooperation with Argentina with a reinforcement of Vargas' populist policies.

(b) Brazil's quest for strengthening her position in the hemispheric system

The advantages of the special relationship with the USA was qualified by Brazil's fears of too great a dependence on the USA. Moreover, Brazil considered that her strategic

convenience of closer political and economic cooperation between Brazil and Argentina, and set forth many ideas that would reappear later in the 'New Foreign Policy'.

importance for the USA depended in part on her capacity to play the role of mediator between the USA and Latin America countries. This strategy was stated by Brazilian diplomats in the following terms:

'In the American continent, the economic asymmetry between the USA and Latin American countries and the singular position of Brazil as an intermediate between the two extremes, are the basis for the definition of Brazilian policy ¹.

Such a role demanded mollifying Argentine resistances to Brazil's regional initiatives and securing a respectful consideration from other Latin America countries. Some ambiguity in the Brazilian position was therefore inevitable in order to make compatible the condition of 'principal ally' of the USA and that of 'honest broker' in Latin America affairs. Both dimensions of Brazil's foreign policy were related and demanded a delicate balancing act by Brazilian diplomats.

Several pieces of evidence confirm this view about Brazil's regional and hemispheric policy. It was particularly apparent in the episode of Brazil's decision to

¹ Cf. Archive of the Ministry of Foreign Affairs of Brazil, Itamaraty Palace, Brasilia, Centro de Documentação (therefrom CDO), 'Expedidos Diversos no Exterior: Instruções para a Delegação Brasileira a Conferencia Econômica da OEA', Confidential, 13 August 1957 (author's translation).

grant diplomatic recognition - despite US efforts to prevent such a move - to the Argentine government which emerged from the coup of June 1943. Brazil sought to prove her autonomy regarding the USA and gain the sympathy of Argentina and other Latin America countries, thereby reinforcing what she saw as her role of 'chief link' between the USA and Latin America ¹. At the beginning of 1946, US Ambassador Berle would complain about what he considered 'Vargas' inescapable habit of playing both ends against the middle, whereby, while working closely with us, he likewise maintained close connections with Argentina' ². Talking to Uruguayan diplomats, Brazilian Foreign Minister Velloso observed that Brazil

'would follow US policies towards Argentina, but within

¹ The British ambassador in Rio observed that 'in the first days after the revolution (the military coup in Argentina) the Brazilian ambassador was enthusiastic in his praise of the new regime and it seemed that the Brazilian government thought the opportunity a good one to assert dramatically its independence of the USA'. Cf. FO 371/33598, 10 June 1943. In a private conversation with British diplomats, the Brazilian Foreign Minister Osvaldo Aranha emphasised the gains accruing to Brazil from an early recognition of the Argentine government: (i) proved that Brazil was really South American; (ii) obtained the sympathy of the Argentines; (iii) would stimulate Argentine cooperation in continental affairs; (iv) showed to the USA that Brazil remained 'the chief link' between them and South America; (v) it 'assisted in consolidating Brazilian leadership in the region'. Cf. FO 371 33589 A 6952, 27 July 1943. It should also be recalled that Aranha, along with Pinedo, played a key role in the 1939-41 rapprochement between Argentina and Brazil.

² Cf. Telegram, 835.0012-2546, Secret, 25 February 1946, in Foreign Relations of the United States, 1946, p. 223.

certain limits, which would not include (...) the application of economic sanctions nor adopting measures which could made difficult cordial relations in the future'¹.

A similar attitude can be observed in the case of President Dutra's favourable opinion about the Argentine presence at the Rio de Janeiro Conference on hemispheric security². Moreover, this view seems to have been widespread among

¹ Cf. MFA-BA, 'Entrevista con el Ministro de Relaciones Exteriores Sr. Velloso Sobre la Reciente Nota Argentina', Box 31-3 - Brasil, 596/944, 12 November 1944 (author's translation). Moreover, Brazil resented the so centralised control that the USA exercised over certain Brazilian exports during the war. Osvaldo Aranha is reported to have expressed 'in confidential terms that he was opposed to the control mechanisms through which the USA managed the distribution of quotas for rubber and rubber tires. These mechanisms are heavily centralised in Washington' (author's translation). Cf. letter from Ambassador Gutierrez to the Foreign Minister, MFA-BA, Box 31-4 - Brasil, 249/943, Rio de Janeiro, 22 June 1943.

² Cf. FO 371 61157 AS371/371/2, 7 January 1947. In May 1947 Presidents Perón and Dutra met at the border city of Uruguayana, where they inaugurated an international bridge and signed agreements on border trade and transportation. Dutra himself was criticized by Lacerda after his meeting with Perón. Lacerda (who seems to have been haunted by fears of 'secret pacts' between Brazil and Argentina) feared that Dutra had assumed the commitment to give political support for Argentina in exchange of Argentina wheat. Cf. MFA-BA, Box 76 - Brasil, 367/947-1a, Strictly Confidential, 6 June 1947. P.R. Almeida, A Diplomacia do Liberalismo Econômico: As Relações Internacionais do Brasil Durante o Governo Dutra (São Paulo, 1991) offers substantial evidence that the change in foreign policy prompted by Dutra was less dramatic than usually suggested in the bibliography.

Brazilian diplomats ¹. Efforts to mediate were not limited to the conflict Argentina-USA. Brazil also made a frustrated attempt to mediate in the conflict between Argentina-Uruguay of the early fifties in order to stop the stream of economic sanctions then imposed by the Argentines ².

The two directions mentioned in Brazil's foreign economic policy were not contradictory. They reflected the idea that strengthening Brazil's position in the region would contribute to the 'special relationship' with the USA. On the other hand, this implied keeping bilateral relations with Argentina within limits acceptable to the USA. A move towards a broad understanding with Argentina would have aroused suspicions in the USA and hence compromised Brazil's priority objective of maintaining the 'special relationship'.

¹ Even João Neves da Fontoura, who strongly criticized the 1953 Argentine initiative to form an economic union, expressed to US ambassador Byrnes the view that 'Argentina could not be left outside of the pan-American system and that the USA should give more attention to the attitudes and opinions of the neighbours of Argentina' (author's translation). Cf. MFA-BA, 'Política Internacional y Americana', Box 71 - Brazil, Section 1a, 17, 834/946, 10 December 1946.

² Cf. letter from Neves da Fontoura to Vargas, CPDOC GV 52.01.14, Rio de Janeiro, 14 January 1952. On the Argentine-Uruguayan conflict see chapter V.

III. THE EVOLUTION OF BILATERAL TRADE

A critical factor among the determinants of cooperation are the gains from trade. For two neighbouring countries which present a large complementarity in agricultural production, trade is a powerful incentive for cooperation. Trade brings about welfare gains that governments balance with the political influence of affected domestic interests. Three variables will be used in order to assess the role of bilateral trade in shaping cooperation policy: (1) the rates of growth of bilateral trade as compared with that of total trade; (2) changes in the structure of bilateral trade; (3) the constraints on the expansion of trade imposed by the yet low degree of industrialisation achieved by Argentina and Brazil at the time.

III.1. Rates of Growth of Bilateral trade

Two principal periods in the evolution of bilateral trade are easily identified in table III.3. During Second World War (1939-45) bilateral trade expanded steadily as a result of the collapse of traditional markets and suppliers in centre economies. In the early post-war period (1946-55) this dynamism receded, although trade in constant dollars in the triennium 1953-55 was three times higher than in 1934-36.

TABLE III. 3
BRAZIL: BILATERAL TRADE WITH ARGENTINA, 1934-60
(In Millions of Constant US\$ Dollars of 1946-47)

Year	Balance (1)-(2)	Exports (1)*	Imports (2)**
1934	-25.6	28.1	53.7
1935	-30.9	25.3	56.3
1936	-47.6	24.9	72.5
1937	-52.9	29.0	82.0
1938	-41.8	26.0	67.9
1939	-10.1	33.7	43.9
1940	-15.8	36.9	52.8
1941	3.8	58.6	54.7
1942	21.6	82.8	61.2
1943	-23.1	64.0	87.1
1944	-11.9	116.4	128.4
1945	-25.4	113.3	138.8
1946	27.1	93.9	66.7
1947	32.7	113.5	80.8
1948	31.1	107.3	76.2
1949	-31.6	85.0	116.7
1950	-25.8	73.6	99.4
1951	-5.5	101.7	107.3
1952	52.6	86.3	33.7
1953	-98.0	69.9	168.0
1954	-4.5	90.6	95.1
1955	-46.9	90.3	137.3
1956	-10.4	56.8	67.3
1957	11.0	87.5	76.5
1958	15.9	89.7	73.8
1959	-51.8	35.9	87.8
1960	-32.6	46.8	79.4

* Exports of Brazil to Argentina, FOB prices.

** Imports of Brazil from Argentina, CIF prices.

Source: Cf. Table III.1.B. Prices in US\$ constant dollars calculated by using US wholesale index, United States, Department of Commerce, Historical Statistics of the United States (Washington, various years).

Table III.4 shows the expansion of Argentine and Brazilian exports to each other and to the rest of the world. In the case of Argentina, trade grew at higher rates with Brazil than with the rest of the world in any of the

sub-periods considered, namely 1934-39, 1940-45, 1946-50 and 1951-55. In the case of Brazil, the role of the regional market was less stable and a significant change took place after the war.

TABLE III.4
EXPORTS BY DESTINATION: YEARLY RATES OF GROWTH
(In percentage)*

Average	1934-9	1940-5	1946-50	1951-55	1934-55
Total Arg	0.03	5.5	-3.3	0.6	1.9
Arg to Bra	1.3	10.9	7.0	4.7	2.7
Total Bra	0.9	16.1	6.7	-10.1	9.4
Bra to Arg	3.3	21.1	-7.5	-1.9	7.2

* Calculated from Exports and Imports in US\$ Constant Dollars of 1946-47.

Total Arg = Total Exports of Argentina.
Total Bra = Total Exports of Brazil.
Arg to Bra = Exports of Argentina to Brazil.
Bra to Arg = Exports of Brazil to Argentina.

Source: Cf. Tables III.1.A, III.1.B and United States, Department of Commerce, Historical Statistics of the United States.

Brazil's exports to Argentina grew at an especially impressive rate during the war and her participation in the Argentine market rose from an average of 5.2 % in 1936-8 to an average of 24.5 % in the period 1942-44. She became the principal source of Argentine imports in 1943. The trend was reversed after the war and Argentina lost ground in Brazil's total trade. This probably did not reduce Brazilian commercial interests in Argentina, however, as the 'dollar shortage' reinforced the interest in diverting imports away

from the dollar area and - as will be shown later - this provided an incentive for cooperation in trade and payments.

III.2. The Structure of Bilateral Trade

The important place that Argentina occupied as a source of Brazilian imports is largely explained by her critical role as a supplier of wheat. Argentina was almost the exclusive source of wheat imports for Brazil until 1950. After 1950 the USA became a significant competitor for Argentina in the Brazilian market due to the highly favourable (subsidised) terms provided by Public Law 480. Moreover, the crop failure of 1952 in Argentina severely reduced her exports of wheat to Brazil. This was reflected in the fall of the Argentine participation in the Brazilian market by the end of the period.

TABLE III.5
BRAZIL: IMPORTS OF WHEAT, 1937-55

Average	From Argentina (Millions of US\$ Dollars)	Total (Millions of US\$ Dollars)	Argentina/total (Percentage)
1937-39	36.2	36.7	99
1940-45	39.9	40.1	99
1946-50	62.8	70.1	89.6
1951-55	66.6	122.1	54.6
1956-60	63.0	107.0	61.7

Source : Cf. Table III.1.B.

Despite this fall, wheat continued to be the backbone of the Argentine exports. This dominant role of wheat reflected in a low degree of diversification of the Argentine export structure (cf. table III.6). Brazil, on the other hand, exported to Argentina a wider range of products, especially during the war (cf. Table III.7).

TABLE III.6BRAZIL: COMPOSITION OF IMPORTS FROM ARGENTINA

(Percentage of Total Value of Imports from Argentina)

Year	I	II	III	IV
1938	..	4	94	2
1939	..	6	92	2
1940	..	3	95	3
1941	..	5	89	6
1942	..	11	83	6
1943	..	14	80	6
1944	..	12	83	5
1945	1	6	89	4
1946	2	9	82	7
1947	..	3	93	4
1948	..	2	96	2
1949	1	2	96	1
1950	..	3	96	1
1951	..	4	94	1
1952	2	7	89	2
1953	..	1	97	2
1954	..	2	94	3
1955	..	1	98	1
1956	..	3	94	3
1957	..	1	95	3
1958	97	2
1959	..	1	98	1
1960	..	1	96	3

I = Live Animals
 II = Raw Materials
 III = Food
 IV = Manufactures

Source: Instituto Brasileiro de Geografia e Estatística, Anuário Estatístico do Brasil (Rio de Janeiro, various years) and R. Fonseca, 'O Intercambio Brasil-Argentina e o Comércio Intra-Industrial', Master Dissertation, Pontifícia Universidade Católica, Rio de Janeiro.

TABLE III.7.
BRAZIL: COMPOSITION OF EXPORTS TO ARGENTINA
 (Percentage of Total Value of Exports to Argentina)

Year	I	II	III	IV
1938	..	26	72	2
1939	..	30	61	10
1940	..	30	49	21
1941	..	42	28	30
1942	..	33	20	47
1943	..	40	25	35
1944	..	36	22	42
1945	..	37	20	43
1946	..	49	28	23
1947	..	37	28	35
1948	..	52	29	19
1949	..	50	25	26
1950	..	30	56	14
1951	..	47	44	9
1952	..	47	47	3
1953	..	25	74	1
1954	..	17	81	2
1955	..	39	56	4
1956	..	26	71	2
1957	..	44	55	..
1958	..	39	60	1
1959	..	49	48	2
1960	..	47	49	3

I = Live Animals
 II = Raw Materials
 III = Food
 IV = Manufactures

Source: Cf. Table III.6.

On average, during 1940-45 and 1947-50, 36.3 % and 23.3 % of Brazilian exports to Argentina were manufactures, respectively. As a result, the interest of Brazilian industrial exporters in the regional market grew

consistently in this period ¹. Brazilian exports of iron bars to Argentina rose from 2,170 tons on average between 1935-38 to 17,494 tons on average between 1940-42, representing 8 % and 82 %, respectively, of the total Argentine market. Cotton textiles occupied an especially significant place in Brazil's exports of manufactures, as can be seen in table III.8. The 1940 trade agreement with Argentina received enthusiastic support from Brazilian industrialists. This opened a market that would alleviate the situation of the Brazilian textile industry, which, industrialists claimed, suffered from surplus capacity ².

¹ Already in mid-June a Brazilian economic mission was formed with a view to visiting Latin American countries and promoting industrial exports. Cf. Federação das Indústrias do Estado de São Paulo (FIESP), circular no. 68-40, 28 June 1940. The fear of loosing the markets conquered by Brazilian exporters during the war attracted the attention of the industrial associations. In the 1944 Industrial Congress governmental support was demanded in order to keep the momentum of industrial exports after the war. Cf. FIESP Congresso Brasileiro da Indústria (São Paulo, 1944), p. 10. This concern was also evidenced in a memorandum handled to President Vargas in late 1952. Cf. Boletim Informativo FIESP (therefrom BI), vol. XIV, no. 167 (15 December 1952), p. 273. See also BI, vol. XVI, no. 184, 13 April 1953, pp.42-43, in which the specific role that the Argentine market could play was emphasized.

² Cf. FIESP, Relatório dos Trabalhos Realizados em 1940 (São Paulo, 1941a), especially pp. 33-4. Cf. also letter from Pupo Nogueira, Director of the Textile Syndicate to Osvaldo Aranha, CPDOC OA, 40.6.23, São Paulo, 20 June 1941. Exports of textiles, however, fell sharply in the early fifties, out of increasing competition from other countries and Balance of Payments difficulties in Argentina.

TABLE III.8
BRAZILIAN EXPORTS OF COTTON TEXTILES BY DESTINATION
(In tons and percentage)

Year	Argentina	Total	Argentina/Total
	In Tons		In Percentage
1940	3270	3959	82.7
1941	5544	9238	62.2
1942	13133	25539	59.3
1943	5319	26434	24.0
1944	9718	20070	58.1
1945	6637	24246	35.7
1946	2453	14103	18.9
1947	5541	16678	34.6
1948	2123	5638	37.7
1949	2880	4010	71.8
1950	988	1361	72.6
1951	771	1596	48.3
1952	62	153	40.5

Source: Cf. Table III.1.B

The expansion and diversification of trade led to changes in the relative position of the two countries. Firstly, Brazil's trade balances with Argentina, which had been negative during the thirties, turned into a surplus in the forties (cf. table III.3). Secondly, Brazil's importance as a source of imports for Argentina was enhanced. In effect, before the Second World War Brazil had been principally regarded in Argentina as an important market for wheat. In addition, by the late thirties, contemporary Argentine observers pointed out the compensatory role that Brazil could play in alleviating Argentina's trade deficits

with the USA ¹. During the war, however, Brazil would also become a source of industrial and semi-industrial products, such as that of rubber and iron goods, for Argentina. The conditions generated by the war and the USA economic boycott of Argentina heightened the latter's reliance on trade with Brazil. Correspondingly, the Argentine market became a significant outlet for Brazilian industrial production.

III.3. Industrialisation and Constraints on Trade

The inability of Argentina and Brazil to supply to each other the industrial goods which were most demanded - capital and intermediate goods - constrained the expansion of trade in the period. This had to do with the fact that industrial capabilities were still relatively limited in both countries. The process of industrialisation demanded increasing imports of capital goods. However, Argentina and Brazil had not yet developed their capital goods industries. This can be seen in tables III.9.A, III.9.B, III.10.A and III.10.B. While industrial production was concentrated on light consumer industries, industrial imports were

¹ As Brazil displayed a negative trade balance with Argentina and a positive one with the USA, it was suggested that these countries could find a 'triangular modus vivendi(...) which could resolve at the same time, by simple compensation, the current economic differences between Brazil and the USA and the problems between Brazil and Argentina' (author's translation). Cf. A. Pérez Constanzo, 'Relações Comerciais Argentino-Brasileiras; O Brasil Como Mercado Consumidor de Trigo e Seus Problemas', Boletim do Ministério das Relações Exteriores, no. 11 (1939), p. 19.

increasingly composed of capital goods.

TABLE III.9.A.
ARGENTINA: STRUCTURE OF THE MANUFACTURING INDUSTRY
(In Percentage of the Total Value of Production)

Period	1937-39	1948-50	1959-61	1963-65

Sector				
Food and Beverage	37.3	25.4	19.2	18.7
Textiles	7.4	11.7	8.4	7.8
Wood products	2.1	2.1	1.9	1.7
Paper and Printing	6.3	4	3.6	3.4
Chemicals	4.4	5.8	7.1	8
Petrochemical	4.9	5.3	7.2	8.4
Rubber Products	0.8	1	1.4	1.4
Leather Products	4.2	4.7	4.1	2.6
Metal products	6.4	6.5	8.8	10.1
Transport Equipm. & Non Electrical Machinery	5.6	9.6	14.1	16.5
Electrical Machinery	1.1	2.0	6.6	5.8

Source: C. Díaz Alejandro, *Essays on the Economic History of the Argentine Republic* (New Haven, 1970), p. 224.

TABLE III.9.B.
BRAZIL: STRUCTURE OF THE MANUFACTURING INDUSTRY
(In Percentage of Total value of Production)

Sector/Year	1939	1949	1959
Food	31.4	31.9	24.1
Beverage	2.6	3.2	2.4
Textiles	23.0	18.6	12.5
Shoes and Garment	4.6	4.3	3.4
Chemicals	5.8	5.2	8.9
Metal products	6.3	7.6	10.5
Machinery	1.1	1.6	2.8
Transport Equipment	2.9	2.3	6.8
Electrical Machinery	0.9	1.4	3.5

Source: Instituto Brasileiro de Geografia e Estatística, Serviço Nacional de Estatística. Censo Industrial (Rio de Janeiro, 1950 and 1960).

TABLE III.10.A
ARGENTINA: IMPORT STRUCTURE, 1935-54
(In Percentage of the Total Value of Imports)

Period	1935-39	1945-49	1950-54
Sector			
Food and Beverages	9.9	6.8	7.8
Textiles and Garment	25.6	15.6	9.5
Chemicals	6.2	6.8	7.3
Iron Manufactures	12.1	12.5	13.8
Rubber Products	1.0	1.7	1.8
Vehicles and NEM a/	11.9	18.8	20.3

a/ NME = Non Electrical Machinery

Source: C. Díaz Alejandro, Essays on the Economic History, p. 257.

TABLE III.10.B
BRAZIL: IMPORT STRUCTURE, 1938-50
(In Percentage of Total value of Imports)

Sector/Period	1938-39	1948-50
Food Products, Beverage and Tobacco	14.9	17.9
Fuels, Lubricants, Derivatives coal and Petroleum	13.1	12.8
Raw Materials	30	23.8
Capital Goods	29.9	35.2
Manufactured Consumer Goods	10.9	9.7
Others	1.2	0.6

Source: W. Baer, Industrialization and Economic Development in Brazil (New Haven, 1965), p. 36.

In Argentina, imports of transport equipment and non electrical machinery increased their participation in total imports from 11.9 % to 20 % between 1935-9 and 1950-4. In

Brazil, capital goods imports increased their participation in the import structure from 29.9 % to 35.2 % between the late thirties and the late forties. Conversely, the representation of these sectors in the total value of production of the industry was 6.7 % and 11.6 % in the case of Argentina (1937-39 and 1948-50, respectively) and 4.9 % and 5.3 % in the case of Brazil (1939 and 1949, respectively). This meant a supply constraint on the expansion of trade ¹. A similar conclusion can be reached looking at Argentine and Brazilian exports of capital goods in the period (cf. Tables III.11.A and III.11.B). The participation of Argentina and Brazil as suppliers of capital goods to each other was extremely low (1.2 % is the highest figure, for 1941-42) illustrating the limits placed by industrial capabilities on higher regional trade and inter-dependence.

¹ In developed countries, in accordance to the pattern early observed by S. Linder, Essays on Trade and Transformation (London, 1961), industrial production and import structure tend to overlap, giving rise to more intensive trade.

TABLE III.11.A**ARGENTINA: EXPORTS AND IMPORTS OF CAPITAL GOODS***

(Thousands of US\$ current dollars)

Average	1941-42	1951-2
Total Imports capital goods	11480.6	96.8
Imports from Brazil	63.7	0.24
Brazil/Total (% source)	0.6	0.3
Total exports capital goods	1106.3	406.1
Exports to Brazil	198.6	23.4
Brazil/total (% destination)	18	5.8
SA/total (% destination)	92.6	91.5

* Capital Goods defined as "Non Electrical Machinery" in the Argentine Foreign Trade Classification.

Source: República Argentina, Dirección General de Estadísticas y Censos, Anuario de Comercio Exterior (Buenos Aires, various years). Figures in current US\$ dollars obtained by applying official sellers' exchange rate, as provided by the Banco central de la República Argentina, Suplemento Estadístico de la Revista Económica (Buenos Aires, various years).

TABLE III.11.B**BRAZIL: EXPORTS AND IMPORTS OF CAPITAL GOODS***

(Thousands of US\$ current dollars)

Average	1941-2	1951-2
Total imports capital goods	6815.9	124540.3
Imports from Argentina	78.9	19.4
Argentina/total (% source)	1.2	0.02
Total exports capital goods	238.3	194.3
Exports to Argentina	84.2	4.7
Argentina/total(% destination)	35.3	2.4
SA/total (% destination)	99.6	17.1
SA and Africa/total(% destin.)	99.6	93

* Capital Goods defined as "Machinery and Tools for the Industry" in the Brazilian Foreign Trade Classification

Source: Elaborated from Ministério da Fazenda, Comércio Exterior do Brasil: Por Mecadorias Segundo os Países (Rio de Janeiro, 1947 and 1953). Figures in current US\$ Dollars obtained by applying official sellers' exchange rates, as provided by W. Baer, Industrialization and Economic Development, pp. 271-72.

In addition, industrialisation followed a competing pattern in both countries. This had to do with the so called 'easy stage' of import-substituting industrialisation or ISI-1. At this stage, industrial growth occurred in industries which were less demanding in terms of technology and scale - the consumer goods industries. The pattern of import substitution was intensive in capital and intermediate goods exports, while the internal market was reserved for domestic producers of consumer goods ¹. Therefore, there was an implicit bias against regional trade in industrial goods. The participation of imports of industrial consumer goods in total imports tended to fall in the period, reflecting this pattern of industrialisation (cf. Tables III.10.A and III.10.B).

Moreover, the fact that these industries did not present such significant increasing returns as the capital goods implied that the costs of protection were still relatively reduced in this stage of industrialisation - despite of the fact that there were gains in efficiency and growth to be obtained through higher levels of specialisation ². Conversely, the scope for competition with domestic production were high. As far as both economies were

¹ This pattern has been thoroughly reviewed in the literature. Cf., for example, J. Katz and B. Kosacoff (1989), El Proceso de Industrialización en la Argentina: Evolución, Retroceso y Perspectiva (Buenos Aires, 1989).

² This argument will be develop more rigorously in the next chapter.

specialised in similar products, it can be expected that industrialists would resist liberalising industrial trade. In other words, gains from trade were relatively lower, while the costs of competition could be high - thus increasing the resistance of domestic producers to freer trade ¹.

Finally, not only were the capital- and technology-intensive industries poorly represented in the industrial structure of Argentina and Brazil. They also were run by state firms (in Brazil) or directly controlled by the military (in Argentina). The Direction of Military Factories (DGFM) in Argentina controlled a group of metal-mechanical, naval and chemical industries, including some nationalised German firms ². In Brazil, public enterprises were prominent

¹ As mentioned, Brazilian industrialists were very much in favour of a more aggressive policy for industrial exports to other Latin American countries. But they were far from enthusiastic with the idea of a free trade area. In a speech given at the Military Club in April 1948, the Brazilian industrial leader Roberto Simonsen offered a sceptical view regarding economic integration in Latin America on the basis of the lack of industrial complementarity in the region: 'Given the nature of tropical production, large part of the (Latin American) countries offer similar products. (...) Thus, a Latin American customs union would not have, at the moment, the same justification, foundations and results as a customs union among European countries' (author's translation). Cf. R. Simonsen, 'O Plano Marshall e um Novo Critério nas Relações Internacionais', in FIESP, Simonsen e a Operação Pan-Americana (São Paulo, 1958), p. 134. In other words, in the conditions of the late forties, a free trade area would imply more competition rather than the exchange of complementary products.

² On the role of the military in encouraging 'strategic' industrial production see R.A. Potash, The Army and Politics, pp. 80-81. In particular, General Savio, as Director of the DGFM, push forwards an initiative for

in steel (CSN), vehicles (National Motors) and some chemicals (National Alkalies). Although direct control of the industry by the military was less marked in Brazil than in Argentina, the Escola Superior de Guerra (Superior War School) showed an especial and early concern with industrial production in its programmes¹. The importance of the links between industry and defence, in turn, were repeatedly emphasized by Brazilian industrialists, who carefully cultivated a connection with military interests². It can be expected that this perceived inter-relation between industry and defence was a factor preventing the liberalisation of trade in industrial goods in the region. Uncertainties about the redistribution of industrial capabilities in a free trade area placed efficiency and welfare concerns in a

building an integrated steel mill and a weapons factory. On the DGFM see also R. Mallon and J. Sourrouille, Política Económica en una Sociedad Conflictiva: El Caso Argentino (Buenos Aires, 1973), p.8.

¹ The School was created in August 1949 and from the beginning identified 'development' and 'industrialisation' as areas which should receive careful attention by the military. Cf. A. Stepan, The Military in Politics: Changing Patterns in Brazil (Princeton, 1971), pp. 172-187.

² The FIESP systematically received military authorities and students of the Superior War School. In an editorial of its official publication, FIESP praised 'the inter-relation of interests, the growing rapprochement between the military and the producers (as classes produtoras). (...) Weapons, ammunition and transport equipment cannot be improvised, but they result from an advanced and well organized industrial machine, that is, from an industry technically developed' (author's translation). Cf. BI, vol. VIII, no. 92 (9 July 1951), p. 1. See also BI, vol. XIX, no. 159 (20 October 1952), p.30; BI, vol. XVIII, no. 220 (21 December 1953), p.447; BI, vol. XX, no. 239 (3 May 1954), p.139.

second place as regards independent production of "strategic" industrial goods in a context of power rivalry in the region.

On the other hand, trade in capital goods in that period is illustrative, in a very reduced scale, of a trend that would acquire full expression in the late sixties and seventies, namely the importance of the regional market for capital goods exports from Argentina and Brazil. Although Argentine-Brazilian trade in capital goods fell in the period 1950-55, Latin America continued to represent the largest destination of these exports for Argentina. In the case of Brazil, Latin America was the almost exclusive destination of her exports of capital goods in 1941-2, of which Argentina accounted for more than a third. Latin America participation in Brazil's total capital goods exports fell in the period 1951-2, matched with the increase in the participation of a group of African countries (Abyssinia, Mozambique and Angola). Clearly, absolute figures are rather unimpressive. As mentioned, they can at best be considered as indicative of the potential of the regional market for expanding trade in these sectors, rather than a actual significant force in stimulating cooperation.

IV. CONCLUSIONS

1. This chapter has analyzed the structural variables shaping economic cooperation and integration between

Argentina and Brazil in the period 1939-55. These variables were related to changes in the international system and to the evolution of trade and industrialisation. But behaviour did not result directly from structures. Domestic and international political variables played a significant role as well, especially in certain critical situations, in which a new response to changing conditions was required.

2. The outbreak of Second War World was a major event that prompted a convergence of perspectives in Argentina and Brazil. Ministers Federico Pinedo and Osvaldo Aranha led a very significant effort to expand regional trade at a moment in which international trade collapsed. These efforts gave rise to an agreement for progressive free trade in November 1941, which would have permitted the creation of a regional market for new industries. However, the agreement was not implemented. The reason lies on growing regional and hemispheric rivalry after 1942. It is likely that rivalry could have been lessened had the Argentine conservative government agreed to open the political regime in the early forties and had US policy-makers followed a more judicious approach towards Argentina. In any case, the potential for conflict can be traced to the position of Argentina and Brazil in the international system, which shaped divergent perspectives on constraints and opportunities. Argentine-US rivalry had been nourished by trade friction and the Argentina's close association with the UK. After 1942, Argentine stubborn neutrality made the Argentine-US conflict

especially hard to resolve. Conversely, Brazil held a close economic and political association with the rising hegemon, on which she based her special relationship with the USA. For Brazil, bilateral relations with Argentina were then confined by the limits established by the special relationship and regional power rivalry.

However, Brazil's position was more complex than just following US policy. Brazil tended to see herself as the 'chief link' and interlocutor between the USA and Latin America, a position which could enhance her bargaining power with respect to the USA. This demanded some ambiguity in order to gain Argentina's confidence. Brazil's interests in Argentina were reinforced by the fact that substantial gains from trade could be obtained, stemming from complementarity in agricultural production.

3. In the early fifties a convergence of perspectives again emerged. In both countries, the dollar shortage represented a stimulus for the diversification of trade and the celebration of payments arrangements. Disenchantment with the results of the special relationship with the USA was high in the Brazilian government at that moment. Gradually, a new perception of the position of Brazil in the international system began to emerge. It seems that in 1953 Vargas regarded with sympathy an attempt at rapprochement initiated by Perón. However, cooperation with Argentina became an issue of Brazil's domestic political conflict. As a result, behaviour diverged from what could be expected

from the change in structural conditions. The rapprochement between the two countries would have to wait for a change in Brazilian politics, which would occur after the election of Kubitscheck in 1955.

4. Gains from trade were also a major variable favouring cooperation. Complementary in primary production and, especially during the war, high rates of growth of bilateral trade and trade diversification, contributed to develop a mutual interest in cooperation. Although the growth of trade receded in the post-war period, the 'dollar shortage' continued to be a powerful 'focusing device' in favour of cooperation in trade and payments matters. Still, supply capabilities and the progress of import-substitution in consumer goods restrained the possibility of achieving higher levels of regional trade.

5. The contradictory forces influencing the economic relations between Brazil and Argentina produced an ambiguous but distinct pattern of cooperation in the 1939-55 period which can be labelled restrained bilateralism (this point is developed in chapter V). If Brazil made serious efforts to expand trade and preserve a climate of political cordiality with Argentina, she was not prepared to assume any major political commitment that could compromise her strategic alliance with the USA or boost Argentine prestige in Latin America. Divergent perspectives as regards systemic constraints and the existence of geopolitical rivalry imposed a political threshold on cooperation which both

countries would not be able to cross. Economic integration in its different forms necessarily requires certain degree of "sovereignty surrender" or at least "shared sovereignty" in several policy areas. This implies a process of complex, continuous political negotiation not only in the realm of inter-state relations but also regarding the various domestic groups whose interests could be affected. Therefore, economic integration needs both a domestic and an international political climate conducive to the process of negotiation and subsequent adjustments in the economy. None of these conditions was present in the case of the attempts at economic integration between Argentina and Brazil in the period 1939-55 - except during the short-lived effort for cooperation of the years 1939-41. As a result, cooperation stopped at a relatively early stage of economic interdependence and hence the attempts to form a would-be free trade area in 1941 and 1953 were unsuccessful.

CHAPTER IV. 'DEVELOPMENTALISM' AND ECONOMIC COOPERATION
BETWEEN ARGENTINA AND BRAZIL, 1956-60

INTRODUCTION

After 1956 most of the barriers that had hindered closer economic cooperation between Argentina and Brazil in the past fifteen years began to fade. The objective of this chapter is to analyze why these barriers fell and left space for a remarkable convergence of objectives and policies in the external and domestic realms, clearing the way for the creation of the Latin American Free Trade Association (LAFTA) in February 1960. It will be argued that the increase in regional cooperation between 1956-60 resulted from the perception that international support was faltering precisely when the region embarked in an ambitious programme of industrialisation. Section I discusses international constraints on the 'developmentalist' project embraced by Argentina and Brazil in this period. These constraints were related to US policy towards Latin America (I.1) and the consolidation and configuration of the post-war international economic regime (I.2). A systematic divergence of perspectives between Latin America and the USA with respect to the pace of industrialisation and financing for development stimulated a convergence of perspectives in

Argentina and Brazil. In addition, the failure of the Bretton Woods multilateral economic regime to include trade in agricultural goods and ease external disequilibrium also contributed to generate similar defensive attitudes in the two countries.

Sections II and III analyze Argentine-Brazilian bilateral economic cooperation in this period. A large reformulation of Brazil's foreign economic policy took place, in which Latin America and Argentina received higher priority (section II). Concurrently, Argentine diplomacy in the region, although much less dynamic than in the previous period, evolved in a convergent direction to that of Brazil (section III). Problems remained in bilateral relations, but the dominant trend was in favour of cooperation. This created a climate conducive for the creation of a regional market.

Section IV focus on the impact of trade and industrialisation on cooperation. Although regional trade lost dynamism in the late fifties (IV.1), industrialisation began a new stage at that moment (IV.2), the second phase of import-substituting industrialisation (ISI-2), based on capital-intensive industries. A rapid process of structural transformation occurred in which technological change and increasing returns to scale played a more significant role. As a result, the benefits of a regional market increased in the ISI-2 phase.

Finally, section V presents the main conclusions of the chapter.

I. 'DEVELOPMENTALISM' AND THE INTERNATIONAL SYSTEM

I.1. The Challenge of Developmentalism

A critical factor reshaping the context of economic cooperation between Argentina and Brazil after 1955 was the adoption in the two countries of the so-called 'developmentalist' policies. The governments of Juscelino Kubitschek in Brazil (January 1956 - January 1961) and Arturo Frondizi in Argentina (May 1958 - March 1962) set out to promote a process of rapid structural transformation of the economy aimed at building the industrial basis for sustained long-term growth. These policies reflected a higher articulation in economic thought on industrialisation and a response to the experience of the past twenty years. Convinced that the pre-1930 international insertion of Latin America had gone for good, developmentalist policy-makers sought to solve the problem of achieving sustained growth without external disequilibrium by means of 'completing' or 'integrating' the industrial structure of the country. This meant a "deepening" of the process of import-substitution. As shown by Sikkink, such an objective implied ¹: (i) granting first priority to investments in capital-intensive industries, in the intermediate goods sector (energy,

¹ Cf. K. Sikkink, Ideas and Institutions: Developmentalism in Brazil and Argentina (Ithaca, 1991), pp. 33-36. See also C. Szusterman, Frondizi and the Politics of Developmentalism in Argentina, 1955-62 (London, 1993), pp. 75-97.

steel), the capital goods sector (mechanical and electrical machinery) and durable consumer goods (motor vehicles and domestic appliances), along with major investments in infrastructure; (ii) relying on massive external financing and technological support, from public and private sources, on the understanding that domestic resources and capabilities were insufficient to accomplish the desired transformation of the industrial structure; (iii) allowing for substantial state intervention, aimed at directing investments towards high priority areas; (iv) sustaining very high rates of investment with a view both to accelerate the process of development and to catch-up with the industrialised world.

Achieving developmentalist goals would require substantial inflows of foreign resources. Imports of capital and technology from the centre would be crucial to sustain industrialisation. Therefore, developmentalist policies would tend to exacerbate balance of payments disequilibrium in the short run. Although external disequilibrium was recurrent in the economic performance of Argentina and Brazil ¹, the concentrated effort to industrialise strained the external sector in 1956-60. The key feature of 1956-60 was thus the conflict between the region's drive for industrialisation, which heightened demands for international cooperation, and the view that the international system had placed Latin America in a

¹ It was already discussed in chapter III that the external sector remained a central concern for Argentina and Brazil in the period 1939-55.

unfavourable position.

This conflict was strengthened by the negative evolution of the Argentine and Brazilian external sectors in the period. In effect, table IV.1 shows that the terms of trade and the participation of Argentina and Brazil in world exports fell between 1955 and 1960, while the external public debt increased in order to finance current account deficits.

TABLE IV.1
ARGENTINA AND BRAZIL: PERFORMANCE OF
THE EXTERNAL SECTOR
(In millions of current US\$ dollars and in percentages)

Period	Balance of Trade	Terms of Trade (a)	Increase Debt (%) (b)	Exp as % World Trade (c) *

Argentina				
1946-50	1349.3	-55.6		2.374
1951-55	206.7	-788.1	50	1.2906
1956-60	-46.4	-1773.6	146.3	0.9976
Brazil				
1946-50	1384.5	-5.4		2.237
1951-55	674	-138	237.1	2.019
1956-60	655	-1240.5	32.1	1.3372

Sources: Elaborated from ECLA, External Financing in Latin America (New York, 1965) and International Monetary Fund (IMF), International Financial Statistics (Washington, various years).

(a) Effect of the deterioration of the terms of trade: five years losses or gains as compared with export and import prices of 1950

(b) Percentage of increase in the long-term public debt

(c) Percentage of the country's exports in total world exports

* Data correspond to the period 1948-50

This can also be seen in table IV.2. The purchasing power of exports declined slightly ¹ while the demand for imports increased strongly, boosting current account deficit. As public international loans were not enough to cover the deficit, then short-term, more expensive financing from suppliers had to be sought, as will be shown later, generating higher external instability.

TABLE IV.2
ARGENTINA AND BRAZIL; PERFORMANCE OF THE EXTERNAL SECTOR
(In millions of current US\$ dollars)

Year	ARGENTINA		BRAZIL	
	X Purchas.	Current	X Purchas.	Current
	Power (a)	Account	Power (a)	Account
1950	1579	129	1891	142
1951	1385	-238	2174	-560
1952	799	-385	1623	-780
1953	1302	354	1858	17
1954	1225	78	1811	-259
1955	1113	-266	1615	-40
1956	1127	-143	1794	-2
1957	1120	-333	1817	-358
1958	1179	-301	1676	-329
1959	1317	-23	1789	-433
1960	1476	-266	1756	-643
1961	1371	-728	1767	-318

(a) Purchasing power of exports of goods and services = total exports plus the real effect of the terms of trade.

Source: ECLA, Balance of Payments Statistics (New York, 1986).

¹ On average, the purchasing power of Argentine exports fell from US\$ 1.3 millions in 1950-54 to US\$ 1.2 millions in 1955-59. In the case of Brazil, these figures were US\$ 1.9 millions (1950-54) and US\$ 1.7 millions (1955-59).

In sum, external disequilibrium was the consequence of the big gap that existed between developmentalist objectives and the conditions of the international economy, which were not favourable for the strong industrialisation drive that policy-makers wanted to adopt. This gap constituted the basis of friction with the USA and convergence of perspectives between Argentina and Brazil in the late fifties.

I.2. 'Developmentalism' and the Evolution of US Policy Towards Latin America

The Second World War made the hegemony of the USA virtually uncontested in the Western World in general and in Latin America in particular. The objectives of the USA were to prevent the expansion of Soviet influence in Latin America and secure a favourable environment for her business interests. And this at the least possible cost in terms of public resources, given the US already heavy involvement in other areas of the globe. The result was the combination of anti-communism and free enterprise which constituted the bases of US foreign policy towards the region since the late forties and throughout the fifties¹. This policy, however, confronted the expectations that had been generated in Latin America by US promises of post-war support for development, and subsequently, by the success of the Marshall Plan in

¹ Cf. S.G. Rabe, Eisenhower and Latin America, especially pp. 84-99.

Europe¹. Views sharply diverged and inter-American relations then moved towards conflict.

In the late thirties and during the war the USA signed bilateral trade agreements with several Latin American countries with a view to securing a stable wartime supply of foodstuffs and strategic materials. Concurrently, efforts for 'limited' import-substitution in Latin America were regarded sympathetically, to the extent that they would compensate for the loss of imports formerly obtained in Europe and Asia. Thus, US and Latin American objectives and strategies, namely the stabilisation of export prices and the diversification of the economy through ISI, tended to converge. However, a basic disagreement over long-term objectives persisted and this was bound to come to surface with the end of the war.

First, while the USA regarded Latin America industrial diversification as an emergency, temporary goal, Latin America considered this a long-term objective². Secondly,

¹ The USA had promised that after the war economic cooperation would be provided for Latin America, but the discussion of this was postponed several times and eventually set aside by the USA at the Bogota Conference of 1948. Cf. R. Thorp, 'A Reappraisal of the Origins of Import Substituting Industrialisation', p. 190. By the end of this year President Truman administration had already made his mind about policy objectives, which would be based on anti-communism and free trade and investment. These two objectives would be forcefully pursued by the Eisenhower administration after 1953. Cf. S.G. Rabe, Eisenhower and Latin America, pp. 16-41.

² The promise that the Marshall Plan would reinvigorate the European demand of primary goods from and the supply of industrial goods to Latin America was therefore unwelcome by the Latin Americans at Bogota, as this entailed that the region would occupy its former position of primary producer. Cf. S. Rabe, Eisenhower and Latin America, p. 17.

the USA regarded extensive state intervention in the economy and the organisation of commodity markets as an instrument of the war period. In the US view, a liberal international economy (at least for most industrial goods), working upon a multilateral bases, was the desirable framework for post-war economic relations. Conversely, many Latin American countries were ready to adopt a wide array of protection and promotion policies for the industrial sector ¹. From the Latin America's point of view, the USA should give support to this, by providing financial and technological assistance and by stabilising commodity markets ². The USA, however,

¹ The concern with the preservation of industry after the war received considerable attention by industrialists. Cf. R. Simonsen 'O Plano Marshall e um Novo Critério nas Relações Internacionais', in FIESP, Simonsen e a Operação Pan-Americana (São Paulo, 1958) p. 15-17. In addition, the failure of attempts at liberalisation in the post-war years, notably in Brazil during the Dutra years (1946-51) and in Argentina under the Provisional Government (1955-58), convinced these countries that employment and growth required the promotion of industry. Cf. P.R. Almeida, 'A Diplomacia do Liberalismo', pp. 7-15; P. Gerchunoff, 'A Note on the Economic Policies of the Liberating Revolution', in G. Di Tella and R. Dornbusch (eds.), The Political Economy of Argentina, 1946-83 (London, 1989), pp. 103-7.

² Such a perception was also held by the industrial private sector. Speaking in 1947 to the Economic Council of the National Confederation of Industries of Brazil (CNI), Roberto Simonsen observed that 'no plan for the defense of the continent can be dissociated of a plan for economic development. Political objectives require first to work out economic problems, which are perhaps more serious here than in Europe' (author's translation). Cf. R. Simonsen, 'Sugestões para uma Política Pan-Americana: Problemas do Desenvolvimento Econômico Latinoamericano', in FIESP, Simonsen e a Operação Pan-Americana, p. 72. Industrialists considered that the war had compromised the renovation of their industrial equipment and that they would have to compete in disadvantage. Simonsen thus demanded a 'technical conference (...) in order to elaborate an emergency plan and precisely establish the amount of external contributions that each country needs' to renovate industry (author's translation). Cf. *ibid.*, p. 74. See also FIESP BI, vol. I, no. 18 (12 December 1949), p.2 and BI, vol. I, no. VIII (24 April 1950), pp. 1-2.

held different views. She considered that Latin America could achieve high growth by the proper mobilisation of existing resources in the private sector and therefore no special financial assistance would be required. Promoting heavy industry on the bases of extensive state intervention and US public capital was regarded as unsound ¹. It was believed that financial contributions would have the effect of delaying the adoption of policies in favour of private foreign investment, this the genuine solution for Latin America economic difficulties. The US negative approach to Latin American demands created recurrent friction in hemispheric relations in the fifties. Strong feelings were held in Latin America about being 'forgotten' or 'taken for granted' by the USA ². Interests and perceptions in the USA and Latin America then largely diverged and this would lead to growing discontent in the region.

Moreover, the articulation of the Latin American discontent in common proposals was probably made easier by the fact that inter-American fora had been created, originally with the aim of fostering US security objectives in the region ³. This gradually became an arena in which Latin America collectively presented her economic demands.

¹ On the views in the State Department, see R.A. Pastor, Whirlpool: US Foreign Policy Toward Latin America and the Caribbean (Princeton, 1992), p. 174.

² Cf. P. Malan, 'Relações Econômicas', p. 65.

³ Cf. G. Moura, Sucessos e Ilusões: Relações Internacionais do Brasil Durante e Após a Segunda Guerra Mundial (Rio de Janeiro, 1991a), pp. 73-76; G. Connel-Smith, The Inter-American System (London, 1966), pp. 220-28.

Bodies like the Council for Economic and Social Affairs and the inter-American Economic Conferences were used to exert pressure on the USA in the economic field.

Latin American demands focused on three basic points that the USA in turn was reluctant to accept: (i) increasing public financing for development in Latin America, including the creation of a regional development bank with this objective; (ii) establishing commodity agreements for the main Latin America exports in order to stabilise prices and markets; (iii) consultations between the USA and affected Latin America countries as regards the disposal of agricultural surplus under Public Law 480 (which provided for the subsidised exports of agricultural products) and the imposition of quotas and tariffs on Latin America exports ¹.

Disputes along these lines dominated the Economic Conference of American States that took place in Buenos Aires between 15 August and 4 September of 1957. The endurance and repetitive fashion of the conflict was emphasised by Assistant Secretary Rubottom. Commenting on the Buenos Aires conference, he observed that while Latin America advanced its 'customary proposals', the USA had to insist on her 'traditional and thoroughly justifiable view' that 'foreign and domestic private capital(...) should carry the main burden of financing and promoting economic

¹ Cf. 'National Intelligence Estimate: Conditions and Trends in Latin America', NIE 80/90-55, Washington 6 December 1955, in Foreign Relations of the United States, 1955-57, vol. VI (Washington, 1987), pp. 20-22. See also 'Summary of Main Subjects for Discussion at Buenos Aires Economic Conference and of Related United States Policies', Enclosure, Washington, 2 August 1957, in Foreign Relations of the United States, 1955-57, pp. 140-43.

development, and that the Governments should seek to create investment climates conducive to a higher rate of private investment' ¹.

In sum, the USA remained fairly impermeable to Latin American demands for higher financial contributions to development. This represented a recurrent and growing source of friction in hemispheric relations. The conflict between the USA and Latin America was already present in the early post-war period. But it would mature in a common regional positions after 1955. The politics of regional rivalry between Argentina and Brazil then left room for cooperation in their negotiations with the USA.

I.3. Latin America Convergence in the Multilateral Arena

The Bretton Woods agreements and post-war mechanisms of international cooperation were seen by most Latin America countries as highly inadequate for attending their specific problems. Firstly, the multilateral institutions in charge of providing funds for Balance of Payments (BOP) disequilibrium and for development - the International

¹ Cf. 'Letter From the Assistant of State for Inter-American Affairs (Rubottom) to the Deputy Assistant Secretary for International labor Affairs, Department of Labor (Werts)', Washington 23 October 1957, Foreign Relations of the United States, 1955-57, p. 580. Cf. also 'Instruction From the Secretary of State to All Diplomatic Missions in the American Republics", CA-3710, Confidential, Washington, 21 October 1957, in Foreign Relations of the United States, 1955-57, pp. 573-78. The demands placed by latin America in the Buenos Aires Conference would subsequently re-emerge in Kubitscheck's 'Pan-American Operation' (more on this can be found below).

Monetary Fund (IMF) and the International Bank of Reconstruction and Development (IBRD), respectively - fell short of possessing the resources and flexibility that Keynes had envisaged as necessary to underpin a fundamentally open trade and payments international system¹. This was reflected in the 'ad hoc' solution found for the European reconstruction, which was financed by the Marshall Plan, an emergency programme set up outside the multilateral mechanisms of Bretton Woods. Secondly, the organisation envisioned to complement the payments system in the field of international trade, the International Trade Organisation (ITO, set up in the Havana Charter of 1948) would never be sent to the US Congress for ratification and this was a setback for Latin America's interests. The USA considered that the ITO entailed a set of rules that would jeopardise the principles of non-discrimination and the free operation of the market forces. The loose institutional arrangement that by default took its place, the General Agreement on Tariffs and Trade (GATT), neither incorporated the proposals put forward by the developing countries in Havana² nor

¹ Keynes proposed the creation of a 'Clearing Union' that would be endowed with an amount of resources for BOP adjustment much higher than that proposed in the 'Stabilisation Fund' of US negotiator White. Keynes also considered that pressure for BOP adjustment should be placed in both debtor and creditor countries in order to avoid a tendency towards deflation in the international economy. Cf. R.N. Gardner, Sterling-Dollar Diplomacy in Current Perspective: The Origins and the Prospects of our International Economic Order (New York: 1956), chapter V.

² In fact, Article XVIII of the GATT incorporated some special provisions for developing countries previously agreed in Havana. However, this article was subject to so many restrictions that in fact it was much easier to resort to the normal provision stated in Article XII of the GATT, allowing for import controls

included the sectors (agriculture and textiles) which were of highest interest for them ¹.

As a result, Latin American perspectives converged towards a rather pessimistic outlook on the region's place in the post-war international economy and prompted the adoption of a defensive stance during the Havana and GATT negotiations ². Brazil played an active role in setting forward the demands of developing countries and sought to reinforce common positions ³. The attitude of the Brazilian negotiators was spurred by the strong opposition to liberalisation by Brazilian industrialists, which accused the GATT of being a rich-country club interested in

in case of BOP difficulties. If this was easier, it was considered unsatisfactory. ECLA pointed out that restrictions based on BOP were necessarily contingent, a short-term device that could not properly be used as an instrument for a long term policy of development. Cf. ECLA, Estudio del Comercio Inter-Latinoamericano, pp. 51-52.

¹ The 1948 ITO Charter was drafted by a Preparatory Committee during the conferences of London (September 1946), Geneva (April 1947) and Havana (November 1947). Debates were dominated by two different cleavages. The first one was the US-UK dispute about dismantling the system of imperial preferences. The second one had to do with developing countries' demands to be allowed to protect industry. Cf. G. Curzon, Multilateral Commercial Policy (London, 1965), chapter VII; R.N. Gardner, Sterling-Dollar, pp. 364-8. See also C. Wilcox, A Charter for World Trade, (New York, 1949), especially pp. 35-36 and pp. 142-43. The GATT originally emerged as a provisional arrangement (proposed by the USA at the end of the 1946 London Conference) in order to provide a legal framework for the round of tariff negotiations launched in 1947.

² The convergence of perspectives included most developing countries. Argentina, however, did not participate of multilateral institutions until 1960 and hence did not play a role in this move (see II). Conversely, the GATT was regarded with much concern and attention in Brazil.

³ Cf. P.R. Almeida, 'A Diplomacia do Liberalismo', pp. 10-11.

haltering industrial development in Brazil. The representative of FIESP at the Torquay GATT negotiations argued that 'Brazil can only loss for remaining in a body like the GATT whose activities, in fact, are only beneficial for the developed countries' and whose aims were 'to stratify countries in their current position'. He also pointed out that Brazil should abandon the GATT in order to have 'freedom of movements for encouraging economic development' ¹. Therefore, at the beginning, the main objective of the Latin American countries in general and Brazil in particular was to be able to protect industry from international competition ².

By the end of the fifties, however, Latin America defensive attitude was somewhat modified. In 1958, the influential 'Haberler Report' on market access for developing countries (a study carry out under the auspices of the GATT by a commission of experts chaired by Gottfried Haberler) concluded that developed countries' policies had in fact hindered the export potential of developing ones ³. The Report prompted more offensive action by Latin America

¹ Cf. BI, vol. VI, no. 71 (20 May 1951), pp. 26-27, 20 May 1951 (author's translation). In particular, Brazilian industrialists feared the consolidation of tariffs during the GATT negotiations at Torquay. As no system of ad-valorem tariffs existed in Brazil, tariff protection was very low (see also next chapter). The consolidation of tariffs would place industry in a difficult situation when non-tariff protection was removed. Cf. BI, vol. V, no. 51 (25 September 1950), p. 1; BI, vol. V, no. 53 (9 October 1950), pp. 1-2.

² Cf. D. Tussie, The Less developed Countries, pp. 19-22.

³ Cf. GATT, Trends in International Trade, Report by a Panel of Experts (Geneva, 1958).

as regards export promotion. This reflected the perception that external difficulties required coordinated action on the export side of the equation as well ¹. Moreover, the fears of loosing ground in international markets were reinforced by two major events. First, the formation of the European Economic Community in 1957. The trends in the EEC were to give protection to European production of temperate agricultural products and discriminate in tropical products in favour of the former European colonies in Africa and Asia. Secondly, the waiver from GATT rules obtained by the USA in 1955. This allowed her to continue the programme of subsidies and protection for the agricultural sector. In both cases, common concerns about a Latin American marginalisation of the world economy were heightened.

In sum, Latin American countries felt excluded from post-war international economic arrangements. The features assumed by US policy towards Latin America and the shortcomings of the Bretton Woods institutions were already clear by 1956-8, when the developmentalist programme was launched. Fears already present in the region in the early post-war years were heightened in the second half of the fifties by the creation of the European Economic Community (EEC), by US subsidies to agriculture and by the findings of the 1958 Haberler Report on constraints on exports from

¹ This would be the substance of the developing countries' 'Note on the Expansion of Trade' of 1959, the 'Program of Action' of 1961 and the new chapter on "Trade and Development" incorporated to GATT (Part IV) in February 1965. The latter was direct result of the momentous pressure arising from the culmination of the First UNCTAD in 1964. Cf. D. Tussie, The Less Developed Countries, pp. 32-36.

developing countries. The perception of being marginalized from the international system was the framework within which efforts for closer economic cooperation would develop in the late fifties.

II. SHIFTING FOCUS IN BRAZIL'S FOREIGN POLICY: FROM THE 'PAN AMERICAN OPERATION' TO THE 'NEW FOREIGN POLICY'

II.1. Setting a New Agenda for Hemispheric Relations

It was Brazil, the former closest ally of the USA in Latin America, that would take the lead in presenting Latin American demands for more comprehensive economic cooperation. As mentioned, Brazil had been gradually modifying her position as regards the 'special relationship' with the USA since 1945. Brazilians came to understand that after the war the country had been placed on the same footing as other Latin American countries and no special consideration would be given to Brazil's development needs. As part of an hemispheric security alliance within which all members expected to obtain a similar treatment from the USA, Brazil seemed to have lost her former international protagonism. Although President Vargas had acknowledged these changes in the international context, it was only after Vargas' suicide (August 1954) that political conditions in Brazil allowed a broad reformulation of foreign policy.

The need for change was reinforced by President

Kubitschek's (1955-1960) developmentalist objectives. He would adopt a new policy towards Latin America in which regional cooperation was expected to place Brazil as a key actor in the reformulation of hemispheric economic relations¹. With this objective in mind, Kubitschek launched in May 1958 the so-called 'Pan-American Operation' (Operação Pan-Americana, Portuguese acronym OPA). As during the Vargas era, the main objective of OPA was to secure international cooperation for industrialisation, invoking US strategic interests. However, in this case, the special relationship would be between Latin America and the USA - and not just between Brazil and USA, as in the forties². The bilateral approach gave way to a regional approach. The main ideas in the OPA proposal were the following:

(i) immediately after the war it was necessary for the USA to concentrate her efforts on the reconstruction of Europe in order to contain the Soviet military threat. This objective, however, had been by large successfully

¹ These ideas were detailed by Kubitschek in his conference at the Superior War School of Rio de Janeiro, 26 November 1958, reprinted in J. Kubitschek, Kubitschek e a Operação Pan-Americana (São Paulo, 1963).

² Looking at the OPA in retrospective, a Brazilian diplomat emphasised, in the early sixties, that 'the history of the inter-American system since the creation of the Pan-American Union in 1890 to the launching of OPA in 1958 can be described as a series of meetings of a political-juridical (or even political-rhetoric) nature. (...) During this long period nothing or very little has been done to modify or improve the socio-economic conditions of the continent. The important thing that makes the OPA a hallmark in the pan-American history is the fact that for the first time an attempt was made to unify Latin America as a whole in the defence of common interests' (author's translation). Cf. CDO, 'Ofícios Recebidos, Diversos no Exterior, 1960-61, Delegação do Brasil Junto à OEA', 562/196, Anexo 2, Confidencial, 28 December 1961.

accomplished by the mid-fifties. Since then, Latin America had become the 'weakest link' of the Western defensive system because of her economic backwardness and the poverty of the majority of the population. These conditions were conducive to social unrest and political instability. 'Underdeveloped regions are regions open to the penetration of anti-democratic ideas. The battle of the Western World is (...) the battle of development' ¹.

(ii) Competition between the two blocs of the Cold War was no longer confined to the military arena. In fact, it was taking place principally in the economic field. Developing countries would accept help from whoever was prepared to provide it on the most generous terms. Kubitscheck also pointed out that the economic support offered by the Soviet Union to developing countries compared favourably with that offered by the USA ².

(iii) Development could only be achieved by means of a

¹ Cf. letter from Kubitschek to Eisenhower, CPDOC/BDE 58.08.22, 22 August 1958.

² A series of commercial and technical cooperation agreements had been signed between some Latin America countries (including Argentina and Brazil) and the Soviet Union in the fifties. These agreements worried the USA. In 1956 the USA called attention to the 'astute and aggressive' Soviet policy in Brazil: 'the principal weapon is Russia's willingness to supply petroleum equipment to national monopolies contrasting with US unwillingness to do so'. Cf. 'Memorandum from the Assistant Secretary of State for Inter-American Affairs (Holland)', 7 June 1956, in Foreign Relations of the United States 1955-57, p. 703. The same concern existed respecting the Argentine-USSR trade agreement of May 1953, in which the USSR offered to Argentina credits for imports of petroleum, transport equipment and machinery. Cf. Department of State, Central Files, 'Economic and Financial Review, Third Quarter 1953', Microfilm, Section c-2, 16 May 1954. On the Kubitscheck's use of this agreements to press for more US support see G. Moura, Sucessos e Ilusões, pp. 38-39.

dramatic increase in the rate of investment in infrastructure and basic industries. The scale of the investment effort was necessarily beyond the possibilities of foreign and domestic private capital. Therefore, massive inflows of public funds would be a *sine qua non* for the success of the development drive ¹. This enhanced levels of public financing ought to be complemented with other measures to be taken both in developing and developed countries. They comprised most of the Latin America early demands to the USA: the stabilisation of the Latin America export markets through commodity agreements; the promotion of economic integration in Latin America; technical cooperation and the creation of a propitious environment for foreign private investment.

II.2 Latin America in Brazil's Foreign Policy

When the OPA was launched the Eisenhower Administration was especially sensitive to the Latin American situation as a result of Milton Eisenhower's reports over his 'finding trips' in the region. Still of more impact was the hostility that plagued Vice-President Nixon's visit to Latin America in May 1958 ². In November 1958 a Special Commission of the

¹ See in particular J. Kubitschek, Kubitschek, pp. 81-88.

² Nixon had to flee from Caracas after violent street demonstrations. For an account of the incident, cf. M.S. Eisenhower, The Wine is Bitter: The United States and Latin America (New York, 1963), pp. 211-12. As a form of placating the discontent that appeared to have become so widespread in Latin America, the USA eventually decided to accept the creation of a regional development institution - the Inter-American Development

Organisation of the American States (OAS) was created, the so-called 'Committee of the Twenty One', in charge of implementing the OPA. However, the initial diplomatic success of the initiative was overshadowed by the subsequent failure of the USA to take effective action. This was already crystal clear in November 1956. President Kubitscheck spoke of his disappointment with the 'lack of interest in Brazil and Latin America in general' shown by the USA, in a speech given at the American Chamber of Commerce in Rio de Janeiro ¹. New attempts at reviving the initiative were made by Kubitscheck, the last of which through a new letter to Eisenhower in July 1959, with no success ².

Concurrently, Latin America grew in importance in the formulation of Brazil's external policy. There was a shift from a firm opposition to regional blocs - that had characterized the 'special relationship' era - towards a favourable stance on economic integration. At least three factors seem to account for this new Brazilian perspective. First, as mentioned, Brazil was searching for a new foreign

Bank, IDB - in August 1958. However, if the Eisenhower administration was already sensitive about the need of a fresh approach to Latin America, the event that effectively prompted the acceptance of the IDB was the creation of a regional bank for development in the Middle East, which rendered unsustainable the refusal to create a similar institution in Latin America. Cf. S. Dell, The Inter-American Development Bank: A Study in Development and Financing (New York, 1972), pp. 28-30.

¹ Cf. FO 371 139075, AB1021/2, Confidential, November 20th 1956.

² Cf. letter from Kubitschek to Eisenhower, CPDOC BDE 60.07.19, code 1, Brasilia, 19 June 1960. At that moment the USA was in fact already studying a new approach to Latin America.

policy after the exhaustion of the 'special relationship'. In the speech given at the Superior War School Kubitschek observed that Brazil had been 'aloof from the world and even from Latin America'. A new international role for Brazil was expected to come from 'assuming' Brazil's Latin American identity ¹. Secondly, Brazil had developed an industrial basis and technological skills that allowed her to play a much more active role at the commercial and technological level than in the past. The idea of looking at Latin America for more 'mutual aid', while expecting less from the USA, entailed the realisation that Brazil was then placed in a favourable position to reap the benefits of more trade and cooperation in Latin America ². In effect, Brazil approached small neighbouring countries like Uruguay, Paraguay and Bolivia in order to reach agreements on economic cooperation ³. Last but not least, Brazil felt confident about the

¹ Cf. J. Kubitschek, Kubitschek, p. 81.

² Commenting on a conversation held with Itamaraty's Political Director, a British diplomat concluded that 'the Brazilians believed that a lot could be done by the use of soft currencies like the cruzeiro and the peso and by a rational deployment of the technical know-how which some of the Latin America countries now possess. Brazil herself is one best placed in this respect'. Cf. FO 371 139075 AB 1021/2, Confidential, 20 November 1959.

³ Both Kubitschek and Foreign Minister Horacio Lafer spoke about bringing these countries within Brazil's 'commercial orbit' and 'Brazilian leadership' in the region. These statements were made at a press conference in Peru, at the end of a Latin American trip that included Uruguay, Paraguay and Chile. Cf. FO 371 126224 AB 1042/1, Restricted, 6 December 1957. As mentioned, this more aggressive export approach towards Latin America received the support of the Brazilian industrialists. Already in 1956, they had asked former Foreign Minister Macedo Soares 'for the adoption, with respect to South American countries, where the possibilities of an expansion of manufactured exports are higher, of a more realistic and economically oriented policy' (author's

possibility of becoming a regional leader. At that time, her main competitor, Argentina, was beset by economic and political disarray, which prevented this country from playing a more active role in regional politics ¹.

In sum, the combination of three factors encouraged Brazil to seek new opportunities in regional affairs. First, the need to find a new international role for the country. Secondly, the opportunity to use more extensively Brazil's new industrial and technological capabilities. Thirdly, the relative retreat of Argentina, which facilitated Brazilian leadership in the region. Like Argentina in the forties, the relatively more advanced position achieved by Brazil at a regional level, and her dissatisfaction with the support received from centre countries, made her more inclined to play an active role in regional affairs.

II.3. The 'New Foreign Policy'

These new trends in Brazil's foreign policy would experience further developments in the period 1960-1964,

translation). Cf. BI, vol. XXXVIII, no. 394 (22 April 1957), p. 107.

¹ The British Ambassador in Rio observed that Brazil's new role had 'been made considerably easier by the setback suffered by Argentina as a result of the debacle of the Perón's regime' and because Brazil had 'an excellent and much reputed foreign service'. Cf. FO 371 126224 AB1042/1, 6 December 1957, handwritten comments of Ambassador Harrison. On the characteristics of the Brazilian foreign service that made it a highly professionalised institution, relatively isolated from political pressure, see C. Barros, 'The Formulation and Implementation of Brazilian Foreign Policy: Itamaraty and the New Actors', in H. Muñoz and J.S. Tulchin, Latin American nations in world politics (Boulder, 1984).

during the Janio Quadros and João Goulart presidencies, when Brazil embraced the so-called 'Independent' or 'New Foreign Policy'. The Kubitschek government could be seen as a transitional stage in which the new policy was taking shape in a still hesitant fashion ¹. The 'New Foreign Policy' was meant to represent a decisive step in the direction of expanding Brazil's international role through a 'developmentalist' alliance with the countries emerging from decolonisation in Africa and Asia. The policy was an expression of the breaches that had already appeared in the rigid bipolarism of the fifties ². The expansion of the developmentalist alliance should rely on close cooperation within Latin America, and especially between Brazil and Argentina. An ambitious agreement was then signed by Presidents Frondizi and Quadros in order to coordinate foreign policy, as will be analyzed in section III.1. It was believed that this could place countries like Brazil in the position of intermediary between the developed countries and the new independent states. The 'New Foreign Policy' could be seen as a reformulation, now in a world stage, of the 'buffer' strategy already tried by Vargas in the forties with respect to the USA and Argentina. In addition, it also reflected the progress of industrialisation in Brazil, which

¹ Cf. G. Moura, 'Avanços e Recuos: A Política Exterior de JK', in A. Castro Gomes (ed.), O Brasil de JK (Rio de Janeiro, 1991), p. 22. This was particularly evident as regards Brazil's policy towards Africa, in which Brazil hesitated between giving support to the independence forces or preserving her traditional links with Portugal.

² For an analysis of Quadros' foreign policy see P. Malan, 'Relações Econômicas Internacionais', pp. 94-99.

prompted her to look for trade opportunities in emerging peripheral markets.

Although the 'New Foreign Policy' seems a natural development of the policy initiated by Kubitschek, it is difficult to assess whether it was a viable strategy in the context of the early sixties. In particular, the adverse circumstances created by the Cuban revolution for an 'autonomist' foreign policy suggest that this was perhaps a too idealistic move. The Cuban Revolution had led to a broad reformulation of US policies which seemed to represent a late victory of the OPA, but this change was ambiguous. On one hand, the 'Alliance for Progress', launched by President Kennedy in March 1961, did favour reformist efforts in the short term and gave support to the recently created LAFTA¹. On the other hand, the 'Alliance for Progress' was embedded in a security strategy which became dominant. A. Lowenthal has observed that the combination of support for social reforms and the 'modernising' role expected from the military was contradictory and likely to fail². This provided an awkward environment for the 'New Foreign Policy'. However, this cannot be interpreted just as unrealistic move that had no support in current trends in

¹ Although by the end of the fifties the USA was already considering a change in policy towards Latin America, the Cuban Revolution was the catalyst for action. The 'Alliance for Progress' sought to combine social and economic reform (including economic assistance and planning) with a more active role of the army in civic action and counter-insurgency. This was seen as a form of eliminating the roots of discontent and political unrest. Cf. J. Tulchin, Argentina and the United States, p. 123.

² Cf. A. Lowenthal, Patterns in Conflict: The United States and Latin America (Baltimore, 1986), pp. 29-30,

Latin America and in the international system ¹. The fact that a 'conservative' brand of this policy would be adopted by the mid-seventies by Brazil's military government suggests that there were long term trends at work. Industrialisation, to which developmentalism gave a substantial impulse, had transformed the economic basis of the country and Brazil's perceptions about the role that she could play in the international system.

II.4. Conclusions

Looking at the whole period 1939-60, at least three different stages in the evolution of Brazil's foreign policy can be identified. Between 1939-55, the emphasis was placed on the 'special relationship' with the USA. At this stage, Argentine-Brazilian relations were limited by regional rivalry and the conflict between the USA and Argentina. In the period 1956-60, however, Brazil turned towards Latin America with the aim of leading a regional bloc which could negotiate more favourable terms of economic cooperation with the USA. This was prompted by Brazil's understanding that her former position in the continent had been lost and by the shared perception in Argentina and Brazil that they had been neglected by the USA. Finally, the autonomist stance initiated by Kubitscheck was extended in 1960-63 so as to

¹ LAFTA had also been depicted as an idealistic approach with little basis in the real world. It will be argued in this chapter that this view underestimates the role of structural change in this period and the 'learning' of the early post-war period.

include the emerging states of Africa and Asia in the developmentalist alliance. Argentina and Brazil expected to increase their international role as buffer states and leaders of the developing countries.

Thus, there was a continuum in which regional rivalry lost ground in favour of cooperation for enhancing the region's bargaining power in the international system. Argentina increased her role in Brazil's foreign policy along this continuum, and the divergent interests that had prevented closer cooperation in the past faded. ECLA's proposals for regional integration would find a much more conducive context in the late fifties than that found by Pinedo-Aranha in the early forties and by Perón-Vargas in the early fifties.

III. 'DEVELOPMENTALISM' AND ARGENTINE-BRAZILIAN COOPERATION

III.1. Foreign Policy Convergence and the Uruguayana Meeting

The ousting of Perón and the taking office of a new Government in September 1955 fully reinserted Argentina in Washington's mainstream directions in international affairs -although, as mentioned, a rapprochement was already well under way during the last three years of the Peronist era ¹.

¹ In fact, it seems that the USA feared that if Perón was ousted and the Radical Party reached the Government, the Argentine approach towards foreign investments in the oil sector would become stricter than in Perón's final years in government. In effect, after the coup (and despite the burden placed by oil

But this did not mean the end of political conflict in Argentina. The 'Provisional Government' (September 1955 - March 1958), which emerged from the so-called "Liberating Revolution", could not avoid recurrent economic and political instability. This constrained the ability of Argentina to adopt new foreign policy initiatives, although some measures were adopted with a view to liberalizing controls on foreign trade ¹. It was during the presidency of Arturo Frondizi (March 1958-March 1963) that a developmentalist strategy was adopted, setting new priorities for Argentine foreign policy.

Frondizi's developmentalist policy largely converged with that of Kubitschek in Brazil. The close identification between the two countries, stemming from their common developmentalist goals and democratic regimes, led to one of the most remarkable periods of cooperation in the region ².

imports on the balance of payments). General Aramburu would not open this sector to foreign capital. Argentine request of Eximbank credits for the construction of oil pipelines were in turn declined by the USA, as it was considered that 'ample private capital was available for petroleum exploration and exploitation in Argentina'. Cf. US Department of State, 'Ambassador Dinner Conversation with President Aramburu', 611.35/2-1756, Desp. no. 642, 17 February 1956, Argentina: Internal Affairs, Microfilm. Cf. also FO 371 119917, 31 July 1956, Restricted.

¹ The most significant initiatives were the dismantling of the Institute for the Promotion of Exchange (IAPI), the joining of the Paris Club with a view to 'multilateralize' payments with Europe (see also next chapter), and the application for membership to the International Monetary Fund. Cf. R. Mallon and J. Sourrouille, Política Económica, pp. 14-17.

² Like Kubitschek, Frondizi counted on the political asset of being a democratic, reformist President who claimed to represent a new generation of statesmen seriously concerned with social and economic progress in Latin America. He also presented Argentina as an example of the democratic path towards

Although in some moments policies diverged - as in the case of the different attitude adopted by Frondizi and Kubitschek respecting the application of the IMF austerity programmes in 1959¹ - cooperation prevailed in most of the period. Both countries embraced the idea that foreign policy should be put to the service of development goals. Both countries sought political support and trade in Africa and Asia². Both

development, at variance with the socialist path adopted by Cuba. Cf. R. Frigerio, El Desarrollo Argentino y la Comunidad Americana: Conferencias en Universidades de Estados Unidos (Buenos Aires, 1959), especially chapter I.

¹ While in June 1959 Frondizi adopted a severe stabilisation plan that led the economy to an extremely deep recession, Kubitschek decided to continue his ambitious programme of investments, as proposed in the 'Targets Plan' ('Plano de Metas') for the expansion of basic industries and infrastructure. The aim was to sustain the momentum of growth and keep cohered the political coalition that supported the government, despite of its consequences on inflation. Cf. Benevides, M.V., O Governo Kubitschek: Desenvolvimento Econômico e Estabilidade Política, 1956-61 (Rio de Janeiro, 1976), pp. 222-223. See also L. Sola, 'The Political and Ideological Constraints to Economic Management in Brazil (1945-63)', D.Phil Thesis, Oxford University, 1982, chapter III. This would lead Brazil to break relations with the IMF in June 1959. The 'contagious' implications of the Brazilian attitude concerned the USA, which was therefore keen to show support to Argentina and point out her dissatisfaction with Brazil's monetary mismanagement. An US observer considered that the 'contrasting experiences of Government of Argentina and Government of Brazil involve one of the most important problems confronting us in the continent'. Cf. Department of State Central Files, Confidential, 835.1016-1559, no. 1977, June 15 1959, Argentina: Internal Affairs, Microfilm. Concurrently, a British diplomat praised Argentina for remaining 'ostentatiously virtuous' before alleged Brazilian attempts to convince the Argentines to stand with Brazil 'in defiance of the IMF'. Cf. FO 371 139009, 3 December 1959. These comments were made in reference to the alleged motives of the visit to Argentina of Brazilian Foreign Minister Horacio Lafer from the 23rd to 27th of November 1959.

² Frondizi paid a visit to India in 1960. An Argentina commercial mission, with a 'promotional' objective, visited Morocco, Senegal, Guinea, Ghana, South Africa, and the United Arab Republic at the beginning of 1962. Cf. FO 371 162090, 26 February 1962.

countries insistently argued that economic cooperation had been unduly disregarded in the design and operation of the inter-American system ¹. Both countries underlined that security in the Western World ought to be related to large scale economic support for development in Latin America. The OPA received full support from Argentina - after some hesitation rendered by the fact that Brazil launched the initiative without previous consultation with other Latin American countries. Argentina publicly demanded a satisfactory response to the OPA. As early as December 1958 Foreign Affairs Minister Carlos Florit expressed his scepticism about the achievements reached so far by the Committee of the Twenty-One. He then strongly urged a revitalisation of the initiative of President Kubitschek ².

As a result of this convergence, in the early sixties Argentina and Brazil sought to establish a more systematic

¹ Argentina shared the widespread view that Latin America had been marginalised. The formation of the OECD was seen as an attempt to set up an 'economic OTAN' with negative consequences for the region. Cf. Arturo Frondizi Personal Archives, Centro de Estudios Nacionales (thereafter AF-CEN), 'Memorandum from Mr. Arnaldo T. Musich to the Foreign Relations Ministry, Arturo Frondizi Personal: Una NATO Económica', Carpeta 91, no. 1, Política Internacional, Folio 31, non dated.

² Cf. República Argentina, Ministerio de Relaciones Exteriores y Culto, 'Conferencia de Prensa de S.E. el Sr. Ministro Dr. Carlos A. Florit', unpublsh., Buenos Aires, December 1958. This convergence was also stressed by Brazilian diplomats, who observed that in the past there was a 'tendency to accept sporadic aid and assistance as a generous favour of the USA. Still, there is a growing awareness in some countries, like in Argentina, that development in Latin America would only come if it is organised and planned with enough external support' (author's translation). Cf. CDO, 'Instruções para a Delegação Brasileira a III Sessão da Comissão Especial para Formular Novas Medidas de Cooperação Econômica', STAP/DAM/Dur/8-1960-3, Confidential, 31 August 1960.

pattern of consultation and coordination with each other in international affairs. This was a clear aim set forth tentatively by Frondizi and Kubitscheck, which Frondizi and Quadros would consolidate and extend after 1960. A landmark was the meeting of Frondizi and Quadros at Uruguayana, a town on the border between Argentina and Brazil, between April 20th and April 22nd of 1961. The 'Uruguayana Declaration' was then issued, in which both countries declared their intention to strengthen economic and political cooperation. The 'Agreement of Consultation and Exchange of Information' was also signed on this occasion. It was meant to provide for systematic consultation in international matters at presidential level so as to establish 'a definite and formal strengthening of the links between the two countries' ¹. The countries agreed to join forces in negotiations with international institutions and to lend full support to the 'Alliance for Progress'. They also analyzed problems of bilateral trade and economic cooperation ².

¹ Cf. FO 371 155829 AA 10310612, 3 May 1961. This document also highlights the continuity of this agreement with previous initiatives made during Kubitschek presidency. Thus, it was noticed that 'President Frondizi put forward a draft Treaty of Friendship and Consultation, reportedly modelled on a document agreed last year between Sr. Lafer, the last Minister of Foreign Affairs of the Kubitschek government, and Sr. Taboada, then Argentine Minister for Foreign Affairs. Under this Treaty (...) the two countries will (...) undertake to consult each other, at presidential level, before determining their respective attitudes to major international problems'.

² The cooperative utilisation of the hydroelectric energy potential of the 'Sete Quedas' falls on the Parana River was also agreed, a point that both countries failed to push forward later and which would embitter bilateral relations in the sixties and seventies. Cf. A. Lanus, Política Exterior Argentina, p. 296.

If differences of emphasis were still visible in Uruguayana ¹, the meeting marked a very high point in bilateral cooperation. From mutual suspicions in the forties, Argentina and Brazil agreed to coordinate foreign policy in the early sixties. Such a level of understanding would not be reached again until the mid-eighties. Moreover, cooperation continued after the resignation of Janio Quadros in October 1960. On a brief meeting in Rio de Janeiro in September 1961, Frondizi and Goulart reaffirmed the validity of the Uruguayana declaration. It was then clear that 'the main lines of Brazil's foreign policy will continue to be those laid down by Sr. Quadros', but without his 'theatrical gestures'. Moreover, it was suggested that 'Dr. San Thiago Dantas' aim is to professionalise the new and more independent foreign policy of Brazil' ². When he visited Buenos Aires in November 1961, Foreign Minister San Thiago Dantas reaffirmed the importance of Argentine-Brazilian collaboration in the progress of economic integration in Latin America. In a speech at the National Academy of Law, Dantas observed that

'both Brazil and Argentina are in the process of industrial

¹ Frondizi privileged the obtention of economic assistance from the USA while Quadros insisted on the quest for higher autonomy. Frondizi considered that it was unrealistic to emphasise divergences with the USA, as both countries then badly needed financial assistance. Cf. A. Lanús, Política Exterior Argentina, pp. 289-296, on this point.

² Cf. 371 155829 AA 103106/6, 26 September 1961.

and agricultural development. They have much to offer to each other and together they form a solid nucleus for the Latin American common market. This is an important reason why the two countries should cooperate more closely' ¹.

In sum, the late fifties-early sixties was a period of remarkable convergence between Argentina and Brazil in the external front, leading to a steady increase in cooperation. This culminated with an agreement for the coordination of external policy in April 1961. This approach, initiated by Kubitschek and developed by Quadros, was continued by Goulart after Quadro's resignation.

III.2. The Persistence of Rivalry

Some difficulties remained, however, and elements of rivalry were still present. If these elements were relatively controlled in 1955-61 and did not hinder cooperation, they contribute to understand why rivalry re-emerged in the second half of the sixties.

In effect, the ambitions of regional leadership had not been completely abandoned. The reinvigorated Brazilian interest in Latin America concerned the Argentines, who feared to be placed in a secondary position in regional politics ². This was particularly challenging, given

¹ Cf. FO 371 155829 AA 103106/4, 14 November 1961.

² The agreements reached by Argentina with Uruguay, respecting the hydroelectric exploration of the Uruguay river (Salto Grande), and with Paraguay, on the Parana River (Salto de

Argentina's outstanding role in regional politics in the past. The remembrances of past friction could not be immediately dissipated. This was furthered by the newly industrial capabilities that Brazil had developed. Fears that Brazil would dominate industrial production and Argentina retreat to agrarian specialisation were significant ¹. Frondizi made it clear on several occasions that national development programmes should have priority over regional programmes ². The goal of forming a Latin America common market, he argued, 'should be necessarily preceded by a process of national integration within each country' ³. At least some circles in the Argentine government

Apípe), were suggested to 'reveal the Argentine quest for a leadership role in Latin America'. Cf. FO 371 139008 AA 1021, 2 January 1959. Similar comments were made respecting Frondizi's visit to Bolivia in June 1961. Cf. FO 371 155827 AA 1021/3, 22 June 1961. Another element that evidences the persistence of competition in the region was the attitude of Argentina and Brazil towards political conflict in Paraguay. They interfered in the Paraguayan conflict by providing arms and logistic assistance to the contending parties, namely the Paraguayan dictator Alfredo Stroessner, who received Brazilian support, and the febrerista rebels, supported by the Argentines. The involvement was in a very limited scale, but revealed the permanence of rivalry in the bilateral relation. See L.A. Moniz Bandeira, Estado Nacional, chapter 8, on this point.

¹ Rogelio Frigerio, former adviser to President Frondizi, interview, Buenos Aires, 27 October 1993. On the Argentine concerns with Brazil's industrial competition see R. Frigerio, La Integración Regional: Instrumento del Monopolio (Buenos Aires, 1968).

² Cf. 'Discurso Ante el Congreso de Uruguay', Montevideo, 7 April 1958; 'Discurso en el Congreso del Paraguay', Asunción, 30 October 1958; 'Discurso en la Cancillería del Brasil', Rio de Janeiro, 9 April 1958. These speeches are collected in A. Frondizi, La Política Exterior Argentina (Buenos Aires, 1963).

³ Cf. A. Frondizi, Política Exterior, p. 39 (author's translation).

still regarded Brazil as vitally interested in containing the process of development in Argentina and considered that Brazil's conflict with the USA would strengthen the Argentina's role in the region ¹.

In turn, Brazil felt unease at the Argentine rapprochement with the USA. As stated by Luis Bastian Pinto, a Brazilian diplomat in Buenos Aires:

'with her attention directed to the dollar area, in a phase of intense collaboration with and growing dependence on the USA, Argentina - which in the past was the champion of multilateral solutions and adopted an attitude of independence - now seems to incline towards bilateralism through a rapprochement with Washington. (...) To some extent there was an inversion of the basic positions of Brazil and Argentina. Argentina seeks to play the role that Brazil traditionally played in the past, namely that of

¹ Rogelio Frigerio, interview. This perspective also appears in documents of the period. Thus, for instance, a secret Memorandum for the Secretary of Liaison and Coordination of the Argentine government containing the 'keys for understanding the current international situation of Argentina' and intended to serve as an outline for discussions with the military, offers the following assessment: 'Brazil, given her current economic crisis, fears the rapprochement of the Argentine with the USA because that could reduce the financial help in dollars that she needs (...). But, fundamentally, because the Argentine development means the recovery for our country of her mentor role in Latin America and the victory of the River Plate Basin over that of the Amazon and the coastal Rio-Santos axis' (author's translation). Cf. AF-CEN, 'Secretaría de Enlace y Coordinación: Apuntes Muy Breves Sobre una Clave Internacional del Actual Momento Argentino', Memorandum, Secret, Carpeta 91, no.1, Folio 5, Buenos Aires, 17 November 1959.

conciliator between Washington and Latin America' ¹.

Thus, competition for influence and expectations about special support from the USA (now from the Argentine side) were still present and this probably facilitated the subsequent reversal of cooperation.

III.3. The Lack of Political Consensus in Argentina

Despite the interest of President Frondizi in coordinating policies with Brazil, Janio Quadros 'neutralist' positions raised resistances in Argentina and Frondizi had to consider the reaction of the military ². The Uruguayana meeting was heavily criticized in Argentina as a dangerous move in foreign policy ³. In this there was too an inversion of positions between Argentina and Brazil. In 1951-53, the opposition to Vargas tried to block cooperation between Vargas and Perón. In 1960-62, it was the opposition

¹ CDO, 'Embaixada de Buenos Aires, Ofícios 1957-59, XI Conferencia Inter-Americana: Asuntos Econômicos, Posição Argentina', N.1128, Confidential, 29 december 1959 (author's translation).

² Cf. R.A. Potash, The Army and Politics in Argentina, p. 336.

³ Paradoxically enough, while the Argentine press and the military criticized Frondizi's alignment with the 'irresponsible' attitudes of President Quadros, in Brazil and in diplomatic circles it was believed that Quadros had obtained great benefit from Frondizi's 'experience' and 'moderation' in international affairs. This clearly emerges from the conversation between the British Ambassador in Rio, Wallinger, and the Argentine Ambassador, Muniz (cf. FO371 155829 A103106/3, Confidential, 2 May 1961).

to Frondizi that objected closer cooperation with Brazil. Like Vargas, Frondizi faced a complex domestic situation and his room for manoeuvre was reduced. Frondizi had to endure an hostile surveillance of his foreign policy, where his rivals saw a failure to uphold international responsibilities as they understood them.

The anti-communist ideology of the military, for whom the boundaries between an 'autonomist' and a 'pro-communist' policy were not clear, made foreign policy still more complicated. The military had become an increasingly powerful actor based on the ideology of the Cold War. If foreign policy had never attracted domestic consensus in Latin America, the Cold War made this a still a more divisive and destabilising issue ¹. It was an issue which could be used to mobilise the opinion of the USA and the military in support of domestic political groups and the governments of Frondizi and Quadros-Goulart were weakened by this. Therefore, at variance with the European case, in Latin America the Cold war contributed to weaken rather than

¹ Although the main factors behind the ousting of Frondizi by the military in 1962 seem to have been principally related to the advance of Peronism in the provincial elections and the unveiling of the pact between Frondizi and Perón, the disastrous manner in which Frondizi managed his foreign policy with respect to Cuba also made a significant contribution to weaken his government. In particular, his secret meeting with Cuban Minister Ernesto Guevara led to a major crisis between the President and the military - still more serious than that provoked in Brazil by the alleged pact between Perón and Vargas in 1954. Cf. R.A. Potash, The Army and Politics in Argentina, p. 345-351. See also A. Conil Paz and G. Ferrari, Política Exterior Argentina, p. 211. This was added to the insatisfaction provoked by Frondizi's refusal to support the expulsion of Cuba from the OAS in December 1961 (a position also adopted by Bolivia, Brazil, Chile and Ecuador).

to foster regional cooperation.

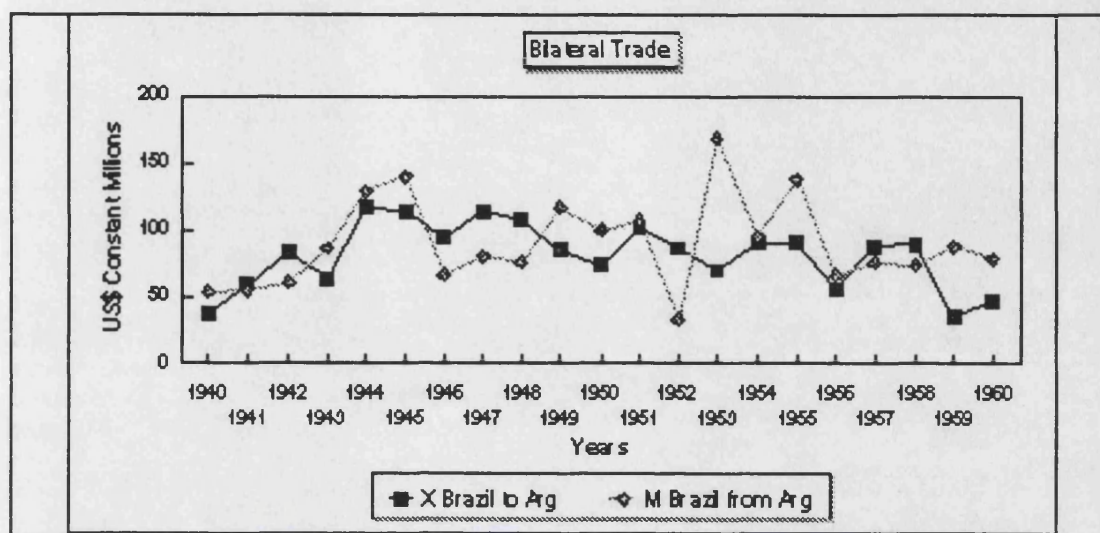
IV. THE NEW STAGE OF IMPORT-SUBSTITUTING INDUSTRIALISATION AND REGIONAL COOPERATION

From the point of view of regional trade, the period 1955-60 was dominated by two trends. On the one hand, bilateral trade fell, adding to the external difficulties of Argentina and Brazil. On the other, both countries went through rapid structural change on the basis of the implantation of new industrial sectors. This resulted in a strong incentive to reshape bilateral agreements.

IV.1. The Loss of Dynamism of Regional Trade

In the previous chapter it was shown that bilateral trade lost dynamism after the end of the War. This became more pronounced in the second half of the fifties, when total trade in constant dollars fell from an average of US\$ 211.8 millions in the biennium 1953-54 to an average of US\$ 149.9 millions in the biennium 1959-60 - a fall of about 30 %. Tables III.3 and graph IV.1 show these trends in bilateral trade.

GRAPH IV.1. Bilateral Trade Argentina-Brazil^{1/}
(In millions of constant US\$ dollars of 1948-50)



Source: Cf. Table III.3.

Brazil's exports to Argentina fell at a rate of minus 13.2 % annually in 1955-60. This record was worse than that of 1951-55, when exports to Argentina fell at a rate of minus 1.9 % annually. The Argentine export performance was dismal too. The rate of growth of Argentine exports to Brazil was minus 5.6 % in 1955-60. Although the fall of exports was less marked than that of Brazil, it compares badly with the period 1951-55 (when exports grew at a positive 4.7 %). As a result, the importance of Argentina and Brazil as markets for their reciprocal exports fell, as can be seen in table IV.3.

TABLE IV.3
BILATERAL TRADE IN TOTAL TRADE, 1955-60
(In Percentage)

Brazil: participation of Argentina in total exports and imports

Year	Exports	Imports
1955	7.0	11.6
1956	4.4	6.2
1957	7.4	6.0
1958	8.6	6.5
1959	3.4	7.6
1960	4.4	6.5
Average		
1956-60	5.6	6.6
Average		
1951-55	6.3	6.9

Argentina: participation of Brazil in total exports and imports

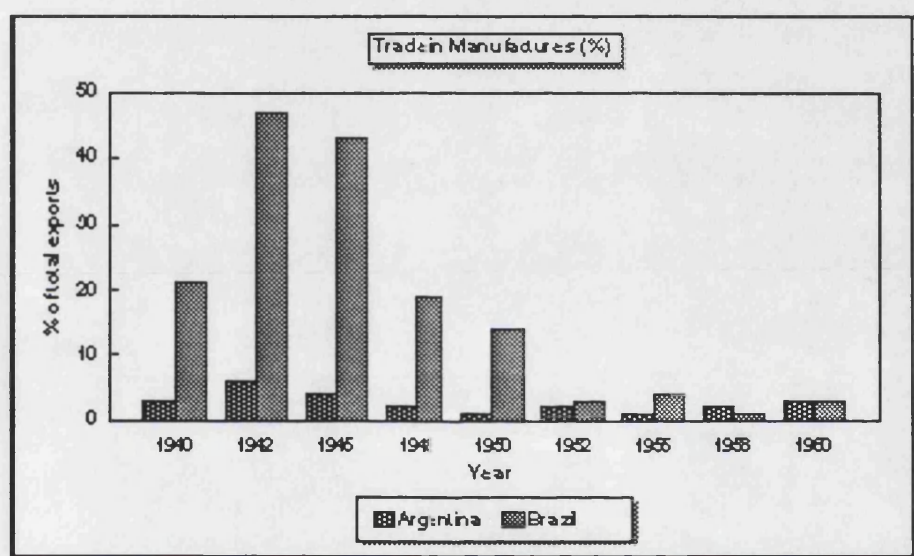
Year	Exports	Imports
1955	17.9	14.0
1956	8.2	10.6
1957	9.2	13.3
1958	9.2	14.3
1959	10.3	7.7
1960	9.2	6.4
Average		
1956-60	9.2	10.4
Average		
1951-55	11.2	10.4

Sources: Cf. Tables III.1.A and III.1.B.

The fall in total trade was accompanied by a restructuring of trade towards primary goods, as can be seen in graph IV.2 This was a trend of post-war years that continued in the late fifties. It is remarkable the fall of manufactured exports by Brazil. If Brazil managed to export some new industrial goods after 1955, especially railway

equipment¹, these items did not represent a significant part of actual bilateral trade and its structure continued to present a low degree of diversification.

GRAPH IV.2. Trade In Manufactures
(In percentage of total exports)



Source: Cf. Table IV.6.

Several factors explain the poor performance of bilateral trade after 1955. Two of them will be highlighted in this work, namely (i) the effect of the trade and exchange reforms applied in 1956 and 1959 in Argentina and

¹ Brazil exported railway equipment to Argentina for a value of about US\$ 3 millions of dollars in 1955 and US\$ 1 million of dollars in 1956 (which represented 89 % and 41 %, respectively, of the total exports of the item 'Machinery, Transport Equipment and Accessories'). Cf. IBGE, *Anuario Estatístico do Brasil* (Rio de Janeiro, various years). However, these exports subsequently fell. They reached only US\$ 350 thousands of dollars in 1958 and were almost zero in 1957, 1959 and 1960.

in 1958 in Brazil, which increased the instability of the economy; (ii) the fact that the second half of the fifties was a transitional period in which previous bilateral trade agreements became less effective. These factors will be addressed in detail in the next chapter.

In sum, the evolution of bilateral trade in 1956-60 did not contribute to alleviate the external situation of Argentina and Brazil. It indicated that existing mechanisms for encouraging trade were not working effectively. The combination of this negative signal with the stimulus provided by rapid transformation in the industry would prompt new forms of cooperation in the late fifties.

IV.2. Structural Change in the Domestic Economy and Economic Integration

(a) Structural Change, Increasing Returns to Scale and Regional Integration

The 1956-60 period was characterized by a new phase in the process of import-substituting industrialisation, the ISI-2 phase, based on a set of new capital-intensive industries, in which technology was more sophisticated and increasing returns to scale were more significant ¹. This represented a transformation of the pattern of 'horizontal'

¹ Clearly, the process of industrial transformation did not begin in the late fifties, and some metal-mechanical and chemical industries were already expanding in the forties. However, this process suffered a rapid acceleration since 1955.

industrialisation of the previous period, the ISI-1, which was based on the production of labour-intensive, technologically simple light consumer goods. The leading sectors of ISI-2 were consumer durable goods, transport equipment, chemicals and capital goods, with an outstanding role for the automobile and associated industries. These sectors gained participation in the industrial structure at expense of traditional industries like textiles, food and beverage. The participation of the chemical, electrical and metal-mechanical sectors in total industrial production increased in Brazil from 10.5 % in 1949 to 22 % in 1959 and in Argentina from 22.7% (average 1948-50) to 35 % (average 1959-61) (cf. tables III.9.A and III.9.B).

The ISI-2 phase reshaped the costs and benefits of economic integration. To understand how this occurred, it is convenient to first restate the hypotheses suggested in chapter I in the light of the transformations that occurred in the late fifties. Evidence in favour of these hypotheses will be subsequently presented in the sub-sections (a) and (b).

To begin with, the diversification of the industrial structure opened new opportunities for regional trade which, it can be argued, industrialists were interested in exploring. The implantation of new sectors implied overcoming supply constraints on regional trade. Domestic production became more similar to the import structure in Argentina and Brazil, and therefore more able to produce the goods whose demand grew steadily in both countries, namely

intermediate and capital goods. Concurrently, the importance acquired by static and dynamic economies of scale in the ISI-2 affected the links between protection, industrial efficiency, the size of the market and trade. The gains from trade and specialisation, and therefore the benefits of the creation of a regional market, were higher in the presence of increasing returns to scale. Conversely, the costs of protection increased. If the role of the regional market in achieving economies of scale had already been perceived by Pinedo in 1940, the argument carried still more weight in the late fifties. Finally, increasing returns to scale and overlapping structures of demand and production in both countries created new opportunities for intra-industry trade. Although in 1956-60 it was too early for these opportunities to be reflected in the structure of trade, the potential for intra-industry trade substantially increased. This can be expected to make trade more attractive in the new sectors, as the costs of adjustment would be reduced and so the power implications of industrial specialisation ¹.

Figure 1, elaborated from the North-South trade diagram proposed by Bollino and Padoan ², illustrates the gains that a regional market can offer in the presence of increasing

¹ As intra-industry implies transferring resources between similar activities, adjustment to trade is easier. In addition, intra-industry trade mollifies concerns about security by reducing the vulnerability of the countries to an unilateral suspension of trade. See chapter I on these points.

² Cf. C.A. Bollino and P.C. Padoan, 'Growth and Specialisation in an Enlarged Europe: Is a virtuous Circle Possible?', Revista di Politica Economica, vol. LXXXII, no. 12 (1992), pp. 267-285.

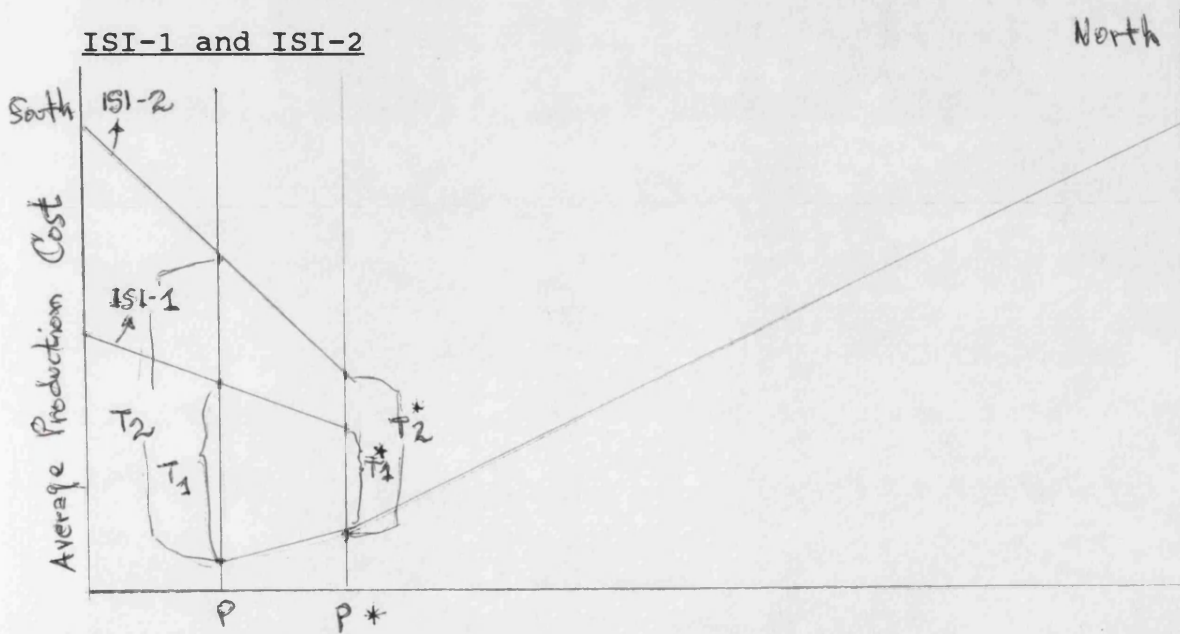
returns to scale. Assuming, for the sake of simplicity, that average total costs depends only on the volume of production, then North countries will enjoy a competitive advantage respecting the South. This stems from an earlier start at industrialisation, which allowed the North to preempt the international market for industrial goods ¹. In the ISI-1 phase of industrialisation, the South gives to its industry a level of protection equal to T1 in order to compensate for the initial North-South asymmetry in the production of light manufactures. As in these industries economies of scale are less significant, and labour costs and natural resources (factors which are generally more abundant in the South) represent a large proportion of total costs, then protection can be expected to be small ². However, when South production moves towards more complex industrial goods, in the ISI-2 phase of industrialisation, cost differences between North and South grow, as increasing returns to scale become more significant (and so does the initial North-South asymmetry of costs and market shares). Hence, protection has to be set now at the higher T2 level. In order to reduce the inefficiency that this implies, a group of South countries may be encouraged to create a free trade area. This allows them to increase industrial

¹ Such a result is consistent with the ECLA and 'new trade theory' presented in chapter I.

² In some cases, the South can export ISI-1 goods to centre economies and T1 would be zero or even negative. Hence the diagram only applies for industries protected and oriented to the internal market, which was the case of most industrial production after the war.

production from P to P^* , and thereby reduce protection from T_1 to T_1^* (ISI-1) and from T_2 to T_2^* (ISI-2). Clearly, as the slope of the total cost curve is higher in the ISI-2 phase than in the ISI-1 phase, the fall in the levels of protection allowed by an increase in production will be higher in the ISI-2 than in the ISI-1 phase, and so will the incentive to integrate ¹.

FIGURE I. The Regional Market and Industrial Protection in ISI-1 and ISI-2



¹ Formally, returns to scale in the ISI-1 and ISI-2 phases, respectively, can be expressed as $\Psi_1(w,x) = [C_1(w,x)/x] [dC_1(w,x)/dx]$ and $\Psi_2 = [C_2(w,x)/x] [dC_2(w,x)/dx]$, where w is a vector of input costs, x is the volume of production and C is the total costs curve. As mentioned, since Ψ is the inverse of the elasticity of the costs curve with respect to production, $\Psi > 1$ implies increasing returns to scale. In other words, increasing returns implies that the marginal cost curve is below the average cost curve and hence the latter is falling with production. The argument that increasing returns to scale are higher in ISI-1 than in ISI-2 amounts to say that $\Psi_2 > \Psi_1 > 1$. Cf. E. Helpman, 'Increasing Returns, Imperfect Markets and Trade Theory', in R.W. Jones and P.B. Kenen, Handbook of International Economics, vol. I (North Holland, 1984), p. 328. In this work, the concepts of economies of scale and increasing returns to scale will be used as synonyms, by assuming that the production functions are homotetic.

The rest of this section concerns itself with the study of the implications of ISI-2 for regional cooperation and is intended to provide historical and statistical evidence for the hypotheses presented above. First, the hypotheses that increasing returns to scale played a more substantial role in the ISI-2 than in the ISI-1 phase of industrialisation is studied by comparing the evolution of production, employment and the stock of capital in both periods in Argentina and Brazil. Subsequently, the impact of ISI-2 on governmental and entrepreneurial perceptions on integration will be considered.

(a) A Simple Test for Increasing Returns to Scale in the ISI-1 and ISI-2 Phases

The suggested association between increasing returns and structural change in the late fifties can be scrutinized through a simple statistical test based on the so-called 'Verdoorn Law' or 'Second Kaldor Law'¹. According to the Verdoorn-Kaldor Law, in the presence of increasing returns, the expansion of production leads to gains in productivity. If this is true, there should be an association between production growth and productivity growth. It has been suggested that increasing returns were more significant in the ISI-2 than in the ISI-1 phase of industrialisation. This hypotheses has been studied by Katz and Kosacoff for the

¹ A theoretical discussion of the Verdoorn Law can be found in J.S.L. McCombie and A.P. Thirwall, Economic Growth and Balance of Payments Constraint (New York, 1994), pp.177-80.

Argentine industry in the periods 1946-54 (ISI-1) and 1954-61 (ISI-2) ¹. The results presented by Katz and Kosacoff support the hypothesis that a new phase of industrialisation began in the second half of the fifties and that this was associated with higher increasing returns to scale. The authors found that production growth and productivity growth were significantly correlated in Argentina between 1954-61 (R squared = 0.78, significant at a 5 % level) but not between 1946-54 (R squared = 0.30, n.s.). They concluded that increasing returns were a relevant variable in industrial production in 1954-61 but not in 1946-54. The work of Katz and Kosacoff offers support to the argument that structural change in the late fifties provided a new stimulus for economic integration, aimed at achieving economies of scale in the new industries.

However, the original specification of Verdoorn, used by Katz and Kosacoff, may lead to problems of spurious correlation ². An alternative test was proposed by Kaldor, which uses employment growth instead of productivity growth as the dependent variable in order to eliminate this problem ³. While the original Verdoorn Law states that $p = a + bq$

¹ Cf. J. Katz and B. Kosacoff, El Proceso de Industrialización en la Argentina, pp. 67-77. A similar argument is presented by R. Mallon and J. Sourouille, Política Económica, pp. 121-25.

² As the variables used in the correlation have a common component, production growth (which appears as a variable on its own and in the numerator of the productivity variable), then spurious correlation may occur.

³ Cf. J.S.C. McCombie and A.P. Thirwall, Economic Growth, pp. 167-70. For a comparison of the Verdoorn and Kaldor specifications and a discussion of the empirical results obtained

(where p stands for productivity growth and q for production growth), the respecified equation states that $e = a^* + b^*q$, where e stands for employment growth, q for production growth, $a = -a^*$ and $b^* = 1 - b$ ¹. The original Verdoorn test requires $b > 0$ for the data to be consistent with increasing returns. The re-specification requires $b^* < 1$. In effect, if $b^* < 1$, an increase in industrial production leads to a less than proportional increase in industrial employment and hence to more than a proportional increase in labour productivity². The results of the application of the re-specified equation for the Argentine and Brazilian industrial sector are presented in Appendix I. They are broadly consistent with the hypothesis of a higher role of increasing returns to scale in both countries in the second half of the fifties.

Still, this re-specification is still unsatisfactory, since it misses the contribution of capital inputs to productivity growth. Part of the increase in labour productivity may have been explained by the use of higher amounts of capital per worker rather than by increasing efficiency in the use of labour for a given amount of

from testing the Kaldor specification see R.W. Rowthorn, 'What Remains of Kaldor Law?', Economic Journal, vol. 85, N. 36 (1975), pp. 10-19.

¹ The re-specification is straightforward, since by definition $p = q - e$. See J.S.C. McCombie and P. Thirwall, Economic Growth, p. 168.

² Obviously, it is also necessary that b^* significantly differs from zero. Otherwise, there will be no association between production and employment growth and no meaningful conclusion can be drawn from the value of b^* .

capital. In order to take into account both factors, a Cobb-Douglas function was adjusted for the economy, on the basis of the time series for capital and labour inputs provided by Elias ¹. The results are presented in Appendix II. They confirm that, in the case of Argentina, increasing returns cannot be rejected for the 1955-65 period, while constant returns to scale cannot be rejected for the 1945-55 period. In the case of Brazil, increasing returns cannot be rejected in the 1950-55 and 1955-65 periods. Still, as employment data is only available in Brazil from 1950, the results of the regression for the ISI-1 period should be taken only as a preliminary exercise, which clearly does not allow to draw definitive conclusions. Moreover, a cross-section study of the Brazilian industry, using data for the stock of capital provided by the 1949 and 1959 censuses, suggests that constant returns prevailed in the late forties and increasing returns in the late fifties ².

In sum, while the hypothesis of a significant change as regards the presence of increasing returns to scale between the ISI-1 and ISI-2 periods is fully confirmed for Argentina, this still remains obscure for the case of Brazil in the ISI-1 period.

These results presented have to be considered most cautiously. Besides the problems of the quality of the data

¹ Cf. V.J. Elías, Sources of Growth: A Study of Seven Latin American Countries (San Francisco, 1992), pp. 175-80 and Appendix E.

² Cf. A.C. Campino et al, "Função de Produção Para o Setor Industrial Brasileiro", mimeo, IPEA-USP, 1971. I am grateful to Leonardo Campos Filho, who called my attention to this work.

and the small number of observations, the Cobb-Douglas function does not include the effect of autonomous technological progress. As during the ISI-2 period new technologies were introduced by foreign firms, productivity increases may have been related to the effects of autonomous technical change and not to economies of scale. However, these problems probably qualify but do not challenge the results. Higher amounts of capital and the introduction of new technologies can be expected to be associated with increasing returns. Higher capital intensity makes more likely the presence of static economies of scale in the shape of falling fixed costs of production. Higher technological complexity, in turn, makes more likely the presence of dynamic economies of scale stemming from technological learning.

(c) Protection and The Political Economy of the Regional Market

The political economy of the ISI-2 period was characterized by huge transfers of resources towards priority sectors, in which the state and the multinational enterprises played a leading role. These were the central actors, with national capital playing a minor role, in accordance with the description offered by Peter Evans ¹. Multinational firms were seen as sources of capital and

¹ Cf. P. Evans, Dependent Development: The Alliance of Multinational, State and Local Capital in Brazil (Princeton, 1979), pp. 64-94.

technology in a context in which international trade and financing were adverse to the developmentalist objectives. The state invested in infrastructure and intermediate industries, and provided a broad array of incentives for attracting foreign capital.

In Argentina, a new Law on foreign investment was passed in July 1958, providing for a liberal policy on profits remittances and capital repatriation¹. These policies succeeded in attracting large amounts of foreign capital to Argentina. While foreign direct investment under Law 14.222 amounted to US\$ 12 millions in 1954-55, it reached US\$ 325 millions in 1958-59, and a total of US\$ 412 millions for the 1957-1963 period, under Law 14.780. In Brazil, the basic instrument for attracting foreign direct investment was comprised by Instruction 113 of SUMOC. This instruction, that had been approved during the Café Filho interim government in January 1955, established that imports

¹ Law 14.780 of 1958 replaced Law 14.222 of 1953 respecting the control of foreign investments. It contemplated a broad array of stimulus for foreign firms, like tariffs reductions for their imports, credit subsidies and the advantages provided by the regime of industrial promotion - the latter defined by Law 14.781-58, embracing fiscal benefits and protection. Cf. Altimir et al, 'Los Instrumentos de la Promoción Industrial en la Post-Guerra', Desarrollo Económico, vol. 6. no. 22-23 (1966), pp. 470-487. Two main differences can be mentioned with respect to the previous legal framework for foreign investment: (i) it was allowed the free remittance of profits through the free exchange market; (ii) it put a larger degree of discretion in the Executive hands as regards the concession of subsidies. When in December 1958 an exchange reform was sanctioned (see next chapter), a tariff of 40 % was imposed on imports of capital goods. However, foreign firms were exempted from this surcharge. In addition, the Frondizi government sought to work out pending disputes with foreign enterprises and opened the search and exploration of oil fields - which were formerly under the monopoly of a state company, Yacimientos Petrolíferos Fiscales (YPF) - to foreign companies

of capital goods by foreign firms would be considered as foreign direct investment. This amounted to an implicit subsidy in favour of foreign firms since their investments could be converted to cruzeiros at the free exchange rate, while profits remittances could be settled at the official rate. Foreign firms made extensive use of this mechanism in the Kubitschek period. More than 70 % of the US\$ 565 millions of FDI placed by foreign firms in Brazil between 1955 and 1960 used Instruction 113 ¹. In addition, in both countries a structure of effective protection was set up assuring the profitability of the priority sectors. Capital and intermediate goods could be imported free of duties for these sectors which at the same time were isolated from external competition through heavy import barriers.

These new trends in economic policy and structural change provided conflicting signals through time as regards regional integration. On the one hand, the state committed a large amount of resources to build the infrastructure, produce intermediate goods (like steel and petrochemicals) and offer the fiscal incentives required by the expansion of priority sectors. These costs were heightened, as mentioned, by the presence of increasing returns to scale and by the small dimensions of the internal markets. The disequilibrium generated by ISI-2 compromised the fiscal and external position of both countries. This boosted the rates of inflation in the late fifties, reflecting the efforts to

¹ P. Malan (1984), 'Relações Econômicas Internacionais', p.

transfer domestic and external resources (in the absence of a long term financial system) in favour of the priority sectors of industry ¹. Therefore, ISI-2 involved heavy costs for the state and the society, which provided a stimulus for the governments to seek less costly alternatives. A regional market, as articulated by ECLA ideas, represented a contribution to this objective.

However, the very array of incentives provided by the state generated strong vested interests in the continuity of protection. To be sure, industrialists were in favour of expanding regional trade, with a view to reducing microeconomic inefficiency. The private sector perceived the importance of the economies of scale and the role that the regional market could play ². This was highlighted in a study of the Economic Department of FIESP in 1958, on the basis that 'the national markets are insufficient to keep

¹ Cf. L. Orenstein and A.C. Sochaczewski, 'Democracia e Desenvolvimento', in M.P. Abreu, A Ordem do Progresso: Cem Anos de Política Econômica Republicana (São Paulo, 1990), pp. 171-195, and A. Petrecolla, 'Unbalanced Development', in G. Di Tella and R. Dornbusch, The Political Economy of Argentina (London, 1989), pp.109-114, for an analysis of the disequilibria of the late fifties.

² It has been already mentioned how the Latin American markets were seen as a especially promising avenue for expanding industrial exports by Brazilian industrialists. Cf. for instance, BI, vol. XXII, no. 268 (22 November 1954), p.307 and BI, vol. XXIII, no. 272 (20 December 1954), p.333. Commenting on Brazil's efforts to increase trade with neighbouring countries, FIESP observed that 'the orientation of Itamaraty (...) of promoting economic agreements with almost all the Latin American countries represents a step forward towards the association of Brazil with the economies of these countries.' A regional market would 'crown all these efforts, if it can be created' (author's translation). Cf. BI, vol. XLIV, no. 448 (27 May 1958), pp. 569-70. Such a position contrasts with the earlier reluctant view adopted by Simonsen and indicates a shift towards a more positive attitude on integration.

industries continuously operating in the case of a large number of manufactured goods' ¹. The private sector would favour controlled liberalisation in sectors amenable to oligopoly arrangements and intra-firm trade. These sectors were comprised principally by the new industries installed in the late fifties, under multinational control. A survey of business opinions in the early sixties showed that firms in the 'new', more internationalised industries were more favourable to a regional market than the 'old' industries of the ISI-1 period ². The British Ambassador in Buenos Aires stressed that

'the industrial enterprises which are looking in a businesslike way at the free trade area idea are principally the American or European firms which have already established enterprises in several Latin American countries. The free trade area holds out to them the long term prospect of being able to specialise and make e.g. cars in Brazil and trucks in Argentina' ³.

Thus, there was a stronger interest in expanding regional trade than in the ISI-1 period. But this interest cannot be

¹ Cf. BI, vol. XLVII, no. 463 (20 August 1958), p. 1067. Economies of scale were as well one of the key arguments used by ECLA in favour of regional integration. See also chapter II.

² Cf. F.H. Cardoso (1968), Ideologías de la Burquesía Industrial en Sociedades Dependientes (Mexico, 1968), pp. 205-06. These new sectors would in fact form the basis of the expansion of industrial exports in the sixties (see chapter VII).

³ Cf. FO 371 147679 A 1123/16, 26 February 1960.

equated to support for a free trade area ¹. These firms would support managed regional trade, not unimpeded regional competition.

In effect, scepticism was widespread among Brazilian industrialists when LAFTA was created. Ignacio Costa, head of the FIESP Foreign Trade Department, observed that 'Brazil's industry was growing so fast that she would be able in the future to enter in the Latin American markets without the free trade area', which was thus seen as 'a disadvantage, rather than an advantage, to Brazil' ². This attitude may explain Brazil's hesitant attitude in the period immediately after the signing of the Montevideo

¹ Dr. José Melero, former Argentine representative at LAFTA and GATT, interview, Montevideo, 11 October 1993. See also next chapter.

² Cf. FO 371 147680 AA 1123/25, 2 June 1960. FIESP insisted to the Brazilian representatives at LAFTA that adequate assurances should be given to industries already installed in each country. During the 1958 negotiations of a Southern free trade area (cf. next chapter) FIESP demanded (i) to be consulted about the list of products whose import would be allowed; (ii) guarantee of protection for industries already established; (iii) the presence of representatives of the industry in the Executive Secretary of the Trade Committee, where the debates on equilibrium in regional trade would take place. Cf. BI, vol. LIV, no. 520 (23 September 1959), pp. 44-45. Subsequently, FIESP editorials emphasised the need to restrict imports that 'go beyond of what is necessary, affecting the national industry'. Cf., for instance, BI, vol. XII, no. 625, p.37. Foreign Minister Horacio Laffer, in his speech to the II Inter-Governmental Meeting of LAFTA, reassured domestic producers that LAFTA would be flexible enough so as not to represent a threaten to domestic producers. Cf. Barbosa, O Brasil e a integração regional (São Paulo, 1991), p.10. If in the first round of LAFTA negotiations, FIESP complained about not being heard by Itamaraty, in the early sixties it praised the high degree of cooperation then achieved: 'the relationship (between Itamaraty and FIESP) is completely different in what has to do with the receptivity to the industrialists suggestions, which are now approved and considered' (author's translation). Cf. BI, vol. LXXXI, no.737 (20 November 1963), p. 4.

Treaty¹. Similar misgivings existed among Argentine industrialists. The Argentine position was described as one in which 'there is marked scepticism in business circles about the success of the new market. (...) Industrialists are more concerned with competition than with opening new markets'². Moreover, resistances to free trade were reinforced by the fact that the industrial structure developed in the late fifties contained a very large number of firms, considering the size of the Argentine and Brazilian markets³. The irrational industrial structure thus

¹ British commentators emphasised that although Brazil 'has been far from backward' in LAFTA negotiations, 'the impression was given, perhaps erroneously, during the second half of the year, that Brazil was suffering from certain misgivings over the concept of LAFTA and might seek to introduce further delays in the already well spaced out programme. There was in fact considerable surprise that the recent meeting in Montevideo was not itself postponed'. The decisive factor seems to have been 'firstly Argentina pressure and secondly (...) the decision of Mexico to climb from the outset on to what she now judged to be a worthwhile bandwagon'. Cf. FO 371 A 1123/16, 26 February 1960.

² Cf. FO 371 147679 A 1123/16, 26 February 1960.

³ In the case of the automobile sector in Argentina, twenty six firms asked for their inclusion in the Regime of Promotion of the Automobile Industry between 1959-60, all of which obtained a favourable reply from the government. Three of these firms gave up before beginning production, ten closed their facilities by 1964 and another four firms left the market in 1967. Only eight firms (all of them multinational firms) remained, along with DINFIA, the producer of vehicles operated by the Armed Forces Cf. J. Sourrouille et al, Transnacionalización y Política Económica en la Argentina (Buenos Aires, 1985), p. 27 and 29. This was still a relatively high number of firms, given the size of the Argentine market for transport equipment. In Brazil, ten firms were installed under the auspices of Kubitschek's Executive Group for the Automobile Industry (portuguese acronym GEIA), of which eight were multinationals, one a public enterprise (FNM) and one a private Brazilian firm (Vemag). Cf. M.A. Leopoldi, 'Crescendo em Meio a Incerteza: A Política Econômica do Governo JK', in A. Castro Gomes (org.), O Brasil de JK (Rio de Janeiro, 1991), pp.86-7. As shown by S. Dell, A Latin American Common Market? (Oxford, 1966), pp.23-24, the combined market of Argentina, Brazil, Mexico, Chile, Colombia, Peru and Venezuela could absorb

configured was the result of both the amount of incentives offered by the government and the dynamics of oligopoly competition, which prompted a synchronised move to new markets ¹. This inefficiency made local producers to look fearfully at the possibility of foreign competition.

In sum, there was a problem of temporal inconsistency in the evolution of the trade and industrial policy. Protection and subsidies provided the stimulus to industrial diversification and created new opportunities for trade and industrial specialisation at a regional level. A regional market could then facilitate the realisation of trade opportunities and contribute to rationalise the industrial structure, increase efficiency and reduce the transfer of resources. However, if more (managed) regional trade was favoured by the new highly oligopolised industries, they would oppose a free trade area, an opposition which the inefficiency of the industrial structure rendered more necessary.

300,000 automobiles per annum in the mid-sixties. This was less than the production per annum of FIAT (566,000), Opel (136,000) and that of Ford in Britain.

¹ Multinational firms tend to move together towards emerging markets in order to prevent oligopoly competitors from establishing an advantage which could affect competition at a global level. The result of this reactive strategy is a concentrated expansion of industrial capacity. This tends to exceed the optimum of installed capacity vis-a-vis the size of the markets. The excess of capacity implies a much costly process of adjustment to trade liberalisation. On the factors shaping foreign direct investment see J.H. Dunning, 'The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions', Journal of International Business Studies, vol 19, no. 1 (1988), pp. 1-31.

V. CONCLUSIONS

1. Many conflicts that had been latent or obscured in the early post-war period, affecting the relationship between Latin America and the international system, acquired full expression and maturity after 1956. These conflicts had to do with the perception that Latin America had been marginalized in the design of the post-war international order. The relationship with the USA, the uncontested hegemonic power of the period, was central in shaping these negative perceptions. It was considered that inter-American economic cooperation had been placed in a very secondary position as compared with the emphasis on security. In addition, the Bretton Woods system seemed to neglect the needs of developing countries regarding exports, financing and industrial protection. The decision of the governments of Kubitschek and Frondizi to pursue a program of rapid industrialisation heightened this friction and aggravated external disequilibrium in the region. As a result, Argentine and Brazilian views converged in the late fifties as regards their place in the international system and the need of coordinated action.

2. The result of this convergence of views was a remarkable increase of cooperation and the dilution of the rivalries of the previous period. This opened room for the creation of LAFTA in 1960. Brazil moved from a position of relative distance from Latin America towards an active regional policy. This was aimed to enhance both Brazil's

autonomy and her economic and political role in the region. Argentina moved in a similar direction. Although old rivalries and domestic political conflicts, especially in Argentina, created some difficulties, conflictive forces were curbed and the geopolitical barriers that had hindered the efforts for economic integration in 1939-55 were ironed out in 1956-60.

3. The change in perspectives of the late fifties was not only related to changes in the international system. Structural change in the economies of Argentina and Brazil contributed to reshape the benefits and costs of economic integration. Developmentalist policies encouraged industrial upgrading and diversification between 1956-60. This gave rise to the implantation of new intermediate and capital goods industries which sustained the ISI-2 or 'intensive' phase of import-substituting industrialisation. Increasing returns to scale became more significant and so did the costs of protection and the gains from trade. Governments sought to reduce these costs and, based on ECLA ideas, set out to create a free trade area. Industrialists would adopt a narrower point of view. Important industrial sectors supported the idea of limited trade liberalisation in order to reduce microeconomic inefficiency and explore the opportunities for industrial exports and intra-industry trade. In this sense, the ISI-2 created more favourable conditions for regional trade.

4. On the other hand, there was a problem of temporal inconsistency between industrial diversification, achieved

behind high tariffs, and the subsequent creation of a free trade area. Protection to priority sectors consolidated interests against regional competition. This factor - along with other variables that will be discussed in the next chapter - led to the failure of the free trade area project. This, however, should not obscure the fact that substantial progress was made in these years in terms of regional cooperation. The consequences of this period of cooperation and the institutions then set up would be reflected in the growth of regional trade after 1960.

APPENDIX I: A TEST OF THE VERDOORN-KALDOR LAW

Tables IV.4.A and IV.4.B present the results of the regression of the logarithm of employment (dependent variable) on the logarithm of production (independent variable), using the raw data provided by Katz and Kosacoff for Argentina and that of the industrial censuses of the years 1939, 1949 and 1959 for Brazil.

TABLE IV.4.A
ARGENTINA: REGRESSION OUTCOMES

Dependent Variable: log(E)
Independent Variable: log(Q)

Period: 1946-54 (ISI-1)

Constant	1.7067
b*	0.6387
SE b*	0.1290
$t_0(\beta^* \geq 1)$	2.80 +++
R Squared (%)	65.34 +++
Durbin-Watson	1.9859

Period: 1954-61 (ISI-2)

Constant:	2.1844
b*	0.4606
SE b*	0.1889
$t_0(\beta^* \geq 1)$	2.85 +++
R Squared (%)	31.37 ++
Durbin-Watson	2.3746

+++ Significant at the 1 % level

++ Significant at the 5 % level

+ Significant at the 10 % level

Source: See statistical appendix

TABLE IV. 4. B

BRAZIL: REGRESSION OUTCOMES

Dependent Variable: $\log(E)$
 Independent Variable: $\log(Q)$

Period: 1939-49 (ISI-1)

Constant	4.3776
b*	0.1228
SE b*	0.2929
$t_0(\beta^* \geq 1)$	2.99 +++
R Squared (%)	1.44 (n.s)
Durbin-Watson	1.5129

Period: 1949-59 (ISI-2)

Constant	0.5434
b*	0.8382
SE b*	0.09430
$t_0(\beta^* \geq 1)$	1.71 +
R Squared (%)	83.16 +++
Durbin-Watson	1.7505

+++ Significant at the 1 % level

++ Significant at the 5 % level

+ Significant at the 10 % level

Source: See statistical appendix

In the case of Argentina, the original conclusions of Katz and Kosacoff stand when the re-specified test is applied. In effect, both periods showed increasing returns to industrial production - the coefficient b^* is significantly lower than 1 and employment and production growth are significantly correlated in both cases. But gains

in efficiency with the increase of production tended to be lower in the ISI-1 than in the ISI-2 phase. This can be seen by comparing the coefficient b^* in the two periods. As b^* in 1946-51 (ISI-1) is higher than b^* in 1954-61 (ISI-2), employment tended to increase relatively more (and thus labour productivity relatively less) with an increase in production. However, as mentioned, this test does not consider the influence of the increase in the capital stock. As it is shown in Appendix II, when a Cobb-Douglas function is applied, constant returns to scale cannot be rejected in the case of Argentina in the 1945-55 period.

The evidence for Brazil is less clear-cut but nevertheless broadly consistent with the suggested hypotheses of an enhanced role of increasing returns to scale in the ISI-2 period. The coefficient b^* is significantly lower than unity and significantly different from zero for the period covered by the industrial censuses of 1949 and 1959, which roughly corresponds to the ISI-2 phase. Hence, the hypotheses of increasing returns in this period is not contradicted by the evidence. However, while b^* is significantly lower than 1 between the censuses of 1939-49, there is no significant correlation between e and q and hence b^* does not differ from zero. In this case, the test does not offer any indication about the nature of the links between production and productivity growth and is consistent with any hypotheses about returns to scale in industrial production - increasing, decreasing or constant. In sum, increasing returns to scale were present in the ISI-2 period, but no conclusions can be drawn from the test for the ISI-1 period ¹.

¹ The vagaries of industrial investment, more related to the availability of foreign currency than to the growth of industrial production, may have contributed to set apart the evolution of these variables. As has been argued in chapter I, learning does not automatically follow production, but it is an active process which involves investments. If the expansion of production is not accompanied by the introduction of new equipment and technology, but is based on stretching the use of existing capacity, the virtuous circle among production,

TABLE IV.5.A
ARGENTINA: EVOLUTION OF MANUFACTURING PRODUCTION AND EMPLOYMENT, 1946-62

Sector	Period 1946-52 (1946 = 100)		Period 1952-61 (1952 = 100)	
	Q	E	Q	E
Food	111	98	123	86
Tobacco	123	101	105	51
Textiles	98	132	115	75
Garment	92	92	147	95
Wood	87	98	100	65
Paper	139	107	147	130
Editorial	86	82	157	85
Chemicals	131	117	134	87
Petrochemicals	181	129	160	97
Rubber	214	200	127	128
Shoes&Leather	65	80	106	66
Non Metals	117	109	130	85
Metals	130	128	161	95
Vehicles	115	185	270	100
Machinery	309	217	274	105

Q = Production in Volume
E = Employment

Source: J. Katz and B. Kosacoff, *El Proceso de Industrialización en la Argentina*, pp. 69 and 71

productivity and investment growth may be limited. This problem was especially important during the war and early post-war periods, given the obsolescence of existing industrial facilities and the international constraints on the supply of new equipment. On the other hand, this problem may have been less relevant in the ISI-2 period, since the concentrated inflow of foreign capital and technology in 1956-60 linked the expansion of production with the installation of new industries and technical capabilities.

TABLE IV.5.B
BRAZIL: EVOLUTION OF MANUFACTURING PRODUCTION AND
EMPLOYMENT, 1939-59

Sector	Period 1939-49 (1939=100)		Period 1949-59 (1949=100)	
	Q	E	Q	E
Non Metals	288	226	200	126
Metals	288	164	274	174
Metal Mechanical	361	101	352	239
Electrical Appliances	n.d	n.d	543	360
Transport Equipment	n.d	n.d	577	426
Wood	289	77	154	172
Furniture	n.d	n.d	220	161
Paper	272	201	298	165
Rubber	655	196	267	237
Leather&furs	193	142	141	116
Chemicals	227	198	304	145
Textiles	194	145	133	97
Garment&shoes	223	156	156	128
Food	243	133	150	115
Beverage	247a/	170a/	148	116
Tobacco	---	---	161	101
Editorial	258	155	160	124
Others	316	252	197	40

a/ Beverage and Tobacco

Q = Total value of production

E = Employment

Source: Instituto Brasileiro de Geografia e Estatística,
Censo Industrial (Rio de Janeiro, 1940, 1950 and 1960).

APPENDIX II: ESTIMATION OF A COBB-DOUGLAS PRODUCTION FUNCTION

A Cobb-Douglas production function was estimated for Argentina and Brazil for the ISI-1 and ISI-2 periods on the basis of the time series provided by Elias. The equation adjusted is the following:

$$\text{Log (GDP/L)} = A + B(K/L) + (\alpha + B - 1)L$$

If $\alpha + B - 1$ is statistically higher than zero, then the production function shows increasing returns to scale; if $\alpha + B - 1$ does not differ from zero, then the production function shows constant returns to scale; if $\alpha + B - 1$ is negative (and significantly different from zero) the production function presents decreasing returns to scale.

Tables IV.6.A and IV.6.B present the results of the Cobb-Douglas estimations. In the case of Argentina, it can be seen that increasing returns cannot be rejected in 1955-65. Conversely, the coefficient of L does not differ from zero in 1945-55 and thus constant returns prevailed in this period. The regressions for Brazil suggest that in both periods increasing returns cannot be rejected. Still, as there is only six observations available for the ISI-1 period (1950-55), this result should be taken with great caution.

TABLE IV.6.A
ARGENTINA: PRODUCTION FUNCTIONS, ISI-1 AND ISI-2 PERIODS

Dependent Variable: GDP/L (in constant Argentine pesos of 1960)

Regressor	Coefficient	t-statistic	Probability*
1945-55			
C	-0.1268	-0.3216	(0.756)
K/L	-0.0116	-0.0239	(0.982)
L	0.3414	1.0609	(0.320)

R-squared = 21.62 % F(2,8) = 1.1032 (0.377)

Durbin-Watson = 1.2252

Regressor	Coefficient	t-statistic	Probability
1955-65			
C	-2.6487	-6.3296	(0.000)
K/L	-0.0116	11.891	(0.000)
L	0.3414	5.3474	(0.000)

R-squared = 96.92 % F(2,8) = 114.55 (0.000)

Durbin-Watson = 1.2710

* Figures between brackets are probabilities

Key for the Independent Variables

C = Constant

K/L = Ratio of the Stock of Capital to Employment

L = Employment (thousands of people)

The regression uses the logs of the dependent and independent variables

Source: Calculated from V. Elías, Sources of Growth, Appendix B.

TABLE IV.6.B
BRAZIL: PRODUCTION FUNCTIONS, ISI-1 AND ISI-2 PERIODS

Dependent Variable: GDP/L (in constant cruzeiros of 1949)

Regressor	Coefficient	t-statistic	Probability*
1945-55			
C	-0.70461	-0.1794	(0.000)
K/L	-0.09858	-0.9989	(0.927)
L	1.3189	8.7023	(0.003)

R-squared = 96.27 % F(2,3) = 38.69 (0.007)

DW = 3.1365

Regressor	Coefficient	t-statistic	Probability
1955-65			
C	-12.9874	-8.0267	(0.000)
K/L	3.7516	8.5091	(0.000)
L	0.4355	7.2927	(0.000)

R-squared = 97.34 % F(2,8) = 146.23 (0.000)

Durbin-Watson = 1.6204

* Figures between brackets are probabilities

Key for the Independent Variables

C = Constant
 K/L = Ratio of the Stock of Capital to Employment
 L = Employment (thousands of people)

The regression uses the logs of the dependent and independent variables

Source:Cf. Table IV.6.A.

CHAPTER V. THE EVOLUTION OF THE TRADE REGIME, 1939-60INTRODUCTION

It was argued in chapter I that international economic relations are articulated through institutions (more specifically, through international regimes) that constrain behaviour and make interactions among international actors more predictable. This chapter analyzes the institutions that regulated trade relations between Argentina and Brazil in 1939-60. Two different phases in the evolution of the trade regime in this period are identified. The first phase corresponds to the emergence and consolidation of the regime of 'restrained bilateralism' (1939-55). The second phase corresponds to a transitional period (1956-1960) in which the regime of restrained bilateralism went through increasing difficulties and a new regime was negotiated. This process culminated with the creation of the Latin American Free Trade Association (LAFTA) in 1960, which was intended to liberalise trade on a Latin American basis ¹.

The objective of this chapter is twofold. First, it aims to present the trade and payments agreements of 1939-60 in terms of international regimes, that is, in terms of principles, norms, rules and decision-making procedures, as

¹ The main proposals for the constitution of LAFTA are briefly presented in this chapter, while the problems of their effective implementation are discussed in chapter VI.

defined in chapter I. This will permit to shed light on the process of institutional change, i.e., how changes within a regime (adaptation) and changes of regime (learning) occurred. Secondly, the relationship between institutional and structural change is explored. Some hypotheses suggesting that, under certain structural conditions, economic cooperation can be expected to increase were raised in chapter II. These hypotheses are now tested by looking at the co-variation between structures and institutions in the period 1939-60.

The chapter is organised as follows. Section I presents the principal agreements and instruments of cooperation of the 1939-55 period. Section II analyzes the transition towards a proposed free trade area in 1956-60. Sections I and II offer a description of the framework in which trade between Argentina and Brazil developed until 1960. The links between institutional and structural variables are addressed in section III. These links are illustrated with the help of two simple game theory models. Section IV summarises the conclusions. In an appendix a catalogue of the bilateral trade agreements between 1939 and 1960 is provided. As most of this detail is not available in the existing literature, appendix I presents the material in a chronological order with a view to facilitating further analysis on bilateral cooperation before 1960.

I. THE REGIME OF RESTRAINED BILATERALISM, 1939-55

The regime of restrained bilateralism was characterized by a pattern of cooperation which was limited in terms of both scope (products included) and depth (degree of cooperation achieved). The scope was limited to a small number of products, among which complementary primary products were dominant. The depth was limited to bilateral trade preferences with no efforts to coordinate policy in the industrial, fiscal and monetary fields. Such a pattern of cooperation clearly reflected the structural conditions of the period 1939-55 (see section III). It was rooted in different perceptions in Argentina and Brazil as regards their insertion in the international system. It was also the reflection of the low level of industrial development prevailing in these countries until the mid-fifties.

Two different phases can be identified within the regime of restrained bilateralism. The first one corresponds to the creation of the basic instruments for cooperation between 1939 and 1941. These instruments were applied to expand trade in the context of the import constraint provoked by the Second World War. The second phase corresponds to the efforts to adjust to post-war conditions (1948-1955) after a short-lived experience of liberalisation in Brazil (1946-48). The need to save dollars fuelled the concession of trade preferences between Argentina and Brazil

after the war ¹. The evolution of cooperation in this period can be understood as a process of adaptation, which affected rules and decision-making procedures but maintained the basic principles established in the earlier 1939-41 period.

I.1. Bilateral Economic Cooperation in the War Years

The outbreak of Second World War prompted efforts to facilitate the expansion of trade between Argentina and Brazil. The objective was to overcome the barriers that accumulated in the thirties ². During 1939-41 a set of bilateral arrangements were signed, reflecting the momentum that cooperation had acquired ³. These agreements provided

¹ During the period 1946-51 83% of inter-Latin American trade (excluding oil) took place through compensatory agreements. In 1953 this proportion raised to 90.7%. Including oil, compensatory trade represented 73.4% and 70.5%, respectively, of inter-Latin American trade. Cf. ECLA, Estudio del Comercio Inter-Latinoamericano, p. 120.

² On the escalation of protectionist measures in the thirties, cf. 'El Tratado de Comercio con el Brasil', La Prensa, Buenos Aires, 25 January 1940.

³ The agreements were based on the new instruments that the Latin American states had adopted to regulate international trade after the 1930 crisis, namely exchange controls and quantitative restrictions on imports. In Brazil, a new exchange system was adopted in April 1939. It was made up of three exchange rates by which 70 % of export earnings could be sold in the free market while the other 30 % had to be sold to the Bank of Brazil at the official rate. A higher exchange rate, the so-called free special (livre especial) was applied to financial transaction. Cf. S.B. Vianna, 'Política Econômica Externa e Industrialização', in M.P. Abreu, A Ordem do Progresso (São Paulo, 1990), pp. 105-22. In Argentina, a system of multiple exchange rates was established in August 1939, comprised by the preferential, basic, auction and free exchange rates. This complex system was replaced by a simpler one in August 1950. Cf. R. Mallon and J. Sourrouille, Política Económica, pp. 67-9.

the institutional basis for the expansion of trade in the war and early post-war years ¹.

Already in April 1939 Argentina and Brazil signed an Exchange Protocol in which they pledged to apply the most favourable exchange treatment to their reciprocal imports and avoid the distorting effects of export taxes. The subsequent 1940 Treaty of Commerce and Navigation was the most significant agreement of the period ². It would provide the institutional framework for trade between Argentina and Brazil until the creation of LAFTA in 1960. The main features of the 1940 Treaty were:

(a) the concession of the unconditional Most Favoured Nation (MFN) treatment as regards all regulations over exports and imports;

(b) the consolidation of duty reductions and exemptions, along with new commercial benefits, applied to the principal export products of each country, namely wheat on the Argentine side and coffee, maté, cacao and timber on the Brazilian;

(c) the commitment of not setting import quotas below the average import level of previous years.

The Treaty represented a broad framework providing for

¹ Four principal agreements were signed: (i) the April 1939 Exchange Protocol; (ii) the January 1940 Treaty of Commerce and Navigation; (iii) the April 1941 Agreements on the addition of substitutes, facilitation of imports and reciprocal credits; (iv) the November 1941 Treaty for Progressive Free Trade. For details see appendix I. The failure to implement the November 1941 Treaty for Progressive Free Trade was already studied in chapter VI, so it will not be discussed here.

² Cf. FO 371 24167, 26 January 1940.

trade preferences, which would be extended afterwards ¹. Moreover, a Payments Agreement providing a credit of 50 millions of Argentine pesos (about US\$ 12 millions) for reciprocal trade was signed in April 1941. According to this agreement net balances were expected to be used for purchases of the debtor country's exports. The objective was not only to settle net balances in the bilateral clearing account. It also sought to avoid the use of restrictive practices (controlling imports) and promote trade-enhancing instruments (expansion of exports) in order to balance trade.

In sum, the basis of the regime of restrained bilateralism were established between 1939 and 1941. The 1940 Treaty of Trade and Navigation was the backbone of the trade regime until 1960 and facilitated bilateral trade in a context still dominated by the fragmentation of the international economy. The April 1941 Payments Agreement was the necessary complement to this. Both arrangements supported the steady increase in bilateral trade of the war years.

I.2. Adaptation Through Incremental Growth in the Post-War Years, 1946-55

During the period 1948-1955 important modifications in the bilateral trade regime between Argentina and Brazil were

¹ Subsequent agreements extended the concessions and controlled certain trade-reducing practices, like the addition of substitutes to coffee and wheat.

adopted which, however, preserved the basic features of the 1940 Treaty ¹, namely the offering of trade concessions for a selected group of products. Therefore, they can be seen as adaptative responses within the regime of restrained bilateralism. These efforts to increase bilateral trade were preceded by a short liberal interregnum in Brazil, whose failure was significant for encouraging the move towards cooperation with Argentina in the late forties.

(a) A Liberal Interregnum: The Early Dutra Years, 1946-

48

An important departure from the dominant regime occurred between November 1946 and October 1948, when Brazil reformulated her exchange and trade policy in a liberal direction. The change of government in Brazil represented the rise of a political coalition which sought to reverse the interventionist policies of the Vargas era ². President Dutra eased trade controls, liberalised the exchange market and adopted a fixed exchange rate, which was set at the value of the pre-war period. Conversely, the system of quantitative controls on trade and multiple exchange rates remained in place in Argentina. No similar political transition had occurred in Argentina and the first

¹ During a short period, in the early years of the Dutra government, there was a substantial departure from the dominant pattern. This will be addressed later.

² cf. T.E. Skidmore, Politics in Brazil, 1930-64: An Experiment in Democracy (Oxford 1967), pp. 65-73.

presidency of Perón represented a continuity of the nationalist coalition in power since the June 1943 coup¹. The continuation of the US boycott and the failure of the UK to return to convertibility reinforced trade and exchange controls in Argentina. Therefore, a phase of divergence in terms of economic policies began in the early post-war years. This divergence naturally affected the normal operation of existing bilateral agreements.

In particular, the new liberal regime in Brazil compromised the April 1941 Payments Agreement with Argentina. Brazil adopted a regime of convertibility for all her external transactions. Such a system strained Brazil's payments relations with Argentina, whose system was based on non-convertibility and discrimination. The 1941 Agreement established that bilateral balances between the two countries should remain blocked and could only be used for purchasing goods from the debtor country. Clearly, this contradicted Brazil's new system. Moreover, Brazil held a large favourable net position with respect to Argentina at the end of 1946, made up of the balances accumulated between July 1941 and November 1946. This implied that Brazil was in fact financing Argentine imports. As Brazil's deficit with the USA sharply increased after liberalisation, this credit became too costly for Brazil and she asked for the payment of the Argentine debt in convertible currency. In January 1947 Argentina agreed to release US\$ 43,1 millions in the

¹ Cf. J.C. Torre and L. Riz, 'Argentina Since 1946', in L. Bethell (ed.), Cambridge History of Latin America, pp. 73-100.

form of convertible currency so as to alleviate Brazil's Balance of Payments problems ¹.

In sum, the move towards convertibility in Brazil challenged her agreements with Argentina, based on bilateral trade and exchange advantages. As her deficit with the USA increased, Brazil had to demand the settlement of net bilateral positions with Argentina in convertible currency, thereby eroding the basis of the 1941 Payments Agreement.

(b) Policy Convergence and Cooperation, 1948-55

The new liberal approach to economic policy in Brazil would not last, however. It collapsed under the pressure of external imbalances with the dollar area ². Since February 1948 a severe regime of direct controls on imports was adopted ³, which constituted the backbone of Brazil's policy until October 1953. Then, it was replaced by the 'Aranha Plan', which substituted direct controls by a multiple

¹ Cf. Boletim Mensual, vol. XXXII, no. 376 (31 January 1947), pp. 12-14.

² Cf. W. Baer, Industrialisation and Economic Development, p. 48.

³ In June 1949 import controls were made especially severe for imports payable in hard currency and only a previously defined amount of available hard currency could be used for this. Controls were eased in 1951-52 as a precautionary measure in the context of the Korean war. Cf. W. Baer, Industrialisation and Economic Development, pp. 455-51. See also Desenvolvimento e Conjuntura, vol. II, no. 5 (May 1958), pp. 93-104.

exchange rate system based on exchange auctions ¹. This led to a convergence of policies in Argentina and Brazil after 1948. Bilateral negotiations gained momentum again, following two main directions: (i) the renewal and diversification of the list of products to be exchanged; (ii) the setting up of a comprehensive payments agreements based on the use of 'soft' currencies and reciprocal credits.

This clearly represented a return to the forms of cooperation that had been developed during the war. The agreements can be seen as a process of 'incremental growth' within the regime of restrained bilateralism. Improvements were made into the instruments of cooperation, and trade-diversion, which had been the natural consequence of supply constraints in the international economy during the war, became more explicit and deliberate with the experience of the 'dollar shortage'.

Five significant agreements were signed in the 1948-55 period. These agreements were the following (see also appendix I): the Payments Agreement of October 1948; the Commercial Complementary Agreement of May 1949; the Commercial Agreement of June 1950; the Commercial and Payments Agreement of March 1953; the Commercial and Payments Agreement of June 1954; the Wheat Agreement of January 1955 (which established the conditions for trade in

¹ This system was based on exchange auctions for different categories of imports, subject to minimum premiums (agios) in accordance with the priorities set by the government. Cf. S.B. Vianna, 'Duas Tentativas de Estabilização, 1951-54', in M.P. Abreu, A Ordem do Progresso, pp. 138-43.

wheat between 1955 and 1957). They were aimed at (i) sustaining the levels of bilateral trade, which began to lose dynamism after 1946, through the concession of trade preferences¹; (ii) diversifying the composition of trade, by encouraging manufactured exports²; (iii) saving scarce hard currency in face of the 'dollar shortage'³.

¹ As mentioned in (a), concessions included lower tariffs, a favourable exchange rate and the promise to settle net balances through exports by the debtor country. In Brazil, imports of wheat payed the lowest exchange rate, namely the 'cost of exchange surcharge' (custo de cambio), which entailed a strong subsidy. After 1953, Brazil's imports of fruit from Argentina were placed in the preferential 'general' category and received a more favourable rate than imports from other countries, this classified in the expensive 'special' category. Argentina, in turn, settled Brazilian imports at the official exchange rate. Certain products like coffee and pine wood could only be imported from Brazil in the late fifties, although imports of pine woods from Chile were allowed as well. Cf. ECLA, Comercio Inter-Latinoamericano de productos en 1954 y 1955: Situación y Perspectivas para 1956 (Santiago: 1958), pp. 106-111. When Argentina suspended the concession of import permits in 1948 as a result of the inconvertibility of the pound, this was almost immediately reestablished for imports from Brazil and areas of non-convertible currencies.

² In both countries, preferences seem to have played a significant role in promoting exports of manufactures after 1949. Brazil granted concessions to Argentine domestic electric appliances, drugs and machine writers. Argentina granted concessions for a diversified set of Brazilian manufactures, including railway equipment in 1955. This encouraged exports which were not competitive in the international market, as observed by ECLA, Estudio del Comercio Inter-Latinoamericano, p. 12: 'favoured by the temporal receding of European, Japanese and, partially, US supplies during the war, and despite of the contraction that occurred when these supplies were resumed, trade in manufactures still persists in some degree, principally as a result of bilateral agreements. Manufactures are produced by new industries which frequently display lower levels of productivity than extra-regional producers, and it is therefore difficult for them to enter the market' (author's translation).

³ For Brazil, buying wheat in Argentina represented a significant saving of hard currency, as was demonstrated in 1952, when the failure of the Argentine crop added to the severity of Brazil's disequilibrium with the dollar area. For Argentina, bilateral trade allowed this country to accumulate negative

The new payments agreement was negotiated and eventually signed in October 1948. This agreement, which was a more comprehensive version of that of April 1941¹, would constitute the main instrument for bilateral payments until 1960². In addition, more liberal conditions for the exchange of certain primary products were established. This was the case of trade in fresh, dried, desiccated and industrialised fruits and vegetables. In June 1950 a minimum 'basic programme' of exchange was set for these products, which received automatic import permits. The minimum exchange of products proposed in the 'basic programme' was increased from about US\$ 14 millions in June 1950 to US\$ 18 millions in March 1953³.

balances in non-convertible currencies and hence to finance imports that she should otherwise have had to pay in dollars. Cf. letter from Ambassador Luzardo to Vargas, Buenos Aires, 27 March 1952, CPDOC GV 52.01.14/4, in which Luzardo commented on the Argentine interest in renewing the 1948 Payments Agreement. The advantages for Argentina of a large accumulated surplus in favour of Brazil in the bilateral clearing account had already attracted the attention of Brazilian policy-makers in August 1942. Cf. FO 371 30323 13 August 1942.

¹ The 1948 agreement established that (i) bilateral payments would be made in cruzeiros; (ii) an account would be created in the Bank of Brazil ('Argentina-Brazil Agreement Account') to settle net balances in cruzeiros; (iii) net debtor positions up to Cz\$ 280 millions (about US\$ 15 millions) would not pay interest; (iv) net trade balances at the end of the first three year period could be cancelled either in 'soft' or 'hard' currency.

² The agreement suffered slight modifications in March 1953, when an account in 'agreement dollars' was created. Net balances exceeding the amount of US\$ 35 millions in December 1956 would be transferred to a special account in the Bank of Brazil and paid through exports from the debtor country. A reciprocal credit equivalent to US\$ 35 million was also accorded.

³ Both countries also agreed to apply a favourable exchange rate to imports of fruits (June 1954). Brazil instituted special exchange auctions for the Argentine fruit after the adoption of

In sum, the instruments of the regime of restrained bilateralism were reestablished and improved in both the trade and payments areas in 1948-55.

**(c) Institutional Fragility of the Regime of Restrained
Bilateralism**

It was argued that a central feature of the regime of restrained bilateralism was the unwillingness of Argentina and Brazil to adopt a long-term, comprehensive commitment of cooperation. This can be expected to have weakened the institutional basis of regional trade and increase its instability. Two pieces of evidence can be used to confirm the institutional fragility of the regime of restrained bilateralism, namely the interruptions, impasses and delays in the negotiation and implementation of the trade agreements; and the instability of the trade preferences granted to regional producers. This sub-section briefly reviews qualitative evidence of uncertainty and instability in regional trade. In sub-section (d) an attempt to provide a quantitative assessment of the evolution of trade preferences after 1948 is presented.

Many difficulties hindered the normal working of trade agreements in 1939-55. This was especially evident when they had to be renewed and when changes in economic policy occurred either in Argentina or Brazil.

(i) The payments agreement of October 1948 and the

the new exchange policy in October 1953.

trade agreement of May 1949 seemed to end the era of divergent policies in Argentina and Brazil. However, the failure of the UK to return to convertibility prompted a protectionist reaction in Argentina, which affected imports from Brazil.¹ The protectionist move in Argentina delayed the effective application of the trade agreement of May 1949². Only in early 1950 would the situation be normalised.

(ii) By mid-1952 institutional instability re-emerged. The agreements signed in June 1950 were due to expire in July 1952. As no clause of automatic renovation existed, there was high uncertainty about whether import permits would continue to be granted in the second semester of 1952 and which exchange rate would be used. At that time, all that remained was an agreement for imports of bananas³. The negotiation of the renewal of the 1950 agreement proceeded slowly. Besides the problems generated in Argentina by the

¹ Cf. the interview given by Economic Minister Gomez Morales, published in Boletín Mensual, vol. XXXIV, no. 404 (31 May 1949), p. 23.

² In June 1949 the Argentine-Brazilian Chamber of Commerce in Buenos Aires sent a note to the Argentine economic Minister asking for the effective implementation of the agreement of May, pointing out that the Central Bank 'has not conceded, and it is difficult to know if it will concede at all, the necessary import permits for imports from Brazil, including, among other items, pineapples, nonferrous metals and its manufactures, and shoes' (author's translation). Cf. Boletín Mensual, vol. XXXIV, no. 405 (30 June 1949), p. 15. In November 1949 the Chamber insisted on the fact that there was an 'evident paralysation of trade' and that despite of the agreement 'no concrete progress has been made so far' (author's translation). Cf. Boletín Mensual, vol. XXXIV, no. 410 (30 November 1949), p. 10.

³ This, too, was due to expire by the end of 1952. On the concerns that this generated see Boletín Mensual, V. XXXVII, N. 442 (31 July 1952), p. 2.

failure of the wheat crop of 1952, it seems that the Peronist government used this delay to express its disapproval of the criticisms of Perón in the Brazilian press ¹. Moreover, the Argentine external crisis of 1952 led this country to focus on essential imports which Brazil could not produce ². If an agreement was eventually reached in March 1953, and extended in June 1954, the impasse in negotiations curbed trade in the second half of 1952.

(iii) The agreements of March 1953 and June 1954 were disrupted shortly after their celebration, as a result of the adoption of the 'Aranha Plan' in Brazil (October 1953). This required adjusting concessions to Argentina to the new exchange system. However, this was not done immediately and the Argentine-Brazilian Chamber of Commerce observed at the end of 1954 that the 'so slow pace shown by the negotiations in Rio de Janeiro (...) does not calm the fears of a fall in regional trade' ³.

¹ Perón told Brazilian Ambassador Luzardo that a trade agreement with Argentina at that moment would not be convenient, since it could attract strong attacks on his government and on Vargas from the UDN press. CPDOC GV, 'Correspondencias', 13 March 1952.

² As industrialisation progressed and the import structure became more rigid, the criteria for the concession of import permits were increasingly associated with the degree of 'essentiality' of the different categories of goods. For Argentina in 1952 essential imports were machinery, chemicals, iron and steel, and raw materials for the industry, a few of which could be supplied by Brazil. This restricted the Argentine disposition to offer concessions for Brazilian products. Cf. Luzardo to Vargas, CPDOC GV, 'Correspondencias' (15) 52.01.12/3, 0760, Buenos Aires, 30 June 1952.

³ Cf. Boletín Mensual, vol. XXXIX, no. 461 (28 February 1954), p. 8 (author's translation).

(iv) Finally, changes in the exchange system adopted in Argentina in 1956 introduced new problems in bilateral trade. This was due to the fact that the Argentine government allowed exporters of fruits to sell their dollars in the free market. However, exports of fruit to Brazil would continue to be paid at the official rate in accordance with the payments agreement existing between the two countries. Thus, Argentine exporters demanded higher prices in the Brazilian market in order to compensate the lower value of their 'account dollars' in Argentina ¹. This led the Brazilian government to suspend the auction of dollars for imports of Argentine fruit in February 1956 ².

Not surprisingly, business interests repeatedly complained about this instability. Some contemporary observers considered that the lack of a stable institutional framework was the most serious source of difficulties in the expansion of regional trade. Thus, the Argentine-Brazilian Chamber of Commerce emphasised that

¹ Cf. ECLA, Estudio del Comercio Inter-Latinoamericano, pp. 24-5.

² Cf. Boletín Mensual, vol. XLI, no. 486 (31 March 1956), p. 8. Similar problems were observed in the case of Argentine wheat exports and Brazilian fruit exports. Cf. US Department of State, Central Files, Argentina (1987), 835.00/11-352, Desp. N. 546, 3rd of November 1954). Alternatively, the existence of different exchange rates for extra- and intra-regional exports encouraged contraband or triangular operations. This compromised the objective of achieving an equilibrium in bilateral accounts. Cf. ECLA, 'Comercio Inter-Latinoamericano de Productos', p. 7.

'nothing is more damaging to commercial activities than the lack of precise and stable terms for their development. (...) The instability stemming from frequent changes in the systems and methods that regulate trade and the access to foreign exchange led to a decline in business' ¹.

A comprehensive Treaty providing a long term horizon was the most frequent demand raised by business interests linked to Argentine-Brazilian trade ².

Moreover, it should be observed that if the institutional framework provided by the governments was fragile, the private sector was unable too to give more stability to regional trade. Information about business opportunities did not flow easily between the two countries and business contacts were established only gradually ³. As

¹ Cf. Boletín Mensual, vol. 32, no. 384 (30 September 1947), p. 10 (author's translation).

² In April 1950 the Chamber demanded "a new commercial treaty (...) which replaced the too numerous dispositions which treat separately each problem" (Cf. Boletín Mensual, XXXV, N.415, 30 April 1950, p.17). More than a year later, the Chamber stated that 'it is urgent to consider as a whole the dispositions that now exist in order to unify them in a new Treaty of Commerce' (cf. Boletín Mensual, V.XXXVI, N.430, 31 July 1951, p.9). This demand continued to occupy the editorials of the Chamber in the following years (cf., for instance, Boletín Mensual, V.XXXVII, N.442, 31 July 1952, p.9). Six years later, ECLA (1958), p.22-4, identified the problem of the instability of the trade preferences in this period as one of the most serious setbacks for the expansion of regional trade.

³ From 1940 industrialists from Brazil and from other Latin American countries sought to exchange information about manufactures. An evidence of this was the creation by Brazilian industrialists of the 'Brazilian Economic Embassy' in charge of promoting Brazilian manufactures in South American countries. Cf. FIESP, Circular N. 68-40, June 28 1940. Another evidence was the Brazilian exhibition of industrial products at Buenos Aires in July 1940. Cf. FIESP, Circular N.69/40, 1 July 1940, and FIESP,

there was no system of standardisation for industrial products, in some cases complains about disparities between samples and goods shipped added to uncertainty in regional trade ¹.

In sum, the regime of restrained bilateralism was characterized by institutional fragility. As a result of the lack of a long-term, comprehensive framework within which to control the sources of instability - especially alterations in economic policy - trade was frequently impaired. If political objectives in trade negotiations were rarely made explicit (this seems to have occurred only in 1952), the political economy of rivalry permeated the whole 1942-55 period, by preventing long term commitments for cooperation. Uncertainty and instability were the consequence of these limits.

(d) The Evolution of Trade Preferences

The previous sub-section highlighted the increased importance that trade and payments preferences acquired for Argentina-Brazil bilateral relations after 1948. But it may be asked whether these preferences had an impact on trade or instability rendered them useless. Trends in bilateral trade suggest that preferences were unable to stop the decline of

Circular N.79/40, 24 July 1940. But more systematic business contacts would only appear in the second half of the fifties.

¹ This was a source of concern for Brazilian industrialists. See, for instance, Boletín Mensual, V. 32, N. 378, 31 March 1947, pp.14-15.

the post-war years. However, a closer observation of trade relations in 1946-60 supports a different conclusion.

In order to obtain a quantitative idea of the evolution of trade preferences after 1948, the 'Index of Trade Intensity' (ITI), proposed by Anderson and Norheim, was used¹. In the case of exports, the $ITI = x_{ij}/m_j$, where x_{ij} is the share of i 's exports going to country j and m_j is the share of country j in world imports (net of country i 's imports). If there is no regional bias in trade, the participation of country j in i 's exports will be equal to the participation of country j in world imports, and hence ITI will be equal to unity. A similar index can be calculated for imports, as the ratio between the share of country j in total i 's imports and the participation of j in world exports (net of country i 's exports). There are two reasons why the ITI between two countries or regions, say A and B, may be higher than unity. The first is a high degree of economic complementarity between A and B, which leads to higher levels of trade between them than with respect to less complementary countries². The second is the concession of trade preferences which discriminate in favour of certain

¹ Cf. K. Anderson and H. Norheim, 'From Imperial to Regional Trade Preferences: Its Effects on Europe's Intra and Extra-Regional Trade', Weltwirtschaftliches Archiv, vol 129, no. 1 (1993), pp. 78-101.

² For instance, the ITI between Argentina and Brazil will tend to be higher than the ITI between Argentina and the USA, given the complementarity in agricultural production between Argentina and Brazil and the lack of complementarity between Argentina and the USA. For simplicity, it will not be considered here the influence of transport costs, which naturally implies that neighbouring countries will show a higher ITI.

countries and against the rest of the world ¹. This is the focus of this sub-section. If the ITI is above the figure explained by economic complementarity, this means that trade preferences did impact trade in 1948-55, or in other words, that the institutions for cooperation played a role in shaping regional trade. Clearly, the influence of these factors - trade bias based on complementary specialisation as against trade bias based on cooperation policies - cannot be easily separated in practice. However, assuming that specialisation and transport costs remained stable in the period of analysis, variations in ITI should principally reflect variations in trade preferences ². Hence, the evolution of the ITI may provide an idea of the evolution of trade preferences ³. Graph V.1 and Table V.1 presents the

¹ To the extent that trade preferences may reflect trade diversion, a higher ITI could be considered as an indicator of losses in welfare. However, in the context of dollar shortage that prevailed in the period, trade preferences probably represented trade creation rather than trade diversion, as suggested in the works of ECLA (cf. chapter II). Therefore, the efficiency implications of trade preferences will not be considered in this discussion.

² In effect, ITI can be considered as composed by the product of two other indexes, B_{ij} and C_{ij} , where B_{ij} is a residual transaction costs index and C_{ij} is a complementarity index. C_{ij} is defined as $\Sigma(x_{ki} \cdot m_{kj} / t_{kw})$, where x_{ki} is the share of commodity k in i 's exports, m_{kj} is the share of commodity k in country j 's imports and t_{kw} is the share of commodity k in world trade (cf. K. Anderson and H. Norheim, 'From Imperial to Regional Trade', pp. 82-3). If C_{ij} does not vary, ITI will only reflect B_{ij} , which (given constant transport costs) reflects policy induced bias in the direction of trade.

³ It is also interesting to note that the ITI of the years 1947-48 in Brazil can be considered as a fairly good 'witness' with respect to the rest of the period. As discussed above, trade and payments preferences were partially eliminated in these years because of the liberal orientation of Brazil's economic policy. Instruments for trade and payments discrimination were

calculations of ITI for 1947-60 in the case of trade between Brazil and Argentina and Brazil and the USA.

TABLE V.1. INDEX OF INTENSITY OF TRADE

Index of Trade Intensity, Brazil-Argentina

Years	<u>Export Index (1)</u>		<u>Import Index (2)</u>	
	Mean	CV (%)	Mean	CV (%)
1947-1950	3.6	6.1	3.4	41.5
1951-1956	4.5	15.3	6.0	52.6
1957-1960	5.4	29.6	6.8	9.8

Index of Intensity of Trade, Brazil-USA

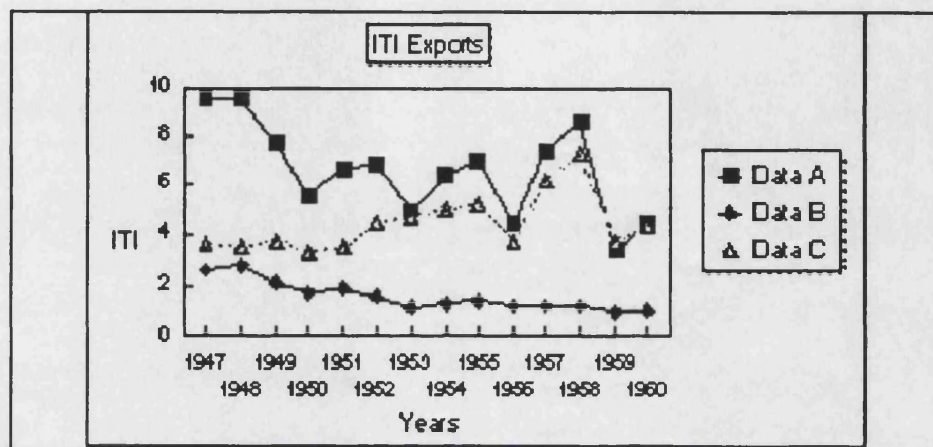
Years	<u>Export Index (1)</u>		<u>Import Index (2)</u>	
	Mean	CV (%)	Mean	CV (%)
1947-1950	3.3	10.3	1.9	6.9
1951-1956	3.1	9.7	1.6	22.8
1957-1960	3.3	7.6	1.8	16.0

Source: calculated from data provided by the International Monetary Fund (IMF), International Trade and Financial Statistics (Washington, various years); and IMF Direction of Trade (Washington, various years).

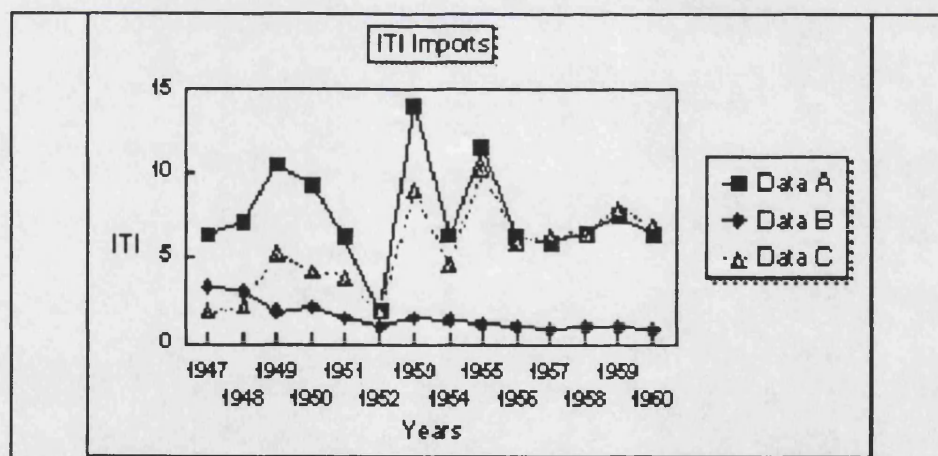
(1) $ITI(x) = x_{ij}/m_j$ and (2) $ITI(m) = m_{ij}/x_j$, where x_{ij} is the share of i 's exports to j ; m_{ij} is the share of i 's imports from j ; m_j is the share of country j in world imports net of i 's imports; x_j is the share of j in world exports, net of country i 's exports.

reintroduced by the end of 1948 and in fact only applied from 1950. Therefore, taking the years 1947-49 as the basis for comparison seems to be especially convenient.

GRAPH. V.1. ITI For Exports and Imports, Brazil-Argentina, 1947-60



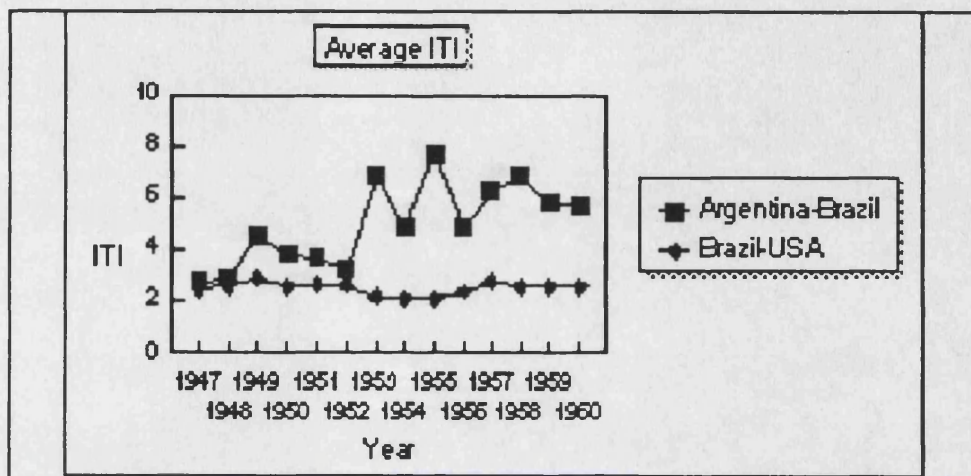
Data A: Argentina share of Brazil's exports; Data B: Argentina share of world imports; Data C: ITI Brazil-Argentina (exports)



Data A: Argentina share in Brazil imports; Data B: Argentina share in world exports; Data C: ITI for Imports.

Source: Cf. Table V.1.

GRAPH V.2. Brazil: Average Index of Trade Intensity, Brazil-USA and Brazil-Argentina



Source: Cf. Table V.1.

The evolution of the ITI for exports and imports in 1947-60 shows that (on the assumption of a relative stability in economic complementarity between Argentina and Brazil) policy-based preferences increased in this period ¹.

¹ The assumption of the stability of economic complementarity between Argentina and Brazil in 1946-60 amounts to consider that structural change in this period did not lead to a significant alteration of the trade structure of the region. The assumption is reasonable for the period 1946-55, in which structural change was less intense than in 1956-60. But it is certainly too strong an assumption after 1956, when industrialisation should have led to a **fall** in economic complementarity, as imports became more concentrated in machinery and intermediate goods produced by centre countries. Therefore, an increase in the ITI implies that policy-based preferences were high enough to more than compensate for the reduction in economic complementarity.

In effect, ITI continued to increase despite the fall of bilateral trade in the late fifties. In the case of Brazil's export index, this was related to a more intense decline of the Argentine participation in world imports than the Argentine participation in Brazil's exports. In other words, ITI increased because x_{ij} fell less than m_j (see graph V.1). The effect of the increase in trade preferences was thus to avoid a still more pronounced fall of bilateral trade, given the dismal performance of the Argentine external sector ¹.

In addition, it can also be seen that the intensity of trade between Brazil and Argentina (in terms of both exports and imports) was higher than the intensity of trade between Brazil and the USA. This probably reflects the efforts to discriminate against dollar imports in the post-war period ². On the other hand, the coefficients of variation (CV) show that the instability of ITI was in general much higher in the case of Brazil-Argentina than in the case of Brazil-USA. This confirms the argument that the lack of a long-term,

¹ This can be illustrated through a very simple comparative exercise. If Argentina had reduced imports from Brazil in 1957-60 in the same proportion as she did with respect to the rest of the world (and hence the ITI for Brazilian exports to Argentina in 1957-60 had been exactly the same as in 1947-50), then she would have imported from Brazil a value of US\$ 43 millions instead of the US\$ 65 millions actually observed.

² It is interesting to compare the ITI Brazil-Argentina with the ITI Brazil-USA because there exists a similar pattern of complementarity in agricultural products. On the other hand, there is a much stronger complementarity in industrial production between Brazil and the USA than between Brazil and Argentina. Hence, one can expect a higher value of the average ITI Brazil-USA. This is not what the data suggest, however, and this reinforces the idea that preferences did impact the direction of trade (in other words, that policy-based trade diversion was applied against dollar imports).

stable institutional framework for trade reflected in the instability of the preferences. The recurrent complaints by traders about the instability of the regional trade regime, reviewed above, were justified. Frequent changes in the rules of the game led to an erratic behaviour of regional trade preferences. This contrasted with the more stable pattern shown by trade between Brazil and the USA.

However, instability cannot be entirely attributed to institutional variables. It was also related to the concentration of Argentine exports in a few agricultural products and especially wheat. The crop failure of 1952 in Argentina, the fall in wheat prices in 1954 and 1955, and the temporary liberalisation of imports in Brazil in 1950 and 1951, made these years especially instable for bilateral trade ¹.

In sum, trade preferences contributed to at least avoid a more pronounced fall in regional trade. The analysis of the index of trade intensity (ITI) suggests that trade preferences increased in 1947-60. On the other hand, the regional ITI fluctuated more than the ITI between the region and extra-regional markets. This confirms the problems related to the fragility of the regime of restrained bilateralism (although other factors associated with the

¹ In 1954 Argentina exported 767.3 tons of wheat to Brazil (including wheat flour) for a total value of US\$ 68.7 millions. In 1955, these exports reached 1233.3 tons, but the total value was only US\$ 92.3. Cf. ECLA, Estudio del Comercio Inter-Latinoamericano, pp. 48-50. Another factor that generated instability was the beginning of the Korean War, which prompted a speculative upsurge of imports in the early fifties.

structure of trade probably contributed to enhance instability).

II. TOWARDS A NEW REGIONAL TRADE REGIME , 1956-60

The 1956-60 period represented a transition from a regime of piecemeal bilateral trade and payments agreements towards an incipient free trade area - the Latin American Free Trade Association (LAFTA), created on 18 February 1960. It was a transitional period in the sense that the main features of the 'old' regime of restrained bilateralism were still preserved - through the successive prorogation of existing agreements - but at the same time its basic principles and norms began to be redefined. This section focuses on how the pattern of adaptation within the regime of restrained bilateralism shifted towards a process of learning in which a new regime was created.

II.1. The 'Demand' for Institutional Change: New Directions in Exchange and Trade Policy in Argentina and Brazil

In the second half of the fifties there was a move in Latin America towards the simplification and liberalisation of the exchange system. Various factors contributed to this: (i) the progress towards convertibility in Europe; (ii) recurrent balance of payments difficulties in Latin America, which led to the devaluation of local currencies; (iii) pressure from the IMF to curb exchange control. Governments also sought to give a higher role for tariffs in industrial protection.

In Argentina, an early but short-lived attempt at liberalising trade and exchange controls was taken after the ousting of Perón in 1955, along with a sharp devaluation of the peso ¹. By the end of 1958 Frondizi implemented a more substantial change in policy. He unified the exchange market, devalued the peso and established a system of 'dirty fluctuations' against the dollar. Quantitative controls were then substituted by differential duties on imports (ranging from zero to 300 %) and compulsory prior import deposits (ranging from 150 % to 300 %). Similar changes occurred in Brazil. The most significant was the approval of a new tariff system based on ad valorem duties and the simplification of the exchange system in August 1957 ². The new system contemplated two categories of imports, the 'general' and the 'special', in which the former received a cheaper exchange rate ³. In addition, a highly subsidised exchange rate, the custo de câmbio, was applied to imports of wheat, oil and newsprint.

These changes in economic policy had significant implications for regional trade. First, because they had macroeconomic consequences in terms of rates of economic

¹ The Provisional Government also undertook a failed attempt at reducing quantitative controls on exports. Cf. R. Mallon and J. Sourrouille, Política Económica, p. 17.

² Cf. M.A. Leopoldi, 'Crescendo em Meio a Incerteza', p. 81.

³ It can be seen that, in practice, Brazil and Argentina moved to a simplified system of multiple exchange rates, as the different values of the new duties and import deposits implied different effective exchange rates for the various categories of imports.

growth and price competitiveness, which affected trade balances. The devaluations of 1956 and 1958 in Argentina strongly reduced imports from Brazil, ¹ as the average exchange rate cruzeiro/peso fell from 3.68 to 2.73 from 1945-54 to 1955-60, respectively ². In turn, the average rate of growth of GDP in Argentina (4%) was about half of that in Brazil (8%) in 1955-60. This prompted disequilibrium and friction in bilateral trade ³. Brazil negotiated with Argentina the purchase of Brazilian railway equipment in order to balance trade and some exports did take place in

¹ Although in February 1959 most imports from Brazil and other neighbouring countries were exempted from the recently established duties and deposits in Argentina, the devaluation of December 1958 offset these trade preferences. The peso/dollar exchange rate increased from 18 pesos (the preferential rate formerly enjoyed by Brazilians exporters) to 85 pesos and this curbed imports. In addition, some Brazilian imports were excluded from the list of products favoured by the exemptions in July 1957. This was the case of sisal fibres (charged with a duty of 100 %), vegetal oil (100 %), cotton textiles (100 %) and palms (300 %), among others. Cf. Boletín Mensual, vol. XLIV, no. 521 (28 February 1959), p.8. In the case of the Argentine exports to Brazil, the impact of the measures of August 1957 was lessened by the fact that wheat continued to receive the most favourable exchange rate - although the custo de cambio was subsequently increased.

² Data obtained from the Instituto Brasileiro de Geografia e Estatística (IBGE), Anuario Estatístico do Brasil (Rio de Janeiro, various years). It is worthwhile noting that the simple correlation between Brazil's exports to Argentina and the exchange rate cruzeiro/peso is not significant in 1939-55 (R-squared = 29 %), while it becomes significant at a 5 % level in 1955-60 (R-squared = 65 %).

³ Total Argentine imports from Brazil fell from US\$ 107 millions in 1958 to US\$ 42.9 millions in 1959. Disequilibrium in the trade balances grew in the second half of the fifties. It was estimated that in 1960 the accumulated deficit of Brazil in the bilateral account with Argentina reached about US\$ 60 millions. Cf. FO 371 147787 16 December 1960.

1955 and 1956. However, subsequent negotiations failed and Brazil turned to other sources of wheat ¹. Brazil complained that she purchased wheat in Argentina on the bases of triannual agreements, but that no reciprocal commitment existed on the Argentine side to buy Brazilian goods, leading to bilateral disequilibrium ².

But the implications of the new economic policies of Argentina and Brazil were not confined to short-term trade friction. They in fact challenged the basis of existing trade preferences. Since tariffs and devaluations became major instruments of trade policy in the late fifties, preferences which depended on exchange and quantitative

¹ Brazil's Economic Minister Edmundo Barbosa da Silva paid a visit to Argentina in November 1960 in order to promote the export of manufactures and thereby balance bilateral trade. However, his demands were not attended, as observed by British diplomats in Rio de Janeiro: 'So far as we can judge from here, his mission appears to have been unsuccessful. No doubt because Brazil's railway equipment and manufactures are more expensive than similar goods obtained from the world market, and because railway equipment in particular can be obtained from the USA under special terms by the Eximbank. According to the press, Brazil is negotiating with the USA to obtain 1.7 million tons of American wheat (presumably...under PL 480) and it is believed that arrangements have already been made for the supply of 200 000 tons from the USSR. If these supplies are forthcoming, domestic production could probably make up the balance of Brazil requirements: total consumption next year is estimated at 2.2 millions of tons'. Cf. FO 371 147787, 16 December 1960).

² This argument was used to demand a diversification and stabilisation of Argentine purchases in Brazil. Cf. CDO, 'Despachos, 1958-60: Instruções Para a Delegação do Brasil à Reunião da Comissão Mista Brasil-Argentina, a realizar-se em Buenos Aires a partir de 20 de Noviembre de 1959', 16 November 1959. In May 1961 it was observed that 'Brazil has for some time been seeking to persuade Argentina to increase her purchases of manufactured goods, notably railway equipment, but so far without success'. Cf. FO 371 155768 AA 10322/61, Confidential, 3 May 1961.

restrictions were eroded ¹. Brazil's new tariff system of August 1957 was especially important in prompting a revision of existing regional agreements. Preferences in favour of Argentina had to be renegotiated, now on the basis of tariff rather than exchange preferences. However, as Brazil was member of the GATT, tariff preferences were incompatible with Brazil's international obligations and an impasse emerged. Argentina, in turn, moved in a similar direction. Although this country was not a member of the GATT, she suffered pressures from the IMF and the Paris Club in order to eliminate her bilateral agreements. When the Brazilian Foreign Minister Horacio Lafer visited Buenos Aires in December 1959 in order to extend the bilateral 1940 Treaty of Commerce and Navigation, observers pointed out that

'Argentina would probably have preferred not to prolong this agreement and might have avoided doing so if the Latin American free trade area negotiation had kept to the timetable. The IMF is known to be critical of Argentina's remaining bilateral agreements. Moreover, the preferential treatment given to Brazil cannot yet be said to be in the context of a plan of regional economic integration and is thus strictly at variance with Argentine undertakings to

¹ It is important to remark that the governments were aware of this conflict between new policies and preferences. Cf. Gustavo Magariños, former Uruguayan representative at LAFTA/LAIA, interview, 20 June 1993, Montevideo. This is also recognised in the study conducted by the Brazilian Economic Ministry on the impact that the 1957 tariffs would carry on regional trade. Cf. Ministério da Fazenda, 'Uma Zona de Livre Comércio', unpubl. paper, Rio de Janeiro, 1959, especially pp. 12-14.

members of the Paris Club' ¹.

The mismatch between the old agreements and prevailing trends in economic policy implied that they were increasingly inoperative ². ECLA observed that the

'Argentine exchange reform of 1955, the subsequent reforms in Paraguay, Chile and Uruguay, and the modifications experienced by trade policy in most of the Southern Latin American countries, have created a new situation in which the mechanisms that have been applied before in order to facilitate and encourage regional trade no longer work. On the contrary, these mechanisms represent in certain cases serious barriers to regional trade' ³.

¹ Cf. FO 371 139029 A 1136/2, 4 December 1959. On the external pressure for a change of policies see also next sub-sections.

² This was also complicated by the lack of synchrony between policy reform in the two countries. While Brazil adopted a system of tariff protection in mid-1957, Argentina moved away from direct controls in December 1958. For more than a year the two countries applied different instruments to regulate their external economic relations. Common grounds were thus more difficult to find, and this led to a 'virtual paralysation' of trade in the last quarter of 1958. Cf. Boletín Mensual, V.XLIII, N.509, 28 February 1958, p .9.

³ ECLA, Estudio del Comercio Inter-Latinoamericano, p.6 (author's translation). The contradiction between bilateral arrangements and the new economic policies was especially apparent in the case of the exchange reform in Argentina in October 1956. As mentioned, the lower value of the dollar agreement Argentina-Brazil than that of the dollar in the free exchange market severely hampered the exports of Argentine fruits to Brazil.

Clearly, the previous agreements had to be extended while the new trade regime was being negotiated, so as to give continuity to bilateral trade preferences. However, this was a provisional solution, beset by higher instability¹. New basis for cooperation had to be looked after in order to adjust the interest of Argentina and Brazil in keeping their bilateral preferences to the new international and domestic context. The idea of a forming a free trade area or customs union, set forward by ECLA in 1956, offered an answer to this.

II.2. Sources of Institutional Change: ECLA as an Epistemic Community

It was mentioned that in the forties industrial entrepreneurs and the military were in favour of industrialisation, but no articulated set of ideas lent

¹ The transitional nature of the agreements naturally added to uncertainty in regional trade. Bilateral relations remained provisionally regulated during 1956-1960 by the old Trade and Navigation Treaty of 1940 and the Commercial Agreements of March 1953 and June 1954. Uncertainty was particularly high considering that both countries announced their intention to set aside the old agreements. On 21 September 1956 Argentina expressed her intention of terminating the payments agreement of the 25 June 1954. On 12 September 1957 Brazil formally denounced the 1940 Treaty of Commerce and Navigation. These announcements created an awkward situation, since in fact the validity of both agreements had to be nevertheless extended several times after the date of their postulated cancelation. Argentina and Brazil renovated the validity of these instruments seven times, always over the date in which they were supposed to be terminated (in September 1956, March 1957, July 1957, May 1958, September 1958, June 1959 and December 1959). Cf. Boletín Mensual, various years.

support to this objective ¹. The same was true for the policy of regional cooperation, still conducted under the pressure of the 'dollar shortage' and the opportunities provided by economic complementarity. However, when the policy of regional cooperation had to be changed, a basis of 'shared knowledge' became more important. Translating the crisis of the previous regime into a new agenda for cooperation demanded an articulated perception of the relationship of industrialisation, regional integration and international trade. This was provided by ECLA. ECLA's role conformed to the insights provided by Haas as regards the role of epistemological communities as sources of innovation. The highly significant role played by ECLA derived from the influence of its economic ideas among policy-makers and técnicos of Latin America ². It contributed to build up common perceptions among técnicos of different countries about how economic integration could enhance industrialisation ³. ECLA also represented a source of

¹ On the debate on industrialisation before ECLA see R. Bielshowsky, Pensamento Econômico Brasileiro: O Ciclo Ideológico do Desenvolvimentismo (Rio de Janeiro, 1982).

² These ideas were also welcomed by Brazilian industrialists in the early fifties. On the (highly selective) absorption of ECLA ideas among industrialists in Brazil, who supported the industrialisation proposals but ignored those related to efficiency, and social and political reform, see R.P. Colistete, 'A Força das Idéias: A CEPAL e o Industrialismo no Brasil no Final dos Anos Cinquenta', unpublished paper, First Brazilian Congress of Economic History, São Paulo, 7-11 September 1993.

³ ECLA encouraged a 'Latin American' perspective among policy-makers, who had until then been working in isolation from other Latin American colleagues. Cf. Eduardo Gana, consultant to ECLA, interview, Santiago de Chile, 15 October 1993. This point was also emphasized by Anibal Pinto in a

independent technical capability at a moment in which this was scarce in Latin America ¹. In sum, ECLA facilitated a transformation of the crisis of the bilateral regime into a process of learning, that is, a search for new principles of regional cooperation.

In November 1956 the ECLA Trade Committee (created in September 1955) held its first session in Santiago ². The Trade Committee set up two panels, the Central Bank Working Group (in charge of studying the possibility of a regional payments agreement) and the Working Group on the Latin American Common Market (in charge of proposing guidelines

seminar on ECLA ideas at UNICAMP, 15 September 1993. C. Lafer, O Brasil e a Crise Mundial (São Paulo, 1984), p. 156, observes that 'the great diplomatic proposal of ECLA was the hypotheses of a common action in order to answer the challenge of growth and viability. In this sense, the theme that ECLA introduced in the diplomatic agenda of Latin America from the fifties was the theme of the avenues for cooperation' (author's translation).

¹ ECLA gathered, analyzed and disseminated information about regional trade among the countries involved in negotiations. The first study on intra-regional trade was produced by ECLA in 1953. Cf. ECLA, Study on the Prospects of Inter-Latinamerican Trade (Santiago, 1953). Subsequent studies were published in 1956, ECLA, Estudio del Comercio and 1958, ECLA, 'La Promoción del Intercambio Regional: El Caso del Comercio Entre la Argentina, Chile y Uruguay', unpublsh. paper, Santiago, 1 September 1958.

² ECLA, The Latin American Common Market, p. 29, points out that the proposal of a regional market appeared in a study conducted by Garrido Torres of Brazil and Eusebio Campos of Argentina, written under ECLA auspices in 1956. M. Wionczek, 'A Brief History of the Montevideo Treaty', in M. Wionczek, Latin American Economic Integration (New York, 1964), p. 74-75, observes that ECLA only gave priority to the theme of the creation of a regional market in 1956-57. The main preoccupation of ECLA studies had formerly been international cooperation for development and the reduction of trade barriers in centre countries.

for a future common market) ¹. In February 1959 a detailed draft providing for a two-stage process of liberalisation of regional trade was produced ². The bases then suggested by the Working Group on a Latin American Common Market were formally presented to the Latin American governments at the ECLA Conference at Panama City in May 1959. But its discussion was complicated by a parallel proposal set forth by the Southernmost countries, Argentina, Brazil, Chile and Uruguay. These countries had concluded a draft providing for the creation of a free trade area among themselves a month before the Panama Conference, to which it was submitted for

¹ In February 1958 the Working Group on the Latin American Regional Market issued a report. Proposals comprised among other considerations: (i) membership open to all Latin American countries; (ii) gradual trade liberalisation of most goods in regional trade; (iii) special treatment for less developed countries; (iv) definition of a common tariff with respect the rest of the world; (v) promotion of industrial specialisation; (vi) creation of a regional payments system; (vi) provision of technical assistance and credits for industrial development. The report of the Working Group on the Latin American Common Market can be found in ECLA, The Latin American Common market, pp. 28-35.

² Cf. ECLA, The Latin American Common Market, pp. 38-49. A 'substantial' reduction of regional trade barriers would be undertaken in the first ten years - although no specific timetable for tariffs reduction was then set forth. In a second phase, tariff reductions would be completed and the agreement should progress towards its ultimate objective, namely forming a common market. Liberalisation would be faster for primary goods and new dynamic industries (capital, intermediate and durable goods), which were produced by only a few Latin American countries, than for simpler consumer goods currently produced in several countries. The ECLA proposals also allowed for complementary industrial agreements open to all interested countries. A special treatment for less developed countries was included. Finally, it was recommended the coordination of trade policies, collective negotiations with third countries and the organisation of a regional payments regime in Latin America. Cf. ECLA, The Latin American Common Market, especially pp. 39-43.

information ¹. As a result, two similar but competing projects existed by mid-1959 ². The Southern countries had been prompted to action by the urgency to stop the fall in their mutual trade in the late fifties. They hurried to device a simpler, geographically circumscribed arrangement to reinvigorate trade as soon as possible, spurred by the expiration of their bilateral agreements. Intense negotiations were conducted in order to find a formula of compromise between the project of ECLA and that of the Southern countries. It was feared that the Southern project could lead to the fragmentation of the regional market in various sub-regional groupings ³. A solution was provided by an article of the Southern project opening the free trade area to other Latin American countries (article 40). In addition, dispositions for a special treatment to less developed countries, the regulation of escape clauses and industrial complementarity were strengthened, drawing on the

¹ Cf. M. Wionczek, 'A Brief History of the Montevideo Treaty', in M. Wionczek, Latin American Economic Integration (New York, 1964), p. 81. The negotiations of the Southern countries free trade area took place in the headquarters of ECLA at Santiago in August-September 1958 and April 1959. The Southern Countries project is published in ECLA, The Latin American Common market, pp. 102-6.

² The features that differentiated the Southern proposals from the ECLA Working Group were: (i) the precise definition of a timetable for reducing trade barriers and creating a free trade area; (ii) the lack of distinction among different goods as regards the pace of liberalisation; (iii) the lack of special treatment for less developed countries. In addition, the Southern project had a circumscribed geographical scope which conflicted with the idea of open membership to Latin American countries.

³ Cf. V. Urquidi, Trayectoria del Mercado Común Latinoamericano (Mexico, 1960), p. 75.

ECLA Working Group suggestions ¹, which ironed out difficulties for regional negotiations.

As a result, invitations to participate in the common market were extended to Bolivia, Paraguay and Peru. These countries joined a round of negotiations held at Lima in June 1959. A meeting was then convoked in Montevideo in September 1959 to which observers from Mexico and Venezuela were also invited. Eventually, the Montevideo Treaty was signed on the 18th of February 1960, creating the Latin American Free Trade Association LAFTA ².

ECLA ideas have already been presented in detail in chapter III ³. Still, it is worthwhile recalling the basic ECLA tenets on regional integration, which would inform the principles and norms of the proposed free trade area. First, regional economic integration was an instrument of industrialisation. Regional integration would allow to overcome the inefficiency associated with parallel industrial activities in isolated national markets. Secondly, the negative welfare implications of trade diversion would be minimal, since trade diversion would be translated into higher rates of growth (allowed by regional import-substitution) and thus the total amount of imports

¹ Cf. V. Urquidi, 'Trayectoria del Mercado Común', p. 75.

² The Montevideo Treaty was originally signed by Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay. Later, it received the adhesion of Colombia, Ecuador, Venezuela and Bolivia.

³ The evolution of the specific proposals for the free trade area are summarised in section III.

from centre countries would remain constant or even increase. Thirdly, regional integration would encourage the diversification of exports towards manufactures. Finally, reciprocity and balanced regional trade would be central to the success of economic integration, since this assured that all countries would share in the growth of manufacturing.

If ECLA ideas shaped the negotiation of a regional market, the 'supply' of institutions had to consider as well international commitments. The international regime might or might not facilitate the strategy proposed by ECLA. Two different situations are found in this respect, namely a coincidence of proposals with GATT and confrontation with the IMF.

II.3. Sources of Institutional Change: The GATT Regime

The regional regime had to take account of the broader international regime that had emerged from Bretton Woods. Brazil, Chile and Uruguay were members of the GATT and had therefore to lend attention to its rules. The main obstacle to consider was the need to obtain a waiver from the Most Favoured Nation clause, which provided for the automatic extension of trade preferences to all GATT members. In two cases the GATT allowed for a waiver from the MFN clause. Article XXV (5) allowed for a special waiver if a majority of two thirds of GATT members supported a request tabled by a contracting party. Article XXIV allowed for an exception to the MFN clause if trade preferences were granted with the

objective of forming a free trade area or a customs union. It soon became clear that the most convenient course of action would be the constitution of a Latin American free trade area or custom union, in the terms defined by article XXIV of the GATT, rather than requesting a waiver under article XXV ¹. This would raise less resistances from other countries and especially from the USA, which made it clear that she would favour a solution in the terms of article XXIV ². This was expressed in several occasions during the negotiations of LAFTA ³. Raymond Mikesell (US representative

¹ With this objective, consultations with the GATT took place in November 1958. Concurrently, the Brazilian and the Chilean representatives informed the GATT about the initiative of forming a regional market at the thirteenth session of the Contracting Parties in Geneva. Representatives of the USA and the UK were also approached, given the weight that their views carried within the GATT. Cf. the report given by Mr. Edmundo Barbosa da Silva at the meeting of Consultation in Trade Policy of representatives of the four Southern countries (Argentina, Brazil, Chile and Uruguay) in Santiago, on 6 April 1959. Cf. ECLA, The Latin American Common Market, pp. 100-1.

² This meant that Latin American countries had to complain with GATT conditions as regards the formation of a free trade area. First, the free trade area should not apply higher trade barriers to the rest of the world than those formerly applied by its members. This would lead to more trade creation than trade diversion. Second, the free trade area should include most of the traded goods. The reason for this requirement is theoretically less clear (as noted by Bagwhati), as it implies more potential for trade diversion. Cf. J. Bhagwati, 'Multilateralism and Regionalism'. Apparently, this was intended to avoid piecemeal, discriminatory arrangements which could strengthen the hand of the government in foreign trade.

³ The Embassy of the USA at Rio de Janeiro stated in August 1958 that Washington would be prepared to accept a free trade area or customs union but would study the effects on trade diversion of any other preferential scheme in Latin America. The statement can be found in ECLA, The Latin American Common market, pp. 101-2. The US negative attitude respect to a Latin American free trade area was analyzed in chapter IV.

at the second session of the ECLA Working Group in Mexico, February 1959) criticised aspects of the ECLA project that seemed to contradict GATT rules ¹. A similar position was adopted by the USA at the Buenos Aires Conference of September 1957, in which the US representatives were 'successful in getting eliminated any reference to possible selectivity by product or industry' ². Prebisch himself reassured the USA that the free trade area would have a competitive approach ³.

However, the proposal of the free trade area cannot be seen just as a convenient device to surmount US and GATT resistances to trade preferences in the region. The idea of a free trade area had solid foundations in ECLA's view on

¹ R. Mikesell observed that the steps necessary to create a free trade area were not as clearly spelled out as that required for the creation of a partial scheme of preferences. This could lead to ad hoc discriminatory arrangements. He also observed that the ECLA project of special arrangements for industrial complementarity and specialisation 'seems to leave the door open to bilateral negotiations of a discriminatory nature'. The comments of Mikesell are reprinted in ECLA, The Latin American Common Market, p. 50. See also the reply of Urquidi to these criticisms in V. Urquidi, 'The Common Market as a Tool of Latin American Economic Development: A Comment', in A. Hirschman (ed.), Latin American Issues: Essays and Comments, (New York, 1961).

² Cf. 'Current Economic Developments', Department of State, Lot 70, D467, Secret, Washington, 17 September 1957, in Foreign Relations of the United States, 1955-57.

³ In a conversation with Sub-Secretary Dillon, Raul Prebisch emphasised that 'the idea of creating a common market for individual products in the field of capital goods would be economically productive only if there were complete freedom of competition between the industries in the countries participating in the plan'. Cf. 'Memorandum of Conversation, Alvear palace, Buenos Aires', Lot 60, D 665, MC/1-23, official use only, 16 August 1957, in Foreign Relations of the United States, 1957.

the role of economic integration in the process of industrialisation. It also had support in the antecedents of 1941 and (to a lesser extent) 1953¹. Thus, the support for the idea of a free trade area was not limited to its political expediency. This was pointed out by the Brazilian negotiator at the GATT, Barbosa da Silva, when he considered the disadvantages of asking for a special waiver under article XXV (5):

*'to invoke article XXV (5) might be somewhat risky. By means of subtle distinctions in the wording of the waiver, the Contracting Parties to GATT might to some extent frustrate the aims of the Latin American countries. That provision was also more suitable for sectoral integration than for the broader objectives aimed at by Latin America'*².

Therefore, there was a coincidence of objectives, reflected in a smooth negotiation with the GATT³. Wyonczek observed that 'contacts and discussions between the Latin

¹ A more stable and comprehensive institutional framework for bilateral trade had also been demanded by business sectors in the late forties and fifties. If this demand did not imply supporting a free trade area, it provided a stimulus for change.

² Cf. ECLA, The Latin American Common Market, p. 101.

³ An early draft of the agreement was presented to the GATT in October 1959, in Tokyo, to the fifteenth session of the Contracting Parties. Subsequently the Montevideo Treaty was officially submitted to scrutiny by the GATT Secretariat. While proceeding to further analysis of the application, the GATT gave support to the continuation of negotiations in Latin America.

American members and the GATT Secretariat were most amicable, since GATT was doing its utmost to make allowances for the region's special difficulties in the field of trade and economic growth'¹. This coincidence did not exist, however, as regards the creation of a regional payments system. In this case, the 'supply' of institutions was limited by the opposition of the USA and the IMF and the lack of consensus in Latin America.

II.4. The Limits of institutional Change: The IMF and the Regional Payments Agreement

A key problem in the facilitation of regional trade was the creation of a regional payments system. The early post-war period was characterised by the predominance of rigid bilateral agreements in Latin America² and among Latin American, European and Asian countries. Advancing towards a more multilateral approach to payments in non-convertible currencies became an attractive option at the height of the 'dollar shortage'. Already in June 1948 ECLA was asked to study a multilateral payments system including some Latin American and European countries³.

¹ Cf. M. Wyonczek, 'A Brief History', p. 85.

² Not all Latin American countries, however, used bilateral payments agreements. Countries like Peru and Venezuela had achieved convertibility earlier than Argentina and Brazil and trade with these countries had to be undertaken in convertible currency.

³ The study, which was carried out for ECLA by experts of the IMF, concluded that such a system could have only a limited impact on the facilitation of trade while involving

In the mid-fifties some Latin American countries signed payments agreements with European countries in an attempt to move towards a partially multilateral payments system. The 1955 'Hague Club' gathered Brazil with the Netherlands, the UK, Austria, Belgium, France, Italy and Luxembourg in a multilateral payments agreement which allowed for the transfer of balances in European currencies. The 1956 'Paris Club' was established between Argentina and the same European countries as the 'Hague Club', plus Switzerland and the Scandinavian countries. However, this had little effect on intra-Latin American trade as the two clubs were not inter-related, that is, Argentina and Brazil could not compensate reciprocal balances through their respective clubs¹. Therefore, while trade and payments relations with Europe gradually became more multilateral, they remained on a strictly bilateral basis in the Southern cone of Latin America².

many costly technical problems. It was recommended instead to encourage trilateral compensations and transfers of sterling balances. However, the creation of the European Payments Union (EPU) in 1950 reinvigorated the idea of a payments system. EPU represented an opportunity for compensations within the Latin American area and with respect to Europe. Subsequently, a study conducted by Robert Triffin and handled to ECLA in March 1953 lent support to the idea of multilateral payments in non-convertible currencies. Although Triffin was sceptical about the advantages of creating a Latin American Payments Union, he was in favour of reaching a compensatory multilateral agreement among Latin American and EPU countries. Cf. V. Urquidi, Trayectoria del Mercado Común, p. 36.

¹ Cf. *ibid.*, p.42.

² This was the case of Argentina, Brazil, Chile and Uruguay, which would later take the lead in the quest of a multilateral payments system in the region.

The idea of forming a free trade area encouraged the quest for a complementary payments system¹. A project for a regional payments system was proposed at the second meeting of the Central Banks Working Group, held in Rio de Janeiro by the end of 1958. It included automatic compensations and transfer of balances among Latin American countries. The Southernmost countries would later include the Rio de Janeiro dispositions in their proposed free trade agreement². However, several factors eventually brought these initiatives to a standstill. This failure was associated with: (i) the opposition of the IMF to any form of payments system in Latin America and (ii) divergent views among the

¹ In November 1956, during the first session of the ECLA Trade Committee, a set of norms to be adopted by the Latin American countries in their payments agreements was proposed, with a view to making them more uniform and flexible. These norms were the following: (i) exchange rates for export earnings in clearing accounts should be equal to those applied to transactions in convertible currency; (ii) trade through bilateral accounts should be made at prices no higher than those prevailing in the international market; (iii) payments for trade-related services (transport, insurance) should be included in the bilateral clearing system; (iv) reciprocal credits, partially automatic, should be adopted for the transfer of balances among the members of payments agreements. These norms sought to reduce the instability of regional trade and the opportunities for fraud and contraband, that had beset regional trade under the bilateral system. In May 1957 a meeting of the Latin American Central Banks Working Group approved a model for bilateral payments agreement, the so-called Montevideo Standard Agreement, drawing from the norms defined by the ECLA Trade Committee. Bilateral payments agreements were expected to conform to this model in order to facilitate the transition to a multilateral payments system. The Montevideo Standard Agreement was subsequently adopted by Argentina, Bolivia, Chile and Uruguay and this allowed for some modest compensatory transfers in the region. Cf. ECLA, The Latin American Common Market, p. 106.

² Cf. ECLA, The Latin American Common Market, pp. 106-7.

Latin American countries.

The opposition of the IMF to the idea of a regional payments agreement was based on fears that it could hinder the move towards convertibility. This position was fully supported by the USA ¹. It was believed that a Latin American payments system could either strengthen exchange controls in the Southern countries or reintroduce them in countries that had already achieved convertibility. As reported by an UK observer,

'the IMF, the US government and the UK have all expressed definite opposition to the view that a regional payments system for the multilateral compensation of bilateral balances is either necessary or desirable to stimulate trade among Latin American countries. In our view the introduction of a system in which there is not automatic settlement of balances in convertible currencies would tend to perpetuate bilateralism and the maintenance of exchange controls, particularly if there were no provision for the automatic discouragement of extreme creditor and debtor positions' ².

In particular, a regional system of automatic credits for debtor countries was expected to lead to significant trade-

¹ Cf. The Latin American Common Market, p. 113 for a summary of US official statements and *ibid.*, p. 123, for those of the IMF. The attitude of the USA and the IMF have been analyzed by M. Wyonczek, 'A Brief History of the Montevideo Treaty', pp. 84-104.

² Cf. FO 371 155768 A 1123/10, 3 March 1961. See also FO 371 155768 A 1123/3, 16 January 1961.

diverting effects ¹.

On the other hand, ECLA and many Latin American governments argued that the move towards convertibility had been associated with severe import restrictions. More trade liberalisation would require higher levels of compensatory transfers within the region in order to avoid external difficulties ². This was regarded as a tool for furthering the process of liberalisation on a multilateral basis. However, these arguments did not mollify IMF resistances to

¹ It was considered that 'a common tariff combined with arrangements for automatic credits, whereby countries with a persistent surplus will be obliged to grant automatic credits to other area members rather than use the surplus to import products freely from anywhere in the world, would represent a step back from the high degree of convertibility attained in Latin America'. Cf. FO 371 155769 A 1123/17, 25 May 1961. Concerns about new barriers to trade were also expressed in the press. The Financial Times pointed out that 'the lesson of all this for British industry is clear. (...) If the UK is to retain a stake in the area it must follow the example of her German and Japanese competitors and establish, or share in establishing, manufacturing industries within Latin America'. Cf. 'The Latin American Free Trade Area', Financial Times, 4 February 1960.

² In his speech to Latin American representatives at LAFTA negotiations, Prebisch observed that 'a free trade zone needs a credit system which absorb the initial impact of liberalisation. This requires a payments system which gradually should become convertible. Convertibility will be more easily achieved when trade balances became equilibrated, since that reduces the necessity of settling balances in dollar'. Cf. 'Reunion Para el establecimiento de una Zona de Libre Comercio, Committee N.3', tachygraphy version of the meeting, mimeo, 18 September 1959. In a subsequent report, the ECLA secretariat observed that 'the function of credit will be to give time to correct adverse effects of liberalisation on balance of payments. This correction should come from the favourable consequences of liberalisation measures that countries with a persistent export surplus will have to adopt'. Cf. ECLA, 'The Reciprocal Credits System for the Free Trade Area', unpublished paper, Montevideo, January 1960.

the project ¹, which was particularly significant as external difficulties had strengthened the hand of the IMF in policy decisions in Latin America ². This offers an interesting contrast with the formation of the EPU in 1950. In this case, the IMF expressed as well its opposition to EPU, but strategic concerns led the USA to give support to the initiative. But no similar interest existed in the case of Latin America and a more orthodox approach to the problem prevailed.

Various factors played a role in shaping this different international response to Latin American initiatives. If the creation of the European Economic Community represented a significant antecedent for a free trade area in Latin America, the European return to convertibility implied that a Latin American payments system would contradict the general trend towards convertibility. Moreover, developing countries were more represented and their views more considered in the GATT than in the IMF, and this affected the policy of these organisations. Besides that, the different ability to enforce policies by the GATT and the

¹ The clash of views was especially strong during the meeting of the representatives of Central Banks in January 1961, when Prebisch 'used the formal opening session to launch a strong and at times bitter attack on the IMF's attitude towards the problem of payments in the proposed free trade area'. Cf. FO 371 147678 A 1123/2, 27 January 1961.

² As noted by M. Wyonczek, 'A Brief History', p. 90, the very significance of the role that the IMF had acquired in Southern Latin America in the late fifties was in contradiction with the alleged success of the move towards convertibility. Argentina and Uruguay signed stand-by agreements with the IMF in 1958.

IMF was relevant. The IMF had a say in Latin American economic policies which the GATT had not, especially as a result of the financial difficulties of the late fifties. Countries could have challenged the GATT, and the costs would probably have been low, but challenging the IMF (as Kubitschek learnt in 1959) implied in substantial financial costs.

Moreover, there were as well divergent views among the Latin American countries as regards a regional payment system ¹. The heterogeneity of situations in Latin American prevented her from reaching a common position. At the meeting of Central Bank representatives of January 1961, these divergences were visible. While Argentina, Brazil, Chile and Uruguay supported ECLA's proposal, this was firmly opposed by Bolivia, Paraguay and Peru, while Mexico was neutral ². Therefore, both opposition from the IMF and

¹ In relation with the debate raised by the regional payments system proposal, it was observed that 'conflict, of course, was inevitable (...) because the proposed free trade area contains some countries which already practice free convertibility and some which are years ago from such a goal' Cf. FO 371 147678 A 1123/2, 27 January 1961.

² Cf. FO 371 147680 A1123/2 27 January 1961 and A 1123/22, 29 March 1961. Even within the Southern countries the endorsement of the idea was not uniform. While Chile and Uruguay were the most enthusiastic, Argentina was frequently ambiguous. In 1959 Argentina had joined Peru in opposing the idea of a regional payments system. Cf. 'Conferencia Inter-Gubernamental para el Establecimiento de una Zona de Libre Comercio Entre Países de America Latina', tachygraphy version of the sessions of Committee N.1, mimeo, 18 September 1959. Brazil in turn gave priority to the free trade area and placed less emphases on the regional payments system. These differences were related to the degree of convertibility already achieved by these countries. Argentina conducted her trade with the USA and Europe in convertible currency - although this coexisted with substantial trade restrictions. Conversely, the multiple

internal differences within the Latin American group blocked the initiative for a regional payments system during the negotiations of January 1960 ¹.

In sum, while the GATT adopted a flexible attitude which facilitated the creation of new institutions for promoting regional trade, the opposition of the USA and the IMF, along with divergent views within Latin America, acted as a barrier to regional payments system.

II.5. Conclusions

1. This section addressed the collapse of the regime of restrained bilateralism and the emergence of the free trade area proposal, which led to the creation of LAFTA in 1960. In the second half of the fifties the main instruments that regulated bilateral trade between Argentina and Brazil were challenged. Devaluations, the simplification of the exchange market and the shift towards tariff protection redefined the framework for negotiations and made adaptative responses ineffective. As a result, previous expectations and patterns of behaviour were no longer working in the context of the

exchange rate system still remained in place in Brazil, Chile and Uruguay. Cf. 'Conferencia Inter-Gubernamental para el Establecimiento de una Zona de Libre Comercio entre Países de America Latina', tachygraphy version of the session of the Committee N.3, mimeo, 18 September 1959.

¹ The final declaration of the Conference stressed full convertibility as the final aim while admitting that different payments arrangements would coexist for some time. The only common position achieved in this respect was a pledge for avoiding any kind of intra-zone discrimination that could arise from these different payments arrangements. Cf. FO 371 147678 A 1123/2, 27 January 1960.

late fifties. New arrangements were required in order to keep existing preferences and capitalise on the experience in trade negotiations.

2. In the search for a new trade regime, ECLA played a significant role in promoting the convergence of perspectives among policy-makers in different countries and in providing the technical capabilities demanded by the negotiations. ECLA acted as a catalyst in the formation of LAFTA by extending the basis of consensual knowledge upon which new principles and norms would be adopted. The late fifties were a period of learning in which a new trade regime emerged. However, the formation of LAFTA had to consider other constraints, associated with the international regime of trade and payments. In the case of the GATT, ECLA proposals for a free trade area and GATT requirements converged, and hence no external barriers existed for institution-building. In the case of the regional payments systems, the IMF and the USA understood that this represented a deviation from a general move towards convertibility. The opposition of powerful actors in the international system, and divergent views among the Latin American countries (stemming from their different position in terms of convertibility), weakened the case for a payments agreement and constrained the 'supply' of institutions.

III. TRADE REGIMES AND STRUCTURAL CHANGE

The objective of this section is to provide a more formal definition of the regime of restrained bilateralism and of the proposed LAFTA regime, and relate them to the process of structural transformation of 1939-60. Thus, this section briefly summarises the previous discussion on structural and institutional change.

III.1. Comparing Trade Regimes: Restrained Bilateralism and LAFTA

A change of regime implies a redefinition of the principles and norms which shape expectations and behaviour. If principles and norms differ, then the rules and decision-making procedures that provide for their detailed application should also change ¹. Chart V.1 offers a comparison of the components of the regime of restrained bilateralism and those of the proposed LAFTA regime.

¹ The definition of the concepts of principles, norms, rules and decision-making procedures is presented in chapter I.

CHART V.1. TRADE REGIMES

Restrained Bilateralism	Proposed New Regime (LAFTA)
<p><u>Principles</u></p> <p>(i) Cooperation subordinated to geopolitical rivalry; (ii) Bilateralism; (iii) Obtaining the gains from trade, especially in complementary primary goods; (iv) Saving hard currency.</p>	<p><u>Principles</u></p> <p>(i) Cooperation should reinforce the position of the region in the international system and support economic development; (ii) Regionalism (Latin American MFN clause); (iii) Increasing the efficiency and scope of ISI-2 through regional industrial exports and specialisation; (iv) Saving hard currency.</p>
<p><u>Norms</u></p> <p>(i) Trade liberalisation for complementary primary products and a small set of industrial goods; (ii) Bilateral preferences; (iii) Compensation of payments and equilibrium in the bilateral trade balance.</p>	<p><u>Norms</u></p> <p>(i) Trade liberalisation with a view to include most of regional trade; (ii) Regional trade preferences; (iii) Compensation of payments (since 1965) and equilibrium in the regional trade balance, especially in industrial trade; (v) Special treatment for less developed countries.</p>

<p><u>Rules</u></p> <p>(i) Value and composition of exchange established for a certain period (1-3 years) through a negotiated list; renegotiation of the list of products and quantities at the moment of expiration;</p> <p>(ii) Duty reductions, automatic import permits and favourable exchange treatment;</p> <p>(iii) Credits for financing trade and facilities for the settlement of net trade balances.</p>	<p><u>Rules</u></p> <p>(i) Progressive and irreversible trade liberalisation, that should encompass almost all trade in an 12-year period;</p> <p>(ii) Annual negotiations to define the new products to be added to the progressive list;</p> <p>(iii) Programmed reduction of tariffs and non-tariffs barriers through 'common' and 'national lists'; sectoral 'complementary agreements';</p> <p>(iv) Automatic cancellation of regional credits and debits (since 1965);</p> <p>(v) Non extensible preferences in favour of less developed countries.</p>
<p><u>Decision Making Procedures</u></p> <p>Very low degree of formal institutionalisation and supra-nationality.</p>	<p><u>Decision Making Procedures</u></p> <p>Higher degree of formal institutionalisation but low degree of supra-nationality.</p>

At the more general level, both regimes were based on different principles. In the former regime cooperation was subordinated to geopolitical rivalry, while gains from trade focused mainly on the exchange of primary goods. In LAFTA, closer cooperation was seen as an instrument to enhance economic development. The gains from trade were regarded in the context of the process of ISI-2 in which a regional market would lead to increased efficiency, advance import-substitution and develop industrial exports. Saving hard currency was an objective in both regimes, reflecting the persistence of external disequilibrium in convertible

currency. But the proposed LAFTA regime established this objective at a regional rather than a bilateral level. In LAFTA, a Latin American MFN clause provided for the extension of preferences negotiated at a bilateral level to all members - except in the case of preferences given to less developed countries.

These different principles were translated into different norms in the two regimes. In the regime of restrained bilateralism, the principle of the subordination of cooperation to geopolitical rivalry meant that politically demanding forms of cooperation should be avoided and thus concessions limited to preferences for specific goods. The saving of hard currency was associated with the norms of granting preferences (trade diversion from the dollar area), achieving trade equilibrium and using soft currencies to compensate for trade imbalances. Conversely, in the LAFTA regime the principle of obtaining the gains from trade was associated with the promotion of industrialisation. This was expressed in the norm of extending trade preferences to a more diversified set of goods, especially industrial goods. Complementary agreements were also intended to strengthening industrial specialisation. In turn, the norm of special treatment for less developed countries reflected the heterogeneity implicit in the new regional approach. This norm adapted the principle of enhancing industrialisation to the diversity of industrial capabilities in the region.

Norms were applied through specific rules. In the case

of the regime of restrained bilateralism, rules comprised the definition of the list of products to which preferences were given. They also defined the types of preference granted - a lower exchange rate, lower duties and automatic import permits, depending on the specific trade and exchange regulations in each country. Finally, rules detailed the payments arrangements for financing trade and settling net balances. These rules applied to short periods and then had to be renegotiated. Conversely, in the LAFTA regime, the norm of liberalisation of 'substantially all trade' was detailed in a timetable for progressive trade liberalisation, based on annual product-by-product negotiations, through which 'common' and 'national' lists were defined. Specific, more flexible rules for less developed countries were established, in accordance with the norm of special treatment for less developed countries ¹.

As regards decision-making procedures, the regime of restrained bilateralism displayed a very limited degree of institutionalisation and supra-nationality. This was in full conformity with the principle of subordinated cooperation and the limited scope - in terms of the periods covered and the goods involved - of the agreements. On the other hand, the more complex set of commitments entailed by LAFTA implied a higher degree of formal institutionalisation in the management of the trade regime. LAFTA implied a pattern

¹ The norm of payments compensation was expressed in an agreement for automatic cancellation of credits and debits in regional trade. However, as discussed, this rule could only be included in 1965, while it was absent in the original LAFTA Treaty.

of systematic negotiations which was absent in the former regime. LAFTA thus represented a significant progress in terms of formal institutionalisation. However, the degree of effective supra-nationality in LAFTA and powers conferred to regional bodies remained very low (the point is analyzed in Part III).

III.2. Institutional Change and Structural Change

It has been argued in chapter I that the evolution of the trade regime was closely associated with structural change and to perceptions about how the system works. It has also been suggested that these variables - structures, institutions and ideas - interact in an "evolutionary" model. In the first case, institutions appear as a variable, which depends on structures and ideas. In the second case, institutions are intervening variables that can affect outcomes. The first approach corresponds to a static analysis which permits the identification of how policies are constrained by systemic variables and actors' perceptions. The second approach corresponds to a dynamic analysis in which constraints are changing, in part as a result of past decisions.

(a) Institutions as a Dependent Variable

Chart V.2 summarises the links among structures, institutions and ideas, in which institutions appear as the

dependent variable. Institutions are in this case the regimes of regional cooperation; structures are the systemic variables that shape the costs and benefits of cooperation; and ideas are perceptions of how the structural variables are inter-related and how they affect trade and growth. Institutions are shaped by ideas within the boundaries placed by the structural variables.

CHART V.2. STRUCTURES, IDEAS AND INSTITUTIONS, 1939-60

Variables/ Period		1939-55	1956-60
Structural Variables	Changes in the International System	Opportunities for regional trade created by II World War and the dollar shortage; rise and fall of Brazil-USA special relationship; regional rivalry.	Perception of inadequacy of multilateral institutions and US policy towards Latin America; balance of payments crisis; export pessimism; inflow of the 'new' foreign capital.
	Structural change in the domestic economy	ISI-1: easy stage of import-substitution.	ISI-2: industrial diversific. and increasing returns to scale.
Ideas		Adaptation; Growing emphases on industrial development, with reduced analytical content.	Learning; impact of ECLA ideas on the role of regional trade and integration in economic development.
Institutions		Restrained Bilateralism.	Proposed LAFTA regime.

Chart VI.2 shows that the regime of restrained bilateralism corresponds to a set of structural conditions which favoured diverging perceptions in Argentina and Brazil as regards opportunities and constraints in the international system. This was related to tensions in the

relationship of Argentina, Brazil and the USA, which encouraged regional rivalry and limited Brazil's interest in cooperation with Argentina. The weak industrial basis of the period also contributed to limit trade and cooperation (ISI-1), as weak supply capabilities (especially in the capital goods sector) constrained the expansion of trade and raised the costs of trade diversion. On the other hand, cooperation was stimulated by economic complementarity in agricultural products, the opening of new trade opportunities brought about by the war and the dollar shortage of the post-war period. The regime of restrained bilateralism expressed these structural conditions. The balance of costs and benefits of regional cooperation was tilted towards the costs. This favoured a limited pattern of cooperation based principally on preferences to primary products. The institutional fragility of the regime and the limited scope reached by the agreements were a consequence of this.

Conversely, the new structural conditions of the 1956-60 period reshaped the incentives for cooperation. Cooperation was then enhanced by shared perceptions regarding the place of Argentina and Brazil in the international system, which prompted a defensive move. This was associated with what was seen as the US neglect of Latin American demands for development. It also reflected the inadequacy of the multilateral system (the Bretton Woods institutions) to respond to the demands posed by the developmentalist effort. Domestic structural change reinforced this outlook. The progress of industrialisation

(ISI-2) heightened the inefficiency of production for isolated markets, reduced the costs of trade diversion and increased the potential scope for regional trade. This was accompanied by the diffusion of ECLA ideas linking industrialisation, import-substitution, export diversification and regional trade. This provided a new shared theoretical framework - in the words of Haas, new basis of consensual knowledge - which shaped the reformulation of new principles and norms, thereby giving rise to a process of learning. The demand for institutions prompted by the crisis of the regime of restrained bilateralism in the mid-fifties could then be translated into new principles and norms that comprised a new trade regime.

(b) Institutions as an Intervening Variable

The previous comparative discussion sought to show how structural change and ideas redefined the boundaries within which actors cooperated in 1939-60. By changing the costs and benefits of economic cooperation, these variables shaped different patterns of behaviour, structured in two different trade regimes. Still, institutions may have an impact in structures and ideas. Institutions seem to have played a role in enhancing bilateral trade through trade preferences and special payments arrangements. It was seen that they were unable to avoid the loss of dynamism of bilateral trade after the war. But the increase in the index of intensity of

trade between Argentina and Brazil suggests that the fall in trade could have been still sharper had these preferences not been granted. Therefore, the regime affected structural conditions by encouraging trade and strengthening the interest in cooperation. It should be borne in mind that the main reason that originally moved the Southern Cone countries towards a free trade area was the aim to keep their preferences after the changes in economic policy in 1957-58. The advantages provided by the old regime were regarded as valuable and the new trade regime was seen as a form of giving continuity to this.

On the other hand, institutions may affect ideas by providing experience of negotiation and of a basis for the discussion of alternative policies. Lack of satisfaction with the regime of restrained bilateralism was high among trading interests before the mid-fifties. The experience by these sectors of recurrent instability led them to demand a reformulation of the trade regime with a view to stabilizing trade. In the same vein, in the second half of the fifties Brazilian negotiators pressed for a more consistent programme of imports of Brazilian manufactures by Argentina, in the light of the disequilibrium prompted by the 1956 devaluation in Argentina. Therefore, ECLA ideas as regards the formation of a free trade area found a fertile ground among policy-makers who had experienced the difficulties of negotiating within the old arrangements, especially after 1955.

III.3. The Determinants of Cooperation: A Simple Illustration

The different settings in which economic cooperation between Argentina and Brazil took place in the period 1939-60 can be analyzed, with gains in terms of simplicity, through two well known game theory models, namely the 'prisoner's dilemma' and the dilemma of 'common aversions'¹. This can help to illustrate the options faced by these countries and the role that the regional trade regime played in reducing uncertainty. Rather than an effort in formalisation, this exercise should be seen as a stylized description of the research presented in the previous chapters.

The strategies of Argentina and Brazil with respect to bilateral and regional trade are defined as partial liberalisation, full liberalisation and non-cooperation. Partial liberalisation implies a reduction in trade barriers and the awarding of preferences for complementary primary goods and a small number of industrial goods, while maintaining protected most of the industrial sector. Full liberalisation amounts to the creation of a free trade area. Non-cooperation implies commercial sanctions, in which both countries place heavy restrictions on imports from and exports to each other. Two different scenarios emerge from the combination of these strategies, based on different

¹ Cf. A.A. Stein, 'Coordination and Collaboration: Regimes in an Anarchic World', in S.D. Krasner (ed.), International Regimes, pp. 120-25.

structural conditions: the Pinedo-Aranha/LAFTA scenario (which represents the 1939-41 and 1956-60 periods) and the regional/hemispheric rivalry scenario (which may be loosely labelled a Perón/Vargas scenario, which represents the 1942-55 period).

(a) The Pinedo-Aranha/LAFTA Scenario

The frustrated initiative at creating a free trade area in 1941, and the relatively more successful effort represented by LAFTA in 1960, can be described in terms of the prisoner's dilemma. This is the standard game in trade negotiations and there is nothing special in this scenario. But it sheds light on the more complex situation represented by the regime of restrained bilateralism. Chart V.3 presents the pay-off matrix of the Pinedo-Aranha/LAFTA scenario.

Chart V.3. The Pinedo-Aranha/LAFTA Scenario

Argentina	Brazil		
	PL	FL	NC
PL	2,2	4,1	
FL	1,4	3,3	
NC			0,0

PL = Partial Liberalisation

FL = Full Liberalisation

NC = Non Cooperation

0 = Worst Outcome

4 = Best Outcome

If Argentina and Brazil act unilaterally, the dominant strategy of each country will be partial liberalisation. This strategy allows a country to seize on the opportunities provided by the market of the other country without exposing her industrial sector to international competition. However, the combination of each country's preferred strategy leads to an outcome which is inefficient (2,2). Both countries can achieve an increase in their pay-offs if they adopt a cooperative strategy and both liberalise trade. The outcome will be (3,3) in this case, which is Pareto optimal, as no country can improve its position without reducing the welfare of the other. In other words, in this case,

independent decisions would lead to an outcome which is not Pareto optimal. Therefore, it is rational for Argentina and Brazil to reach an agreement on trade policy based on the strategy of full liberalisation in both countries. However, in order to coordinate decisions and to be sure that each country would fulfil its promises, a regime was necessary - that is, a set of implicit and explicit rules which assured the partners that they would be protected against non-cooperative behaviour. This was the objective of the 1941 Treaty for progressive Free Trade and the 1960 LAFTA agreement.

(b) The Regional/Hemispheric Rivalry Scenario

A different pay-off matrix emerges when is considered the existence of rivalry between Argentina and Brazil and the influence of Brazil's 'special relationship' with the USA during the war years. This scenario is illustrated in chart V.4.

Chart V.4. The regional/Hemispheric Rivalry Scenario

	Brazil		
Argentina	PL	FL	NC
PL	2,3	4,1	
FL	1,4	3,2	
NC			0,0

PL = Partial Liberalisation

FL = Full Liberalisation

NC = Non Cooperation

0 = Worst Outcome

4 = Best Outcome

This matrix differs from the Pinedo-Aranha scenario in that the strategy of full cooperation with Argentina gives to Brazil a lower pay-off than partial cooperation - even if Argentina follows a strategy of full cooperation. In other words, regardless of the strategy followed by Argentina, for Brazil it would always be rational to adopt a strategy of partial liberalisation. In order to understand this matrix it is necessary to consider that a third actor is now in the game, namely the USA. This gives rise to a more complex problem, namely that of coalition formation. Even so, the game can still be defined in very simple terms assuming that a coalition between Argentina and the USA is ruled out and

that the USA can obtain a higher pay-off forming a coalition with Brazil than by not forming a coalition. This assumption is reasonable since conflict between Argentina and the USA prevailed in most of the period and Brazil was the natural partner to restrain Argentina. Thus, it is valid to focus on Brazil's options. Brazil can choose between making a coalition with Argentina or making a coalition with the USA. A free trade area with Argentina implies that Brazil opted for a coalition with her neighbour, as a free trade area would be regarded as a non cooperative move (high political commitment) by the USA and therefore elicit a non cooperative policy with respect to Brazil by the USA. This means that Brazil would lose political, military and economic support from the USA (the 'special relationship' would be terminated). Brazil's outcome would then be only 2, while Argentina outcome would be 3¹. If on the contrary Brazil chooses a partial liberalisation strategy, such a move would not be regarded as unfriendly by the USA, and the economic and political benefits of the 'special relationship' will continue to come. If Argentina follows as well a strategy of partial liberalisation with Brazil, Brazil would receive 3 instead of 2, while Argentina is left with 2.

It could be argued that such a pay-off matrix makes unnecessary the formation of a regime. Regimes imply an

¹ It is assumed that Argentina would obtain more benefits from a cooperative policy by Brazil than on the other way round because Argentina was suffering the US boycott and hence needed trade more than Brazil did.

agreement in which countries accept not to apply certain policies unilaterally. However, no constraint on Brazil's policy decisions seems to exist in this case. Brazil would unilaterally apply the policy of partial liberalisation which assures her the highest outcomes, no matter what the Argentines did. Argentina, in turn, would have to follow a policy of partial cooperation, because any other strategy would leave her in a worse situation (outcome 2 in the case of partial liberalisation, 1 in the case of full liberalisation and zero in the case of a trade sanctions). Why is a regime necessary in this case?

The answer lies on the heightened uncertainty that exists in a context of hemispheric and regional rivalry, in which expectations are particularly volatile. The fact that Brazil formed a coalition with Argentina's rival, forcing Argentina to accept a lower outcome than that she would have obtained with full cooperation from Brazil, left Argentina 'aggrieved'. The controversial secret conference of Perón at the Argentine War School, in which he criticized the ambiguous position of Vargas, is an example of this. Argentina might then consider applying trade barriers in order to force Brazil to reconsider her strategy. In other words, if one of the players feels 'aggrieved', a regime is necessary to manage tensions and avoid the worst possible result, namely a commercial war¹. A regime would prevent the

¹ It could be argued that as a trade war results in the worst outcome for all players (0,0), this strategy violates the assumption that actors play rationally. However, with no coordination and limited exchange of information relatively small steps in terms of retaliation may trigger a major

aggrieved country from resorting to a negative-sum game. The argument also applies to Brazil. During the war, the USA demanded from Brazil a more aggressive attitude towards Argentina. Significant internal sectors in Brazil also demanded a clear-cut break with Argentina. This added to uncertainty and made trade sanctions a likely event, especially in the early fifties. Therefore, a regime providing a context for negotiations (including the basic guidelines and procedures for bilateral agreements), frequent contacts and exchange of information becomes necessary. This hypothesis seems to be confirmed by the discussion presented in Part I of the theses. Even during the turbulent years of the second Vargas government, when cooperation with Argentina was a major source of friction in Brazil's domestic politics, a cooperative atmosphere was sought and maintained through informal (and even secret) channels. Efforts to sustain a climate of cordiality were visible during the Dutra government. Through the 1942-55 period agreements were negotiated and a framework for trade provided by the 1940 Treaty of Commerce and Navigation. Clearly, the trade regime of the years 1939-55 was highly instable and concessions limited. However, the regime of restrained bilateralism provided a framework for curbing

trade conflict. This was more than a purely theoretical possibility. As discussed, Argentina did use the delaying of commercial negotiations with Brazil in the early fifties with a view to penalise the latter for what she regarded as an hostile attitude in Brazil towards cooperation with Argentina, led by the domestic opposition to Vargas. Moreover, this was precisely what happened in the relations between Argentina and Uruguay in the early fifties, as analyzed below.

uncertainty and averting a commercial war in a context of high political rivalry.

III.4. Structures and Institutions in a Negative-Sum Game: Argentina-Uruguay, 1942-55

An interesting contrast can be obtained by comparing the Argentine-Brazilian and the Argentine-Uruguayan relations. Clearly, the distribution of power resources between Argentina and Uruguay is extremely asymmetrical, while between Argentina and Brazil is relatively even. This makes up a different scenario in which to analyze the association between structures and institutions. The 1942-55 period is chosen since it comprised a major crisis in the relationship between the two countries which led to trade sanctions and the collapse of bilateral trade.

First, it is necessary to look at Uruguay's position in the international system. The study of Methol Ferre gives a acute account of this ¹. A 'buffer state' between Argentina and Brazil, with a very close association with the UK - along very similar lines of Argentina - Uruguay had to adjust to the decline of the UK and the emergence of US

¹ Cf. A. Methol Ferre, El Uruguay Como Problema (Montevideo, 1971; first edition 1967). On the evolution of Uruguayan economy see J.P. Barrán and B. Nahum, Historia Rural del Uruguay Moderno (Montevideo, 1967-78) and M.H.J. Finch, A Political Economy of Uruguay Since 1870 (London, 1981). A study on the evolution of industry in Uruguay can be found in L. Bértola, The Manufacturing Industry of Uruguay 1913-61: A Sectoral Approach to growth, Fluctuations and Crisis (Goteburg, 1990).

hegemony¹. A producer of temperate agricultural products like Argentina, Uruguay was placed in an eccentric position in terms of economic complementarity with the rising hegemon. A move towards closer economic relations with her two big neighbours (and especially with Brazil, which was a complementary economy in agricultural production) would have been a natural strategy. It can be expected that the conditions of the war and the post-war dollar shortage would have created an interest in Uruguay for a more active regional policy.

The war prompted a move in Uruguay towards cooperation with Argentina. On 14 December 1941 Uruguay and Argentina signed the Barra de Maldonado Treaty, which provided for facilities in the exchange of fruits and livestock and established conventions for navigation and fishing in the River Plate. A Mixed Commission to study the custom, fiscal and exchange clauses required to constitute a customs union was created². However, as the economies of Argentina and Uruguay were more competitive than complementary, there was

¹ Prompted by the fears of being cut out from the British market, Uruguay negotiated an extension of the Roca-Runciman agreement which provided her with an import quota in the UK. Cf. G. Bernhard, Comercio de Carnes en el Uruguay (Montevideo, 1958), pp. 15-25. Negotiations with the USA were not less complicated. The same day that the USA announced the breakdown of trade negotiations with Argentina, she suspended negotiations with Uruguay, because of the similarity of the export structure of the two countries. Cf. FO 371 2416, 22 January 1940. A trade agreement granting concessions to linseed, canned corned beef, casein, cattle hides, tallow, meat extracts and certain coarse wools in the US market would only be signed in July 1942. Cf. FO 371 30 734 A 6883, 27 July 1942.

² Cf. FO 371 25728, 20 December 1941.

strong opposition to the idea in Uruguayan business circles and the initiative faded. Subsequently, bilateral relations became increasingly problematic and no new trade initiatives were adopted.

In effect, Uruguay adopted an active pro-US stance in hemispheric affairs. This increasingly set her apart from Argentina. The Committee for the Defence of the Continent (a strong pro-US body gathering most Latin American countries and the USA) had its location in Montevideo and was presided by former Uruguayan Foreign Minister Alberto Guani ¹. By the end of November 1944 Uruguay had not recognised yet the Farrell government, demanding a clear anti-axis position from Argentina based on 'effective commitments and measures' instead of 'vague promises' ². Moreover, an Uruguayan note issued in November 1945 (then known as the 'Rodríguez Larreta doctrine'), stating that collective military intervention in other Latin American republics could be considered legitimate if the security of the continent was threatened, was naturally regarded as an hostile move by the Argentines ³ and this further deteriorated bilateral

¹ Cf. A. Frega, M. Marona and Y. Trochón, Baldomir y la Restauración Democrática, 1938-46 (Montevideo, 1987).

² BA, Box 70, 'Mémorandum Para la Reunión de Cancilleres', 29 November 1944. Concurrently, in October 1944 Argentina carried out naval manoeuvres in the Uruguay River, in front of the Uruguayan city of Fray Bentos. This was regarded as an Argentine attempt to put pressure on her neighbour. Cf. FO 371 378899 AS 611/5094/2, 30 October 1944.

³ The 'Rodríguez Larreta Doctrine' received a negative response from most Latin American countries, as it opened a dangerous precedent for military intervention. Cf. FO 371 52077 AS 17/11/51, 14 december 1945. See also the Uruguayan weekly magazine Marcha, 'El Papelón Sin Precedente', vol.

relations.

The situation began to acquire still more serious features from 1950, when Montevideo became a haven for Argentine anti-Peronist exiles. The exiles counted on large support in the public opinion and within the official press, which launched strong attacks on the Peronist government, especially after the Peronist seizing of the Argentine newspaper La Prensa ¹. The Argentine reaction was to demand that Uruguay restrict the political activities of the exiles and curb criticisms from the press - the latter a demand which conflicted with the Uruguayan democratic regime. Argentina retaliated by cutting off the flow of trade and people across the border and trade fell vertically in the early fifties, as can be seen in table V.2. The participation of Argentina in the Uruguayan trade became almost negligible (cf. table V.3). This in turn made it more difficult for the Uruguayan government to change its policies and raised protests even from sectors sympathetic with the idea of regional economic integration ².

VII, no. 311, 7 december 1945.

¹ It should be observed that in Brazil it was the opposition to Vargas which pushed forward the strongest criticisms of peronism. The fact that, conversely, Vargas represented positions more sympathetic with Argentina prevented further deterioration in bilateral relations. In Uruguay, it was the blanco opposition led by Luis Alberto de Herrera which sought to preserve the links with Argentina. On the role of Herrera see A Methol Ferre, El Uruguay Como Problema, pp. 37-41. Yet this effort was not enough for stopping inter-state friction in the early fifties.

² Thus, for instance, Marcha expressed its support to the idea of economic unions but pointed out that 'these ideas deserve other kind of leaders. We believe that the political nature of the governments involved (in the 1953

Table V.2
TRADE BETWEEN URUGUAY AND ARGENTINA
(In thousands of Argentine pesos)

Year	X Argentina	M Uruguay
1934	8761	4130
1935	9628	8416
1936	8203	5495
1937	11472	5568
1938	8089	4628
1939	15230	5162
1940	25474	5659
1941	27279	5339
1942	34098	6201
1943	40978	8433
1944	29464	7425
1945	48298	12019
1946	49211	13178
1947	84600	23121
1948	52068	35421
1949	11234	43578
1950	19981	9336
1951	13294	18870
1952	1511	4748
1953	10108	9
1954	15396	506
1955	12145	--

X Argentina = Exports of Argentina to Uruguay (FOB prices)
M Uruguay = Imports of Argentina from Uruguay (CIF prices)

Source: República Argentina, Dirección General de Estadísticas y Censos, Anuario de Comercio Exterior (Buenos Aires, various years).

economic union agreements) makes more damage than benefit to the progress of integration' (author's translation). Cf. Marcha, 'Los Dos Riesgos', vol. XV, no. 680, 24 July 1953. A month later, it stated that 'we have fought and we still fight against the Argentine government not only for what this regime implies but also for its policy towards our country, founded on authoritarianism and prepotency' (author's translation). Cf. Marcha, 'Un Discurso y una Visita', vol. XV, no. 684, 21 August 1953. It should also be kept in mind that because of its condition of buffer state, Uruguay was extremely sensitive to what could amount to an unduly intervention in her domestic affairs by any of her big neighbours. Cf. A. Methol Ferre, El Uruguay Como Problema, pp. 30-33.

TABLE V.3
URUGUAY: MAIN TRADE PARTNERS
(In percentage)

Period	S.A	Arg	Bra	U.S.	Europe	U.K.	Germ	Fran
1934-39								
Ex	13.1	7.8	4.5	11.6	66.7	24.2	15.1	6.1
Im	31.5	6.7	7.3	10.7	50.9	18.3	11	2.3
1940-45								
Ex	8.7	2.4	3.5	44.4	40.7	27.6	0.3	1.1
Im	48.1	15.1	16.4	24.9	17.2	10.7	0.4	0.4
1946-50								
Ex	7.4	2.0	3.4	32.8	53.1	17.6	3.8	4.6
Im	26.2	6.2	9.6	29.2	35.4	15	1.2	3.3
1951-55								
Ex	11.9	0.3	9.3	21.6	60.7	19.3	6.4	6.0
Im	23.5	0.4	11	21.7	45	12.6	8.8	5.5

Ex=Exports; Im=Imports

Source: República Oriental del Uruguay, Dirección General de Estadísticas, Anuario Estadístico (Montevideo, various years); Banco de la República Oriental del Uruguay, Departamento de Investigaciones Económicas, Revista del Banco de la República Oriental del Uruguay (Montevideo, various years).

The outcomes of the conflict were negative for both actors. Argentina failed to impose a change of policy in Uruguay, which in turn lost a trade partner and faced higher political instability. Although some attempts to reach an agreement were made in 1953 and 1955¹, bilateral relations would only be normalised after the fall of Perón. In

¹ Confidential conversations were reported between the Argentina and the Uruguayan governments in March 1953. Cf. 'Misión Confidencial del Dr. Raúl Jude', El Diario, Montevideo, 11 March 1953. In addition, a note was issued by Argentina on 8 May 1955 in which she formally expressed her view that the most important cause of strained relations between Argentina and Uruguay was the uncontrolled activities of the exiles in Montevideo. This move was seen as an effort to initiate a dialogue on the problem. Cf. Department of State Central Files, 735.00/5-1055, R. 633.35, 10 May 1955, in Argentina 1955-59, microfilms.

November 1956 Argentina and Uruguay reached a new trade and payments agreement that normalised bilateral trade ¹. Still, for most of the period 1941-55 no economic agreements were reached.

This situation contrasts not only with that of Argentina and Brazil - which negotiated several trade and payments agreements after 1947 - but also with that between Uruguay and Brazil. Trade relations between Uruguay and Brazil were regulated by the Treaty of Commerce and Navigation of August 1933, which provided for duty exemptions for a large set of primary products, including some vegetables and live cattle, along with quotas for other primary products like wheat, live cattle and meat ². In addition, Uruguay benefited from the regime of free trade for fresh fruits signed between Argentina and Brazil, which Brazil extended to Uruguay through the MFN clause. Both countries agreed in 1948 to denounce the 1933 Treaty with a view to sign a new, more comprehensive treaty, comprising a new list of products to be exchanged and including a payments agreement. This Treaty was approved in 1949 and applied almost immediately, even before its ratification by

¹ The agreement also included a credit of US\$ 5 millions to finance bilateral disequilibrium. Cf. FO 371 120437 AW 1132/3, 22 November 1956.

² However, certain taxes were not considered in Brazil as part of the 'total exemption' of duties and remained in place. This was the case of the additional tax of 10 % and the ad valorem 2 % tax for Social Security. Cf. BA, Box 69-Brazil, 'Departamento Comercial', no. 129/945, 5 June 1945. In December 1935 the two countries signed an agreement on trade in fruits, favourable to Uruguay, which promised to facilitate imports of Brazilian timber.

the Uruguayan parliament (which only debated the Treaty after considerable delay) ¹.

However, the change in the exchange system in Brazil (the October 1953 Aranha Plan) placed Uruguayan fruit in disadvantage with Argentine fruit. The Uruguayan fruit had then to face the highest exchange premium - twice the premium faced by the Argentine ². This problem was eventually resolved through a new trade agreement (July 1954) which granted to both Uruguayan and Brazilian fruits the best existing regime in their respective markets. Thus - besides the formal difficulties created by the Uruguayan delay in ratifying the agreements - the regime of bilateral trade between Brazil and Uruguay did not differ from that between Brazil and Argentina. The big contrast was between the relatively cordial Argentine-Brazilian relations and the conflictive Argentine-Uruguayan relations. The absence of a trade regime between Argentina and Uruguay is remarkable, especially considering that Argentina had a specific policy of approaching smaller neighbours in order to form 'economic unions'.

¹ The payments agreement began to work in 1949 out of a tacit consensus between the Bank of Brazil and the Bank of the Republic of Uruguay. The same procedure was adopted in the case of the trade agreement signed in 1953. Only in June 1955 the new treaty of Commerce and Navigation (29 May 1949), the Payments Agreement (18 december 1948) and the Trade Agreement (18 december 1953) were ratified. The Comercial Chamber of Montevideo severely criticized the lack of parliamentary interests in the agreements. Cf. 'Confusión y Desorientación en el Tráfico con Brasil', Revista de la Bolsa de Comercio (30 June 1954), p. 5.

² Cf. La Mañana, 'Nuevo Convenio de Frutas', 1 June 1954, and La Mañana, 'El Nuevo Convenio de Frutas con Brasil', 30 June 1954.

Clearly, the non-economic objectives of Argentina (stopping exiles activity in Montevideo) can explain why she drove so hard her bilateral economic relations with Uruguay. This approach was made easier by the fact that Uruguay was relatively negligible for Argentina from an economic point of view and then she could pursue more freely non-economic objectives. On the other hand, an approach exclusively based on structural variables cannot explain why Uruguay insisted on keeping the conflict with Argentina. The cost of such attitude for Uruguay was probably not very high during the war, when the USA absorbed most of Uruguay's exports, especially of wool. But already in the second half of the forties Uruguay realised that the relatively generous stance adopted by the USA in wartime period had changed and there was very little to gain in supporting US policy with respect to Argentina ¹. Argentine-Uruguayan disputes were indeed a burden rather than an asset for the Uruguayan international position in the late forties. As observed by Ambassador Briggs, commenting on the negotiations over a Treaty of Friendship between Uruguay and the USA, 'Uruguay's relations with Argentina would probably be a factor in Uruguay's willingness to sign such a Treaty with us. That is, the more

¹ The US Ambassador in Montevideo reported Uruguayan complaints about the fact that 'the USA grasped Uruguayan friendship and sought Uruguayan cooperation during the war (when having a pro-USA sentinel on the North bank of the River plate was of great importance to us), but once the war was won we started taking Uruguay for granted'. Cf. 711.33/8-548, Secret N.546, 5 August 1948, in Foreign Relations of the United States, 1948, p. 743. Thus, Uruguayan expectations about an US favourable attitude regarding trade and development did not last as long as in Brazil.

strained Uruguay's relations with Argentina(...) the more eager Uruguay might be for a Treaty of Friendship with the USA' ¹. This weakness of the Uruguayan position was especially significant since trade friction with the USA aggravated in May 1953, after the US decision to apply compensatory duties (8 %) on Uruguayan wool top exports ².

Still, for Uruguay a change of policy was difficult to implement, as she could not curb the press and the public was sympathetic with the anti-peronist cause. Again, domestic politics mediated between the international system and the response of the states. Moreover, if the lack of a trade regime was a consequence of the narrow trade interests existing between two very similar primary exporters, it also may have contributed to constrain the opportunities for controlling the conflict. Had a more systematic regime of bilateral trade negotiations been in place, this would have facilitated a settlement of the dispute at an earlier, more

¹ Cf. 711.33/8-548, 5 August 1948, Foreign Relations of the United States, 1948, p.744. In the early fifties, US observers also pointed out that the Uruguayans fear that 'the moment any apparent deterioration come to light in our (US) relations with Uruguay, such as our recent commercial disputes, this fact would be seized upon and exploited by Argentina to create further difficulties'. Cf. 'Memorandum of Conversation by the Chief of Protocol', Eisenhower Library, Withman File, 27 October 1953, in Foreign Relations of the United States, 1952-55, pp. 1568-9.

² Cf. FO 371 103621 AW 1331/2, 8 May 1953. Uruguayans are reported to complain about what they considered an 'unfriendly gesture towards a small but democratic country'. As Uruguay only represented 3 % of the consumption of tops by the US industry, the move appeared as unjustified. The US measure was adopted on the basis that the Uruguayan system of multiple exchange rates implied a subsidy to wool top exports.

manageable stage.

Thus, looking at the Argentina-Uruguay conflict of 1942-55 is interesting for various reasons. First, it is another example that countries can react differently to similar systemic constraints. The rationality of a policy of regional cooperation should have been still more compelling for Uruguay than for Argentina and Brazil because small countries have more to gain from trade. However, specific political variables led Uruguay to play a negative-sum game which compromised her negotiation stance not only with respect to Argentina but also with respect to the USA. Secondly, the advantages of Brazil's policy of dialogue and 'distant' cordiality with respect to Argentina, by which she sought to preserve her trade with that country and increase her bargaining power vis-a-vis the USA, were confirmed by the negative Uruguayan experience of clear-cut opposition to Perón. The logic of the bargain is straightforward: regional conflict debilitates the ability of the countries to negotiate with extra-regional actors, if the latter have no special strategic interest to consider. Thirdly, it should be seen that at the moment of worst political disagreement between Argentina and Brazil (the 1952-54 years) there was in place a regime of negotiations and trade preferences between Argentina and Brazil. A Mixed Commission was working and periodical contacts took place in order to renew the agreements, as mentioned above. This controlled the risk of a potential accumulation of retaliatory measures. No similar regime, however, was in place to restrain Uruguay and

Argentina, through which institutions could play a role of 'intervening variables'. Since the failure of the 1941 agreement, no new negotiations had been carried on. Moreover, institutions need time to be created and the conflict Argentina-Uruguay was already high when some timid attempts at negotiation took place in 1953. Conflict emerged from an institutional vacuum in bilateral relations, which allowed for misconceptions and successive errors in assessing the consequences of policy decisions.

IV. CONCLUSIONS

1. Two phases in the evolution of the regime of trade between Argentina and Brazil can be identified, namely the regime of restrained bilateralism (1939-55) and the transition towards a free trade area (1956-60). These regimes are defined in terms of principles, norms, rules and decisions making procedures which set a framework constraining the behaviour of actors, reducing uncertainty and facilitating the process of negotiation. The regime of restrained bilateralism was formally expressed in the 1940 treaty of Commerce and Navigation and in the 1948 Payments Agreement, within which successive trade and payments agreements were negotiated. The LAFTA regime was formally defined in the Montevideo Treaty of 1960, which reshaped the objectives and instruments of regional cooperation with a view to establishing a free trade area in 12 years. These regimes set the framework for the regional cooperation

policies.

2. This chapter offered evidence on the association between structural change and change of regime. Perceptions on constraints and opportunities in the international system, along with the phase of the process of industrialisation (ISI-1 and ISI-2), shaped the scope and depth of cooperation policies. Economic integration only progressed when structural variables had tilted the balance of costs and benefits in favour of the benefits of cooperation.

3. The sources of change of regime were both exogenous and endogenous, although a neat separation between them is frequently difficult to make. After 1956 the Latin American trade regime was in contradiction with the move towards convertibility in the rest of the world and the commitments assumed at the GATT by its Latin American members. These were exogenous factors straining the bilateral regime. Concurrently, dissatisfaction with the evolution of trade, the change of economic policies and the progress of industrialisation in the late fifties were endogenous factors calling for a redefinition of the trade regime. ECLA offered a response to the demand for a new trade regime through the proposal of a regional free trade area, which should allow to increase the efficiency of import-substituting industrialisation and to diversify exports. The coincidence between ECLA proposals and GATT conditions, and the GATT flexibility with respect to the integration project, facilitated the international acceptance of the

free trade area project. Conversely, the attempt to set up a regional payments agreement was constrained by IMF and USA opposition to an arrangement that they considered contradictory with the consolidation of a multilateral payments regime.

4. The idea that LAFTA emerged as a 'conspiracy' of Latin American técnicos and as an imitative response to the EEC, out of place in the Latin American conditions, does not seem to find support when the study of regime transformation considers the whole period 1939-60. Firstly, because the initiative of forming a free trade already had significant antecedents in the region well before the rise of a regional bureaucracy. The lessons of the years 1939-41 and 1953-54 were probably present in the late fifties. Secondly, because the negotiation of LAFTA emerged as an answer to concrete conditions which were theorized in an innovative fashion. Clearly, ECLA played a key role in promoting the idea. The EEC was certainly influential as a successful example of a regional market. However, the gradual accumulation of experience, the increase in the capacity to learn from this experience, the difficulties to adjust to convertibility and enhance industrialisation were all significant forces driving the region towards economic integration 5.

The change of regime did not automatically follow the change of structural conditions. This is reflected in the periodisation suggested in this work. The year 1956 appears as a turning point for economic integration in Latin America. This timing cannot be entirely explained by

structural variables. Although rapid industrial transformation after 1956 was certainly a new key structural factor, international conditions had changed before 1956. The dissatisfaction in Latin America with US economic support to development and the shortcomings of the multilateral system were already visible in the early post-war years. But the adoption of a new regional cooperation policy was not immediate, and shared perspectives and favourable conditions in domestic politics had to be developed. This confirms the reservations suggested by the 'modified structural' approach in international relations theory as regards the limits of deriving behaviour directly from structures. Perceptions were path-dependent and difficult to change. Changes in ideas and institutions displayed a much slower pace than structural change, as the Argentine difficulties in adjusting her foreign policy in the forties proved. Institutions cannot be created out of the blue, and past experience in cooperation and the existence of regular contacts and agreements were necessary to advance to closer cooperation. The conflict between Argentina and Uruguay in the early fifties provides more evidence on this. A non-cooperative behaviour and a negative-sum game resulted from political conflict (the pro-USA stance of Uruguay in hemispheric affairs and the Argentine exiles in Montevideo), which was not restrained by the existence of interests and institutions favouring bilateral trade.

APPENDIX I: MAIN TRADE AND PAYMENTS AGREEMENTS BETWEEN ARGENTINA AND BRAZIL, 1939-60

1. Treaty of Peace, Friendship, Commerce and Navigation. 7 March 1856.

Main Concessions

(a) Conditional Most Favoured Nation (MFN) treatment for citizens, goods and ships of the two countries.

(b) Rights of navigation of the Paraná, Uruguay and Paraguay Rivers.

Expiration/denunciation

No provisions made in the Treaty.

Note: In October 1933 a new 'Treaty of Commerce and Navigation' and an 'Additional Protocol' were signed. However, none of these agreements was implemented. A similar fate was followed by the 'Treaty of Commerce and Navigation' signed in May 1935. These agreements contemplated the concession of the unconditional MFN treatment and favourable dispositions regarding duties and quotas for traditional items in bilateral trade.

2. Exchange Protocol. 13 April 1939.

Main Concessions

Argentina and Brazil accorded to apply to their reciprocal imports the most favourable exchange treatment provided by each country. Both governments would also avoid to apply export taxes which could lead to an artificial increase in prices.

Expiration/denunciation

Valid until the conclusion of a definitive Treaty of Commerce, to which the exchange agreement would be incorporated.

3. Treaty of Commerce and Navigation. 23 January 1940.

Main Concessions

(a) Unconditional MFN treatment regarding import and export taxes, trade regulations and prohibitions.

(b) The best possible treatment as regards import quotas, which should not be lower than the average levels of trade in previous years.

(c) Reduction and consolidation of import duties for a list of primary products which comprised the principal items of bilateral trade. Argentina received, among others, concessions for wheat, wheat floor, ovine and chicken meat, extracts, fruits and vegetables. Brazil received concessions for cashew nuts, coffee, cocoa, palm, maté and pine timber, timber in general, tobacco, rubber and bauxite. Pine timber and maté were also exempted of the 10% tax applied by Argentina since October 1931.

(d) Equal treatment for ships bearing the flag of either country.

(e) Creation of two Mixed Argentine-Brazilian Commissions, one in Buenos Aires and the other in Rio de Janeiro, in charge of the promotion of trade. These commissions would also function as an arbitrator in case of divergences respecting the interpretation of the agreement.

Expiration/denunciation

Valid from the exchange of ratification until a year after its denunciation by either country.

4. Agreement on the Addition of Substitutes to Coffee and Wheat, Facilitation of Imports and Complementary Payments Agreement. 9 April 1941.

Main Concessions

(a) Mixed Coffee and Wheat

(a.i) Argentina assumed the commitment of prohibiting the addition of substitutes to coffee within the term of a year.

(a.ii) Brazil would limit the addition of substitutes to wheat flour up to 15% in 1941 and 10% in 1942 and 1943.

(a.iii) By January 1944 both products would be sold in each country in accordance with the standards and specifications of the country of origin.

(b) Facilitation of Imports

Argentina would facilitate the importation of Brazilian textiles, iron ore, steel and its manufactures, rubber and timber. Argentina would issue exchange permits for Brazilian cotton textiles (except sacking) from a minimum of MN\$18 millions (Argentine pesos). This quota should increase by MN\$ 12 millions in 1942. Cotton sacking imports by Argentina should amount to MN\$ 8 millions. In addition, Argentina would not reduce the Brazilian quota for cotton textiles below that of 1942 and would also allot to Brazil other countries' unused quotas up to 30 millions of pesos.

(c) Complementary Payments Agreement

(c.i) A reciprocal credit of MN\$ 50 millions was accorded with a view to facilitate the balanced expansion of bilateral trade (*'Agreement on Reciprocal Credits for the Purchase of Surpluses, 9 April 1941*).

(c.ii) Net balances could only be used to pay for

imports from the debtor country.

Expiration/denunciation

Valid from the exchange of ratification (provisionally from the 14th of April 1941) until a year after its denunciation by either country.

5. Treaty for Progressive Free Trade. 21 November 1941.

Main Concessions

(a) Both governments would encourage a system of progressive free trade intended to lead to the formation of a custom union.

(b) In order to implement this objective, trade in activities yet not established or of small economic importance in either country would not be subject to import duties for 10 years.

(c) Trade restrictions on sectors of larger economic relevance for the national economies should be gradually removed, without affecting existing production.

(d) Within a six-month term both countries would present a list of the articles produced in their respective territories together with details of their economic importance.

Expiration/denunciation

Valid for the next 10 years following the exchange of ratification. (The agreement was not ratified.)

Note: A year before, in October 1940, a joint-recommendation had been issued in Rio de Janeiro by the Ministers of Economy of Argentina (Pinedo) and Brazil (Souza Costa) calling for the gradual formation of a free trade area (FTA). The joint-recommendation also emphasised the need of an understanding between central banks in order to improve the existing regime of bilateral payments, including its extension to other LA countries.

6. Commercial Agreement. November 1946.**Main concessions**

(a) Argentina would supply Brazil with a minimum of 1,200,000 tons of wheat annually during five years - from January 1947 to December 1951. If the Argentine exportable surplus of wheat was less than 2,700,000 tons, Argentina would then sell to Brazil at least 45% of her exportable surplus for that year. Both countries were allowed to buy or sell in other markets if they found more convenient prices. Argentina would also export to Brazil annual quotas of unwashed wool (5,000 tons) and casein (1,000 tons).

(b) Brazil would export to Argentina tires for lorries and motorcars with their respective inner tubes. Argentina would also import from Brazil annual quotas of rubber (up to 5,000 tons), growing annual volumes of cotton textiles (from 60,000,000 lineal metres in 1947 to 100,000,000 lineal metres in 1949 and 1951) and carded cotton yards (1,000 tons).

Expiration/denunciation

Valid for five years. No provisions made for denunciation.

8. Payments Agreement. 22 October 1948.**Main Concessions**

(a) All bilateral payments accruing from direct operations between the two countries would be made in cruzeiros. An 'Argentina-Brazil Agreement Account' in cruzeiros would be created in the Bank of Brazil (Article 3).

(b) Net debtor positions up to 280 millions of cruzeiros would not pay interests. An annual interest rate of 2% would be paid for net debtor positions in the range between 280 millions and 560 millions of cruzeiros. Above this value interests would be set at an annual rate of 2.5%.

(c) Net balances exceeding 650 millions of cruzeiros at the end of the first three-year period of implementation of the agreement would be settled in the currency of the creditor country, in convertible currency or in gold. The same mechanism of settlement would be applied in each ensuing two-year period after that date. In case of denunciation of the agreement, the debtor country should cancel the total net balance within a term of 18 months.

(d) Payments related to the transport of goods involved in bilateral exchange, using ships bearing Argentine or Brazilian flag, could also be made through the 'Agreement Account'.

(d) Both countries would adopt all the necessary measures to facilitate bilateral trade, including the concession for their reciprocal imports of the most favourable exchange treatment existing in each country.

(c) The current regime providing for an equal distribution of shipments between Argentine and Brazilian ships as regards bilateral trade would be kept during the period of validity of the agreement.

Expiration/denunciation

The agreement had a validity of three years and would be tacitly renewed for subsequent periods of two years, except in case of denunciation six months before its expiration.

9. Commercial Complementary Agreement. 16 May 1949.

Main Concessions and products

(a) Argentina would firmly sell to Brazil 600,000 tons of wheat in a year term. She also agreed to sell an additional amount of 300,000 tons in conditions to be determined within the following six months.

(b) Argentina would facilitate imports from Brazil with a view to at least sustain the average imports levels of 1946-48 for timber, cotton yarns and fabrics, fruits, maté,

cocoa, tobacco, coffee, iron, steel and their manufactures, nonferrous metals and their manufactures, fibres, tea, waxes, medicines and veterinary products.

(c) Brazil would in turn endeavour to assure that her imports from Argentina reached at least the average levels of the period 1946-48 for fresh and dried fruits, garlic, butter, cheese, frozen poultry, hides, wool, tanned hides, leather articles, medicines, semolina and millet.

Expiration/denunciation

Valid for one year.

10. Commercial Agreement. 23 June 1950.

Concessions and products

(a) 'Basic Program' for the exchange of fresh, dried, desiccated and industrialised fruits and preserved vegetables.

(a.i) With the purpose of balancing bilateral trade in fresh, dried, desiccated and industrialised fruits and preserved vegetables at the highest possible levels, both governments set up an annual 'basic exchange program' for these items.

(a.ii) The Argentine Central Bank would open a 'statistical account' were the balance of the trade in fruits program would be registered using FOB prices.

(a.iii) The exchange of these products would be considered 'balanced' when the net position at the end of the annual period of validity of the agreement did not exceed the value of 30 millions of cruzeiros. In case of disequilibrium, the creditor should adopt measures to increase imports from the debtor. If this alternative failed, the debtor would be allowed to impose restrictions on her imports.

(a.iv) The two governments would endeavour to adopt all

available measures to reach the exchange values proposed in the 'basic program', amounting to 275 millions of cruzeiros.

(b) Wheat and Other Items of Bilateral Trade

Brazil would grant a liberal treatment regarding the concession of import permits for the following Argentine exports: (i) 800,000 tons of wheat and 15,000 tons of wheat floor, amounting to a value of Cz\$ 1,195 millions; (ii) hides, dairy products, wool and wool fabrics, cheese, casein, barley, oats, rye, onions, garlic, vegetal oils, quebracho extract, salt, tartaric acid and drugs, amounting to minimum value of Cz\$ 1,500 millions.

Argentina would offer a liberal treatment in the concession of import permits for the following Brazilian exports: cotton textiles, timber, maté, cacao, tobacco, coffee, iron bars and iron tubes, tea, vegetal ceres, plane glass, non-ferrous metals and its manufactures, and electrical and non-electrical machinery, amounting to a value of Cz\$ 1,352 millions.

Expiration/denunciation

Valid for one year, renewable by common consent of the two countries.

11. Commercial and Payments Agreements. 23 March 1953.

Concessions and products

(a) Trade in Fruits

A free trade regime for dried, desiccated, preserved and industrialised fruits and vegetables was established, subject to the general principles of balanced trade and reciprocal compensations. It entailed the concession of automatic import permits under the most favourable exchange

treatment available in each country. Trade would be considered balanced if net debtor/creditor positions at the end of each annual period was lower than Cz\$ 50 millions. In case of disequilibrium, restrictions might be imposed by the debtor country in the following year. A basic annual program of Cz\$ 380 millions was accorded. In the case of industrialised fruits and vegetables, specific quantities for the various products were set up as a minimum per annum. It was also agreed that all the complementary measures necessary for the promotion of this trade would be adopted, as defined in the agreement of June 1950.

(b) Wheat and Other items of Bilateral Trade

Besides trade in fruits, both governments assumed the commitment of granting to each other import permits for an extended list of products. Minimum values in cruzeiros for this exchange were in turn established. The lists included the traditional primary products that composed the bulk of bilateral trade and also some manufactured goods.

With respect to Argentina's exports, the list was similar to that of the former agreement, but it was further extended in order to include frozen meat (Cz\$ 10 millions, to be exported between August and December of 1953) and a larger amount of exports of manufactures (Cz\$ 34,5 millions, basically composed of books, tartaric acid and drugs). In all, Argentine exports should reach the value of Cz\$ 2,728 millions, of which Cz\$ 2,486 millions corresponded to wheat exports. Thus, wheat represented about 90% of the total Argentine exports (excluding fruits), while manufactures only comprised about 1%.

On the Brazilian side, the list of exports was as well very similar to that of June 1950. Yet a significant new feature in the agreement should be stressed, namely the intended expansion of the Brazilian exports of capital goods. Cz\$ 200 millions in capital goods were proposed to be imported from Brazil by Argentine governmental agencies, of

which Cz\$ 100 millions corresponding to railways equipment. The definitive conditions of this purchase were to be settled in subsequent negotiations. In 1953, Brazil's exports of capital goods were expected to reach the value of Cz\$ 40 millions. Manufactures were therefore to represent about 7% of the total Brazilian exports (excluding fruits) to Argentina this year.

(c) Mixed Argentine-Brazilian Commission

A new Mixed Argentine-Brazilian Commission was established in Buenos Aires with the aim of supervising the progress of the agreement and promoting the development of bilateral trade.

(d) Renewal and Modification of the 1948 Payments Agreement.

(d.i) Beginning in January 1954, Payments between Argentina and Brazil would be made in 'account dollars' in place of the cruzeiro;

(d.ii) when net debtor/creditor positions in the bilateral account (established by Article 3, October 1948 Payments Agreement) exceeded the value of US\$ 35 millions in December 1956, the surplus would be then transferred to a special account in the Bank of Brazil. An annual interest rate of 2,5% would be charged on this surplus. It would be cancelled out through exports from the debtor to the creditor country during the years 1957 and 1958, in two annual payments.

(d.iii) If the agreement were prorogated after December 1956 net positions exceeding the value of US\$ 35 million would be settled in convertible currency, beginning in December 1957. If the agreement were discontinued in that date, total net debtor positions would have to be cancelled in convertible currency.

Expiration/denunciation

The agreements would last until the 31 of December 1956. They would then be opened to prorogation for yearly periods. The list of specific products to be exchanged, however, would be valid for just one year, and both governments assumed the commitment to renegotiate the list three months before its expiration, in order either to prorogate its validity or design a new list.

12. Commercial and Payments Agreement. 25 June 1954.**Concessions granted****(a) Renewal of the Agreement for Trade in Fruits**

(a.i) It was renewed the 'basic program' for the expansion of trade in fresh, dried, desiccated and industrialised fruits and vegetables.

(a.ii) Brazil would auction the necessary amount of exchange for fulfilling the annual basic goal of US\$ 20 millions by applying the minimum exchange premium (first category in the classification of imports) to imports of Argentine fruit;

(a.iii) The Argentine government would guarantee the automatic concession of import permits for the Brazilian fruit within the basic program.

(b) Wheat and Other items in bilateral trade

As contemplated in the previous agreement, the list of products that would receive trade preferences had to be renegotiated after a year. The new list was largely similar to previous one, with wheat making up the backbone of the Argentine exports. Brazil's purchases of wheat in grain would reach 750,000 metric tones plus 26,250 of metric tones of wheat flour during 1954. It was expected, however, a

diversification of the manufactured exports of Argentina. The Argentine list of exports benefited with preferences included several electric domestic appliances, like washing machines, refrigerators, and writing machines. Brazil's list, in turn, included (as in the previous year) the export of railways equipment, together with the traditional list of primary goods - of which imports of iron ore and steel would have to be arranged in accordance with the 'Plan Siderúrgico Argentino' (Argentine Steel Plan).

(c) Modification of the Payments Agreement

(c.i) Since January 1954, all direct payments between the two countries would be made in US\$ dollars and registered in the 'Account of convention dollars Argentina-Brazil'.

(c.ii) Net debtor\creditor positions would not render interests up to the value of US\$ 15 millions. They would pay 2% annually from positions between US\$ 15 millions and US\$ 30 millions and 2,5% for the amount exceeding the latter value.

(c.iii) If the agreement was prorogated, positions exceeding US\$ 35 millions would be paid during the following year in goods, convertible currency or any other from accorded by the two governments. If the agreement was terminated then the total net position would be settled through two equal annual payments.

Expiration/denunciation

The agreement would expire on the 31 of December of 1956. It could then be prorogated for successive annual periods save its denunciation by either country three months before its termination. The list of products would be prorogated on an annual basis, except in case that one of the Parties demanded its renegotiation before the 31 of October of the current year.

13. Reversal Notes: Wheat Agreement. 20 January 1955.

Concessions and products

(a) Argentina would sell to Brazil 1,200,000 tons of wheat in 1955, 1956 and 1957. 4% of this quantity would be delivered in the form of wheat flour. In case that the Argentine exportable surplus of wheat came to be lower than 3,000,000 tons, this country would sell to Brazil at least 30 % of her surplus.

(b) Brazil would be released from the obligation of having to buy that part of the 1,200,000 tons of wheat for which she could not pay through an increase of her exports to Argentina.

(c) In order to facilitate the compensation of Brazil's large wheat purchases, Argentina would increase and accelerate the concession of import permits in favour of Brazilian goods and revoke the legal permission to add substitutes to coffee. It would also be renovated the contract for trade in bananas. The stimulus of other Brazil's export items would be analyzed by the Mixed Argentine-Brazilian Commission.

(d) The Mixed Commission would follow the evolution of trade and the honouring of the agreements.

(e) The Mixed Commission would gather in the first fortnight of each year in order to lay the conditions for the annual purchases of wheat.

Expiration/denunciation. Valid until December 1956. No provisions made for denunciation.

14. Modification of the Trade in Fruits Agreement, 19 September 1956

Main products and concessions

There were introduced some modifications to the Fruit Agreement of June 1954 with a view to regulate the terms of concession and validity of import permits, prices and

quantities regarding the exchange of fresh, dried, desiccated and industrialised fruit.

(a) Argentina would concede automatic import permits for import requests of Brazilian fruit placed before the 15th of February 1957. Import requests for the importation of 300,000 chests of oranges would be received until the 10th of October 1956. Special dispositions were established as regards trade in bananas. Brazil would in turn undertake special auctions for the importation of Argentine fruit amounting to 'account dollars' \$ 1,600,000 . Import permits would be valid until the 31 of March 1957.

(b) Both countries would grant the most convenient exchange rate for their reciprocal imports. This preferential exchange amounted to 18 pesos per dollar in Argentina and to the minimum import bonus of 36 cruzeiros per dollar in Brazil (first category of imports).

Expiration/ Denunciation. The governments would resume negotiations in the first fortnight of January with a view to establish a new regime of trade in fruits from April 1st 1957.

15. Reversal Notes, 29 July 1957.

Main products and concessions. The conditions regulating trade in wheat for the years 1958, 1959 and 1960 were established. Brazil would buy an annual quota of 1.000.000 tons of wheat. Argentina assumed the compromise of selling at least 30 % of her surplus if that quota were not reached. Brazil would keep the option of restricting imports in case of an increase in domestic production. Prices and quantities of the annual purchases of wheat should be contracted before the 28th of February each year. The agreement also regulated the concession of quotas and automatic import permits for trade in fruits.

Expiration\denunciation. The negotiation of a definitive agreement would begin in February 1958.

16. Trade and Payments Agreement, 19 September 1958.

Main products and Concessions.

(i) The 1940 Treaty of Commerce and Navigation (denounced by Brazil on the 12 September 1957) and the 1953 and 1954 Payments and Trade Agreements (of which the June 1954 Payment Agreement had been denounced by Argentina in November 1956) were renovated covering the period of the negotiation of a new trade agreement. This should begin in November 1958;

(ii) Trade in fresh and semi-industrialised fruits was exempted from all quantitative, exchange and price controls;

(iii) It was established that wheat purchases should be made through a single annual contract to be signed before the 26 of March each year, within the framework of the Wheat Agreement of July 1957;

(iv) It was emphasised that Brazil would undertake previous consultations with Argentina before purchasing wheat in the US under Law 480;

(v) A Mixed Group for industrial cooperation was created, with the participation of the private and public sectors. The group should study new mechanisms for promoting industrial complementarity and industrial trade.

(vi) A new Payments Agreement was signed, establishing the parity of the account dollar with that of the dollar freely convertible. Agreements on the expansion of mutual credits and on the possibility of using bilateral balances to settle payments with other LA countries were also reached.

Expiration\Denunciation

The negotiation of a new, definitive agreement should be concluded before the 12 June 1959.

17. Declaration of the 26 November 1959

(i) Prorogation of the 1940 Treaty of Commerce and Navigation and the 1953/54 Trade Agreements until the approval of the Free Trade Area;

(ii) Brazil would not apply the custom tax of 5% approved on August 14th 1957 to the Argentine exports. In turn, Argentina would exempt Brazil of the tax of 8% on fruits established in 1955.

(iii) Both governments would take measures with a view to sustain bilateral trade and promote industrial complementarity.

18. Reversal Notes, 2 December 1959

(i) The Argentine government would ship 200.000 tons of wheat to Brazil. The rest of the shipments contemplated in the July 1959 agreement would be made by means of direct dealings with the Argentine private sector. This was due to the new trade regime for wheat established in Argentina in July 1957.

(ii) The tax exemption for trade in fresh fruits came into vigour.

NOTE: The Treaty of Montevideo that created LAFTA was signed on the 18th of February 1960, ratified by Argentina on the 6th of October 1961 and ratified by Brazil on the 2nd of February 1961. On the 1st of January 1962 began to be implemented the tariff reductions for the list negotiated in the First Conference of the Contracting Parties in Montevideo.

PART III. FROM LAFTA TO MERCOSUR, 1960-90

CHAPTER VI. STRUCTURAL CHANGE AND INTEGRATION, 1960-92INTRODUCTION

This chapter presents the evolution of regional cooperation in relation with structural and institutional change after 1960. It is therefore an extension to the LAFTA period of the framework applied in Part II. This framework can be summarised as follows: (i) cooperation is expressed in institutional change, namely the creation of new patterns of behaviour or the adaptation of old patterns with a view to fostering regional trade; (ii) the stimulus for cooperation depends on structural change in the international economy (international constraints and opportunities) and in the domestic economy (especially industrial transformation); (iii) ideas play a role in transforming the stimulus for change in new international regimes. It will be suggested that these variables contribute to explain why cooperation increased until the mid-sixties and subsequent fell, and why a new generation of bilateral agreements emerged in the eighties.

The chapter is organised as follows. The first three sections are concerned with structural change. Section I briefly reviews the international context in which regional cooperation developed in 1960-92. This section presents the general trends in growth and financing in the period, while

a more detailed analysis of the role of international constraints in shaping expectations and policies will be presented in chapter VII. Section II considers the impact of the 'maturation' of industry in Argentina and Brazil on the evolution of cooperation. Section III focuses on the growth and composition of regional trade. Section IV analyzes the evolution of cooperation and integration in relation with structural and institutional variables. The main conclusions of the chapter are summarized in section V.

I. THE INTERNATIONAL CONTEXT: EXTERNAL CONSTRAINTS AND REGIONAL INTEGRATION

I.1. The 1960-80 Period

LAFTA emerged from an international context which, in the view of contemporary analysts and policy-makers, seemed to consolidate the marginalisation of Latin America. The subsequent twenty years (1960-80) proved that this concern was not entirely unfounded. Protectionism in centre economies remained high in agricultural goods and in some simple industrial exports (especially textiles) in the shape of tariff and non tariff barriers¹. However, high rates of

¹ On the persistence on trade barriers in agricultural goods, see T.K. Warley, 'Western Trade in Agricultural Products', in A. Schonfield (ed.), International Economic Relations of the Western World, vol. 1 (London, 1976), especially pp. 292-334. On protectionism in textiles see B. Baker et al, 'The Multifiber Arrangement', in C. Stevens (ed.), The EEC and the Third World: A Survey 3, The Atlantic Rift (London, 1983), pp. 74-83.

growth of international trade in the sixties offered increasing export opportunities, especially for those developing countries that diversified towards industrial production¹. When recession curbed growth in the centre economies after 1973, Latin America still continued to grow, this time on the basis of an increase in the external debt².

This can easily be seen in table VI.1, which presents the comparative performance of Latin America with respect to other regions in 1960-90.

¹ On the factors that sustained rapid growth in 1960-73, see A. Maddison, Dynamic Forces in Capitalist Development: A Long Run Comparative View (Oxford, 1991), pp. 177-89.

² Cf. C. Saunders, 'Investment, Debt and Growth: The Diversity of Experience', in H.W. Singer and S. Sharma (eds.), Economic Development and World Debt (London, 1989), and Carlos F. Díaz-Alejandro, 'Southern Cone Stabilization Plans', in A. Velasco (ed.), Trade, Development and the World Economy, Selected Essays of Carlos F. Díaz-Alejandro, pp. 268-82.

TABLE VI.1
GROWTH AND TRADE IN THE INTERNATIONAL ECONOMY, 1960-90
 (Annual rates of growth, in percentage)

	World	DC	DgC	LA
1960-70				
GDP	5.2	5.1	5.8	5.5
X	9.3	10.1	7.4	5.7
M	9.2	10.3	6.7	6.3
1970-80				
GDP	3.7	3.1	5.5	5.4
X	20.3	18.8	25.9	20.8
M	20.2	19.5	23.8	20.6
1980-85				
GDP	2.0	2.4	1.9	1.3
X	-0.6	0.5	-4.4	-0.8
M	0.4	-1.4	-2.6	-8.0
1985-90				
GDP	3.3	3.2	3.4	1.9
X	12.1	14.0	11.5	4.5
M	12.0	14.6	13.4	7.5
1990-92				
GDP	0.4	1.6	4.2	2.6
X	3.2	3.7	7.0	1.4
M	2.5	2.0	11.1	15.6

GDP = rate of growth of GDP.

X = rate of growth of exports; M = rate of growth of imports.

DC = Developed Countries; DgC = Developing Countries; LA = Latin America

Sources: UNCTAD, Handbook of International Trade and Development (New York, 1993) ECLA, Economic Survey of Latin America. New York: United Nations, various numbers.

Table VI.1 shows, first, that the region grew at higher rates than the world economy in 1960-80. Latin America grew at a cumulative annual rate of 5.5 % and 5.4 % between 1960-70 and 1970-80, respectively, while the world grew at rates of 5.2 % and 3.7 % in the same periods.

Tables VI.2.A and VI.2.B. display the rates of economic and manufacturing growth in Argentina and Brazil. The annual rates of growth of the Brazilian industry in the sixties and

seventies were impressive - almost 7 % in 1960-70 and 9 % in 1970-80. The Argentine industry performed very well in the sixties but contracted in the seventies.

TABLE VI. 2. A
ARGENTINA: ECONOMIC AND MANUFACTURING GROWTH
(Annual rates of growth, in percentage)

	Growth of GDP	Growth of manufacturing
1960-70	2.9	5.6
1970-80	2.6	1.6
1980-85	-1.7	-3.1
1986	5.2	11.7
1987	3.1	1.8
1988	-1.8	-4.6
1989	-6.3	-9.8
1990	0.2	-0.9
1991	7.3	12.7

TABLE VI. 2.B
BRAZIL: ECONOMIC AND MANUFACTURING GROWTH
(Annual rates of growth, in percentage)

	Growth of GDP	Growth of manufacturing
1960-70	3.1	6.9
1970-80	8.7	9.0
1980-85	1.0	-0.6
1986	7.6	11.3
1987	3.6	0.9
1988	-0.1	-3.4
1989	3.3	2.9
1990	-4.4	-9.5
1991	0.9	-0.7

Source: ECLA, Statistical Yearbook of Latin America (New York, various years).

On the other hand, if high rates of growth in Latin America and the world economy, especially in the sixties, convey an optimistic view of the economic performance of

Latin America, this is qualified by the evolution of Latin American exports. If compared with the rest of the developing world, Latin America was unable to exploit the opportunities offered by international trade. Table VI.1 shows that exports and imports in Latin America grew at lower rates than the world in 1960-70. This changed in the seventies. Latin American exports and imports grew at annual rates of about 20 % in 1970-80, which was slightly above the world average. However, the expansion of trade in the seventies was accompanied by a substantial increase in the Latin American external debt. This can be seen in table VI.3.

TABLE VI.3
DISBURSED EXTERNAL PUBLIC DEBT
 (Balance at the end of the year in current US\$ millions)

Year	Argentina	Brazil
1960	987	2202
1965	1700	2395
1970	1872	3681
1975	3023	13618
1978	12496	52585
1979	19034	58907
1980	27162	68354
1981	35671	78580
1982	43634	87580
1983	46500	96500
1984	49000	102443
1985	49326	105126
1986	51422	111045
1987	58324	121174
1988	58473	113469
1989	63314	115096
1990	60973	122200

Source: ECLA, Statistical Yearbook for Latin America (New York, various numbers).

Table VI.3 shows that the external debt of Argentina and Brazil was multiplied by a factor of four between 1975 and 1978. The recover of the region's position in international trade in the seventies was therefore misleading. Argentina and Brazil reached the eighties in a very vulnerable position ¹. Moreover, this vulnerability was aggravated by the rise of the so-called 'new protectionism' in the central countries, an expansion of non-tariff barriers triggered by the recession of the second half of the seventies ². The new protectionism affected sectors in which peripheral countries had acquired new competitive advantages ³.

¹ The bibliography on the impact of the external debt on policy and growth is huge. Cf., for example, W.R. Cline, 'Latin American Debt: Progress, Prospects and Policy', in S. Edwards and F. Larraín (eds.), Debt, Adjustment and Recovery: Latin America's Prospects for Growth and Development (New York, 1989), pp. 31-64; S. Griffith-Jones, 'The International Debt problem: Prospects and Solutions', in H.W. Singer and S. Sharma (eds.), Economic Development and World Debt, pp. 3-22; R. Bouzas, 'América Latina y la Crisis del Endeudamiento Externo: A Modo de Introducción', in R. Bouzas (ed.), Entre la Heterodoxia y el Ajuste: Negociaciones Financieras Externas de América Latina (Buenos Aires, 1989), pp. 11-25.

² Cf. F. Bergsten and W.R. Cline, 'Trade Policy in the Eighties: An Overview', in W.R. Cline, Trade Policy in the 1980s (Washington, 1983), especially pp. 66-72; R.H. Ballance et al, The International Economy and Industrial Development: The Impact of Trade and Investment in the Third World (London, 1982), pp. 73-83; J. Bhagwati, Protectionism (London, 1988), pp. 42-59. The impact of the new protectionism on perceptions regarding regional integration will be addressed in the next chapter.

³ Cf. B. Balassa, 'Los Países de Industrialización Reciente Después de la Crisis del Petróleo', Integración Latinoamericana, vol. 6, no. 61, pp. 3-62. This author estimates that in the late seventies non-tariff barriers covered about 51 % of the Argentine exports, 23 % of the Brazilian exports and 41 % of the Uruguayan exports.

It was suggested in chapter I that states would only be prepared to share sovereignty, and move towards higher cooperation, if constraints on growth and policy making are high. In general, the expansion of international trade and financing in 1960-80 may have implied a lower stimulus for cooperation, as unilateral, national ISI seemed to have promoted growth successfully, especially in the case of Brazil. The evolution of trade, however, suggest that this view should be qualified as the trade performance of Latin America was worse than that of the rest of the world. If the regional market contributed to improve this (especially in the context of the new protectionism) then interests in regional trade would remain high, despite of the apparent success of unilateral ISI policies.

I.2. The 1980-92 Period

The eighties witnessed a drastic fall in the rates of growth and in trade in the region. The figures presented in table VI.1 show that growth was below the world average in 1980-90, a reversal of the trends of the previous period. This changed again after 1990, as trade and growth recovered. However, the pattern of recovery is similar to that of the pre-1980 crisis. Exports grew below the world average while imports grew at a rate more than six times higher than the world average. This can be seen as an indication of external weakness and of a future painful adjustment to changing international conditions.

The single most important issue in the eighties was the debt crisis. Table VI.4 presents the burden that external debt represented for the Latin American economies in general and for Argentina and Brazil in particular.

TABLE VI.4.
THE DEBT BURDEN: LAIA, ARGENTINA AND BRAZIL
(In percentage)

	Argentina		Brazil		LAIA	
	% gnp	serv/exp	% gnp	ser/exp	% gnp	serv/exp
1975	11.3	27.7	18.7	40.1	18	19.5
1980	28.5	25.1	25.0	57.1	24.5	27.9
1987	67.9	57.2	35.3	25.1	51.4	27.0
1988	57.3	31.7	32.8	43.6	44.9	33.4
1989	103.5	34.4	21.2	26.3	37.0	25.5

% gdp = long term debt/GNP.

serv/exp = debt service/total exports of goods and services.
LAIA = Latin American Integration Association (Argentina, Brazil, Chile, Mexico, Paraguay, Uruguay).

Source: UNCTAD, Handbook of Development Statistics (New York, 1992).

The figures are impressive. The outstanding long term debt represented about 18 % of the Argentine GDP in 1975 and more than 51 % in 1987. The figures for Brazil were 18.7 % and 35.3 %, respectively. Moreover, the debt service absorbed a quarter of Brazil's total exports and more than a third of Argentine total exports in the late eighties. The burden of the external debt prompted major efforts to contract imports and expand exports ¹. This can be seen in table VI.5, which presents the evolution of the import and

¹ Cf., for instance, C.F. Díaz-Alejandro, 'Latin American Debt: I Don't Think We Are in Kansas Any More', in A. Velasco (ed.), Debt, Adjustment and Recovery, pp. 321-44.

export coefficient of the region for a set of selected years.

TABLE VI.5

IMPORT AND EXPORT COEFFICIENTS, SELECTED YEARS

(In percentage of the gross domestic product at constant 1970 prices)

ARGENTINA

Year	Import coefficient	Export coefficient
1950	9.9	8.1
1960	8.6	7.5
1970	6.7	7.1
1975	6.3	5.3
1980	11.9	8.2
1981	11.2	9.7
1982	6.6	11.1
1983	6.0	11.7
1984	6.0	11.0

BRAZIL

Year	Import coefficient	Export coefficient
1950	11.8	9.4
1960	8.2	6.5
1970	7.0	6.5
1975	8.6	6.4
1980	7.1	7.6
1981	6.5	9.5
1982	6.0	8.6
1983	5.0	10.1
1984	4.4	11.5

Source: Elaborated from ECLA, Statistical yearbook for Latin America (New York, 1986).

The contraction of the import coefficient and the increase in the export coefficient in the early eighties highlight the importance of the transfer of real resources to the rest of the world. It is necessary to recall that this fall took place from an already reduced import

coefficient, stemming from the 'closeness' that characterised Latin American ISI. The costs of external adjustment (in terms of lower efficiency and technological diffusion associated with closing the economy to imports) should have been very high. Moreover, the real transfer of resources associated with the change in the import and export coefficients was aggravated by the fall in the terms of trade of the region in the same period, as shown in table VI.6.

TABLE VI.6.
EVOLUTION OF THE TERMS OF TRADE, SELECTED YEARS
(In percentage and in millions of US\$ constant dollars of 1970)

Year	Argentina		Brazil	
	I	RE	I	RE
1960	104.9	26	104.4	53
1965	109.2	160	93.9	-97
1970	100.0	0	100.0	0
1975	100.7	-53	85.4	-544
1978	79.9	-356	87.6	-494
1979	81.1	-81	79.9	-1003
1980	94.2	323	67.4	-2152
1981	97.2	245	56.7	-3598
1982	82.0	-628	54.2	-3573
1983	79.4	-775	55.1	-4226
1984	86.4	-473	59.5	-4662

NOTE:

I = Terms of Trade Index, 1970 = 100.

RE = real effects of the terms of trade in millions of constant dollars of 1970.

RE = $x (p_x/p_m - 1)$, where x are exports at constant prices, p_x is the deflator of exports and p_m is the deflator of imports.

Source: Elaborated from ECLA, Balance of Payment Statistics (New York, 1986).

Finally, the contraction of the import coefficient was

associated with a contraction in the levels of investment, as shown in table VI.7. Investment as a percentage of GDP fell almost 8 percentage points in Argentina and 6 percentage points in Brazil.

TABLE VI.7
INVESTMENT AS PERCENTAGE OF THE GDP
(In percentage)

<u>Period</u>	<u>Argentina</u>	<u>Brazil</u>
Average 1965-70	20.5	23.3
Average 1977-82	21.9	21.9
Average 1983-88	14.1	15.8

SOURCE: Elaborated from IMF, International Financial Statistics (Washington, 1990).

Investment rates can be considered a key indicator of the existence of constraints on growth. Levels of investment are strongly associated with expectations about growth and, in developing countries, with external constraints, as these countries are dependent on imports of capital goods (see section VII). Investment also impacts the ability to sustain growth and trade in the future.

In sum, heavy constraints on growth and policy-making emerged in the eighties as a result of the debt crisis, largely incubated in the seventies. This, it will be argued, shaped defensive attitudes which (after a period of learning and political change) encouraged the move towards a new phase in regional integration.

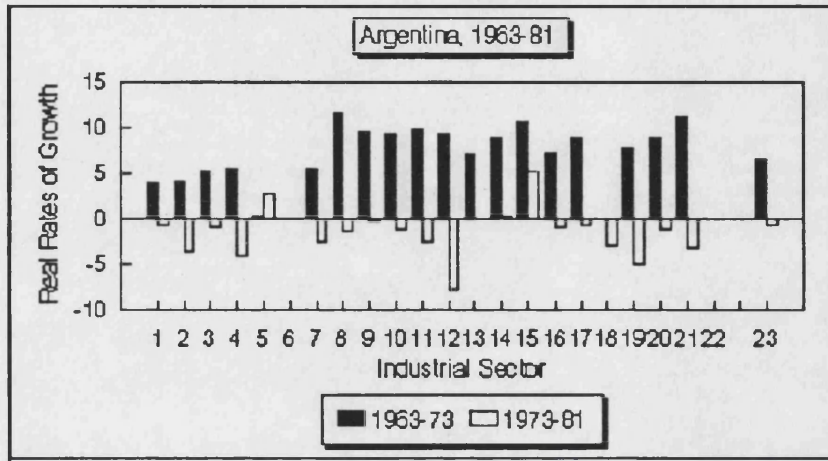
II. INDUSTRIAL TRANSFORMATION IN ARGENTINA AND BRAZIL.

The period 1960-73 can be seen as a period of 'maturation' of the industrial structure established in the late fifties (ISI-2) ¹. The maturation of industry took place through a process of learning in which technological capabilities gradually increased and more capital- and skill-intensive sectors enlarged their participation in the industrial structure. Graphs VI.1.A and VI.1.B present the rates of growth of different industrial branches in the sixties and seventies. In both countries the metal-mechanical and chemical sectors were the most dynamic in the sixties while more traditional industries (food, footwear, textiles) lost ground ². The sixties were therefore a period of convergence in terms of industrial development in Argentina and Brazil. Convergence in the industry occurred despite divergent rates of economic growth.

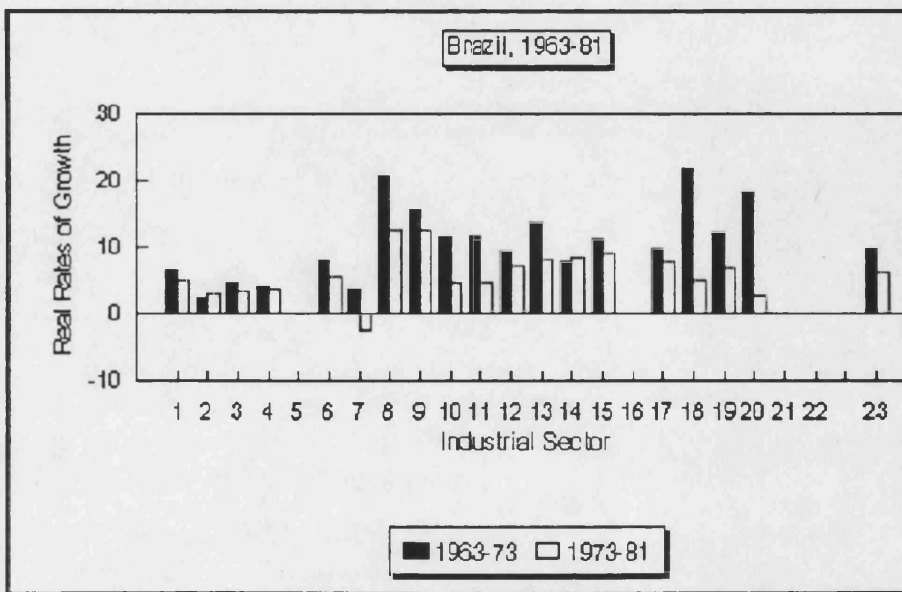
¹ 'Maturation' means that the industry increased its productivity and ability to compete in the domestic and external markets through the accumulation of experience and through formal and informal R&D, leading to improvements and adaptation in imported technology. Cf. J. Katz and E. Ablin, 'Tecnología y Exportaciones Industriales', p. 20.

² For the case of Argentina see B. Kosacoff, 'El Sector Industrial Argentino', mimeo, ECLAC - Buenos Aires, Buenos Aires, 1992. For the case of Brazil, cf. J. Serra, 'Ciclos e Mudanças Estruturais na Economia Brasileira do Pós-Guerra', in L.G. Beluzzo and R. Coutinho, Desenvolvimento Capitalista no Brasil: Ensaio Sobre a Crise, vol 1, (São Paulo, 1983), and A.B. Castro and F.P. Souza, A Economia Brasileira em Marcha Forçada (Rio de Janeiro, 1985).

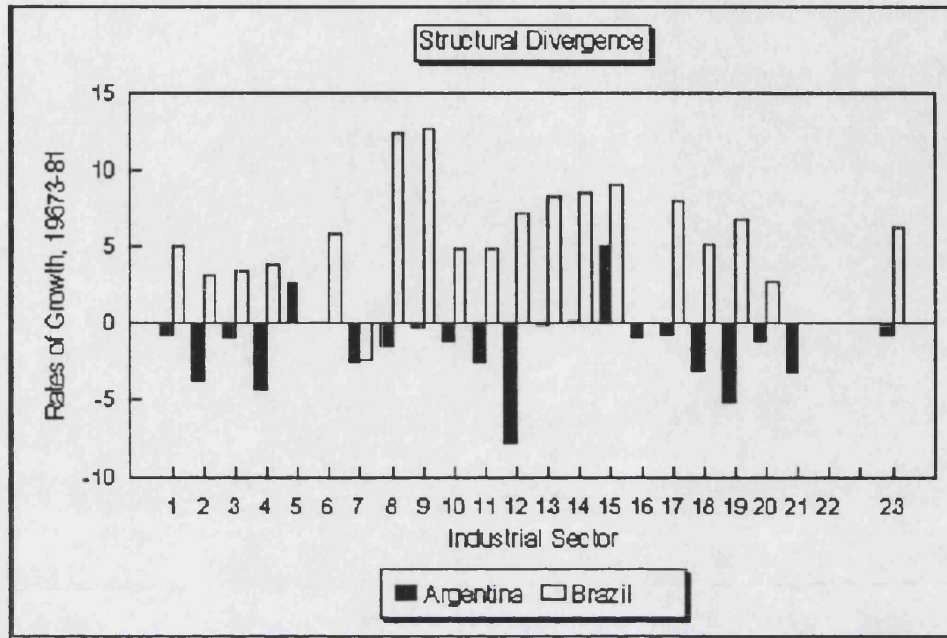
GRAPH VI.1.A and B: Industrial Transformation in Argentina and Brazil (yearly rates of growth)



Key for the industrial sectors: 1. Food and beverages
 2. Textiles 3. Leather and fur products 4. Wood and cork products
 5. Furniture 6. Paper 7. Print and publishing 8. Industrial chemicals
 9. Other chemicals 10. Rubber products 11. Plastic products
 12. Pottery and china 13. Glass 14. Other non-metallic
 15. Iron and Steel 16. Non-ferrous metals 17. Metal products
 18. Non electrical mach. 19. Electrical machinery 20. Transport equipment
 21. Scientific equipment 22. Other manufactures 23. Total.



GRAPH VI.2. The Argentine and Brazilian Industries in the Seventies



Key for the industrial sectors: 1. Food and beverages
 2. Textiles 3. Leather and fur products 4. Wood and cork products
 5. Furniture 6. Paper 7. Print and publishing 8. Industrial chemicals
 9. Other chemicals 10. Rubber products 11. Plastic products
 12. Pottery and china 13. Glass 14. Other non-metallic
 15. Iron and Steel 16. Non-ferrous metals 17. Metal products
 18. Non electrical mach. 19. Electrical machinery 20. Transport equipment
 21. Scientific equipment 22. Other manufactures 23. Total.

Source (Graphs ^{VI} - ? - ^{VI} IV.1 and IV.2): Elaborated from UNIDO, Handbook of Industrial Statistics (New York, various years).

On the other hand, the seventies were marked by industrial divergence between Argentina and Brazil. Graph VI.2 offers a synthetic view of this divergence. It can be seen that in Brazil the leading sectors of industry were the same as in the previous period. High rates of economic growth were achieved in the capital goods sector and in some intermediate sectors ¹. Conversely, Argentina suffered a process of deindustrialization in which the metal-mechanical sector suffered most, while some intermediate sectors expanded ². The results of these divergent patterns can also be seen in Tables VI.8.A and VI.8.B, which indicate asymmetries in the industrial capabilities of the two countries.

¹ Cf. B. Becker and C.A.G. Egler, Brazil: A New regional Power in the World Economy (Cambridge, 1992), pp. 92-95.

² Cf. For the case of Argentina see B. Kosacoff, 'El Sector Industrial Argentino', pp. 10-17.

TABLE VI.8.A
ARGENTINA: STRUCTURE OF THE MANUFACTURING SECTOR, SELECTED
YEARS
(in percentage of total value added)

Sector	1970	1975-77	1981-83	1988-90
Food products	20.4	13.9	15.4	14.5
Beverages	2.2	2.5	3.0	3.8
Tobacco	0.6	1.9	2.2	0.4
Textiles	9.1	8.2	7.4	7.0
Wearing apparel	2.4	4.6	2.5	1.7
Leather and fur	0.6	1.5	1.1	1.0
Footwear	0.7	1.2	0.9	0.6
Wood and cork	1.2	1.6	1.1	0.9
Furniture	0.7	2.7	2.5	2.1
Industrial chemicals	4.4	3.8	5.0	5.7
Other chemicals	7.1	4.9	5.9	6.0
Petroleum refineries	2.5	12.7	16.0	17.5
Petroleum products	0.9	0.3	0.4	0.4
Rubber products	2.3	1.3	1.4	1.3
Plastic products	1.2	1.5	1.9	1.3
Pottery and china	0.4	0.8	0.6	0.6
Glass	0.9	0.7	0.7	0.8
Other non-metallic	3.4	2.6	2.3	3.1
Iron and Steel	4.4	3.6	4.1	5.2
Non-ferrous metals	1.1	0.7	1.0	1.0
Metal products	6.4	5.3	5.4	5.6
Non electrical mach.	5.6	7.1	4.2	2.7
Electrical machinery	3.9	3.8	3.4	3.7
Transport equipment	10.7	8.9	7.6	6.9
Scientific equipment	0.6	0.4	0.3	0.4
Other manufactures	n.a	0.5	0.3	0.3

SOURCE: Elaborated from UNIDO, Handbook of industrial statistics (New York, various numbers).

TABLE VI.8.B
BRAZIL: STRUCTURE OF THE MANUFACTURING SECTOR, SELECTED
YEARS
 (% in total value added)

Sector	1970	1975-77	1981-83	1988-90
Food products	15.8	12.7	12.5	9.7
Beverages	1.0	1.9	1.4	1.1
Tobacco	0.7	1.1	0.9	0.7
Textiles	9.9	6.9	6.2	6.5
Wearing apparel	2.1	2.6	2.9	2.8
Leather and fur	0.7	0.6	0.7	0.7
Footwear	1.3	1.2	1.9	2.3
Wood and cork	2.7	2.6	2.0	1.4
Furniture	2.7	1.6	1.4	1.1
Industrial chemicals	2.3	4.3	7.8	6.2
Other Chemicals	6.0	5.4	4.0	6.2
Petroleum refineries	3.5	4.2	5.7	6.1
Petroleum products	0.4	0.5	1.7	0.8
Rubber products	1.9	1.6	1.5	2.0
Plastic products	1.8	2.4	2.2	2.6
Pottery and china	1.5	0.7	0.2	0.2
Glass	1.0	0.8	0.7	0.7
Others non metallic	3.8	4.8	4.0	3.5
Iron and Steel	6.3	6.0	5.6	7.5
Non ferrous metals	1.5	1.5	1.6	2.4
Metal products	4.2	5.3	4.4	4.3
Non electrical mach.	4.8	10.4	9.1	9.3
Electrical machinery	7.8	5.9	6.0	8.2
Transport equipment	8.4	7.2	7.4	6.2
Scientific equipment	0.4	0.7	0.7	0.9
Other manufactures	n.a.	1.5	1.5	1.0

SOURCE: Cf. Table VII.2.A.

Tables VI.8.A and VI.8.B shows that the participation of the capital goods sector and transport equipment in the total value added of the Argentine industry fell 5 percentage points between 1973-55 and 1981-83. Conversely, intermediate sectors increased their participation, namely iron and steel, chemicals and petroleum products. In Brazil, the participation of capital goods and transport equipment in the total value added of the industry remained at about

the same levels as in the mid-seventies (24 %). Intermediate sectors increased their participation in the Brazilian industry, especially industrial chemicals. But the move from capital to intermediate goods was less pronounced in Brazil than Argentina. In the mid-seventies the metal-mechanical sector represented about 20 % of the industrial value added of Argentina and 24.2 % of that of Brazil. In the early eighties the respective figures had moved apart - 15.5 % in Argentina and 24 % in Brazil. This divergent trend was reinforced in the eighties. The metal mechanical and electro-mechanical sectors experienced further contraction in Argentina, from 15.5 % to 13.7 % of the total value added of industry, between the early eighties and the late eighties, respectively. Conversely, these sectors slightly increased their participation in the total value added of Brazil's industry in the same period.

Structural change in the industry of Argentina and Brazil had significant implications for regional trade and integration. The 'maturation' of industry and the convergence of industrial transformation in the sixties led to enhanced opportunities for trade in industrial goods and intra-industry trade. This would encourage the interest in regional trade. On the other hand, structural divergence in the late seventies reduced the scope for intra-industry specialisation as Argentina lost industrial capabilities, especially in the metal-mechanical sector. This can be expected to have weakened the interest in the regional market. Views would diverge in the future as regards the

costs of multilateral liberalisation and regional liberalisation. In order to assess the impact of structural change on the interest in regional trade, the composition and growth of trade will be considered in the next subsection.

III. THE EVOLUTION OF REGIONAL TRADE

III.1. The Growth of Trade

The first element to consider in assessing business and state interests in regional trade are both the total values of trade and the comparative rates of growth of intra-regional and extra-regional trade. Table VI.9 presents the comparative evolution of regional trade with respect to extra-regional trade. It can be seen that regional trade grew at rates higher than total trade for both Argentina and Brazil taking the 1960-90 period as whole. However, differences are visible between the two countries as regards the various sub-periods considered. Regional trade grew at higher rates than extra-regional trade in all the sub-periods in the case of Argentina. This was true for the eighties too - when regional imports fell sharply as a result of the debt crisis - probably reflecting the boost to Argentine exports provided by the bilateral agreements with Brazil in the second half of the decade. On the other hand, Brazilian exports to both Latin America and Argentina were severely affected by the debt crisis (1982-85) and the

recessive consequences of hyper-inflation in Argentina in 1989 and 1990 ¹.

Table VI.9
BRAZIL AND ARGENTINA: YEARLY RATES OF EXPORT GROWTH
(In percentage)

Period	1960-90	1960-70	1970-80	1980-90
Brazil total	7.8	5.5	10.7	3.2
Brazil to Latin America	9.4	11.7	14.6	-1.3
Brazil to Argentina	4.2	11.4	7.1	-6.1
Argentina total	3.3	3.2	7.5	0.2
Argentina to L. America	4.6	9.1	8.4	2.7
Argentina to Brazil	4.3	9.4	9.2	5.2

Source: Elaborated from IMF, Direction of Trade (Washington, various years), and IMF, International Financial Statistics (Washington, various years). Rates of growth calculated from values in constant US\$ dollars of 1985.

As a result of the trends presented in Table VI.9, the participation of the region in total trade increased between 1980 and 1990 in the case of Argentina (cf. Table VI.10). In 1990 more than a quarter of Argentina's exports and more than a third of her imports were destined to or came from the regional market. In the case of Brazil, the region lost ground in Brazilian total trade. However, this trend changed in recent years and Latin America had increased her participation in Brazil's trade, as shown in Table VI.10.

¹ In constant dollars, Brazilian exports to Argentine fell at an annual rate of -12.7 % between 1980-85 and increased at a rate of only 1.1 % between 1985-90. The corresponding figures for the Argentine exports to Brazil were -12.8 % and 18.1 %, respectively.

TABLE VI.10
PARTICIPATION OF REGIONAL EXPORTS AND IMPORTS IN TOTAL
TRADE, SELECTED YEARS
(In percentage of total trade)

ARGENTINA

	X	M
1970	20.6	22.1
1975	25.5	23.1
1980	23.0	20.2
1985	17.7	34.1
1990	25.3	33.0
1991	29.2	28.1
1992	32.9	31.2

BRAZIL

	X	M
1970	11.1	10.9
1975	13.8	5.7
1980	17.2	11.6
1985	8.7	11.9
1990	10.2	16.9
1991	15.6	17.4
1992	21.1	17.4

Source: LAIA, Estructura y Evolución del Comercio Regional (Montevideo, 1992) and ECLAC, Statistical Yearbook for Latin America (Santiago, various years).

The rates of growth of extra- and intra-regional trade in 1960-92 suggest that economic interests in the regional market should have consistently increased after 1960. Clearly, the fact that the participation of regional trade in the total trade of Argentina and Brazil never exceeded 20 % indicates that priorities remained in the markets of central countries. But the dynamism of regional trade until the late seventies cannot be overlooked when the bases for cooperation are considered. Moreover, such a conclusion is

strengthened when due consideration is given to the composition of trade. This reveals more clearly the impact of structural change in redefining interests in regional trade.

III. 2. The Composition of Regional Trade

If the region played a relatively minor role as a destination of total exports, it was the principal market for exports of certain industrial goods for most of the 1960-90 period. Given the emphases that Latin American governments placed on the industrialisation process, this means that the region attracted a larger interest than what total trade values suggest. Table VI.11 shows the region played a central role as a market for manufactured exports from Argentina and Brazil. The importance of the region fell in the case of Brazil by the end of the period, but it was still responsible for about 20 % of Brazil's exports of manufactures in the late eighties. Argentina remained heavily dependent on the regional market for these exports throughout 1960-90. The regions absorbed more than 40 % of Argentine manufactures in the late eighties.

TABLE VI.11
REGIONAL TRADE IN MANUFACTURED GOODS, SELECTED YEARS
 (As percentage of total manufactured exports)

Year	Argentina	Brazil
1965	49.1	59.5
1970	50.0	41.6
1975	52.2	38.4
1980	45.7	35.0
1986	40.8	20.2
1990	44.6	18.8

Source: Elaborated from Inter-American Development Bank, Economic and Social Progress in Latin America (Washington, 1985); LAIA, Estructura y Evolución del Comercio Regional (Montevideo, 1992).

The importance of the region is further enhanced by the type of manufactures that made up intra-regional trade. The region continued to represent the principal market for more complex industrial goods. Table VI.12 shows that Latin America represented the principal market for Brazil's chemical and metal-mechanical exports in 1988-90. And so it did for Argentina. Moreover, about 17 % of Argentine capital goods and transport equipment imports came from the region in 1988-90.

TABLE VI.12
COMPOSITION OF MANUFACTURED REGIONAL EXPORTS
 (Mean 1989-90, in millions of US\$ dollars and as percentage
 of total exports in each category)

ARGENTINA

Exports	LAIA	Global	%
Chemicals	325	716	45.4
Machinery and transport equipment	408	669	61.0
Total manufactures	1164	2647	44.0
Imports	LAIA	Global	%
Chemicals	294	1112	26.4
Machinery and transport equipment	226	1344	16.8
Total manufactures	638	2921	21.8

BRAZIL

Exports	LAIA	Global	%
Chemicals	478	1903	25.1
Machinery and transport equipment	1290	6364	20.2
Total manufactures	2376	13377	17.8
Imports	LAIA	Global	%
Chemicals	392	3226	12.2
Machinery and transport equipment	230	5818	4.0
Total manufactures	1147	11411	10.1

Source: Cf. Table VI.10.

The fact that the region absorbed a higher proportion of exports from sectors which are usually considered to be more dynamic in terms of the generation of external economies and the use of skilled labour has significant implications for regional cooperation. Governments give more

attention to the development and promotion of exports from this kind of industries. In addition, it can be expected that trade preferences would be more necessary (and hence more demanded) by exporters from sectors which are less dependent on natural resources and low salaries, and more dependent on technology. These conditions were present in the leading sectors of the ISI-2, which originated an increasing flow of industrial exports in the sixties.

Table VI.13 offers more evidence of this by comparing the Argentine and Brazilian composition of trade with the region in 1970 and 1987. The participation of manufactured goods in total regional exports increased between 1970 and 1987. The fall in the participation of food (from 63 % to 36 %) and the increase in the participation of manufactures (from 35 % to 52 %) in the Argentine trade with the region in this period was impressive. Not less remarkable was the change in the structure of Brazil's exports, in which the participation of manufactures increased from 33 % to 62 %. The chemical and metal-mechanical industries in particular expanded their role in regional trade ¹.

¹ In addition to exports of manufactures, Argentina and Brazil began to export technology, engineering and construction services, which are also skill- and technology-intensive. Cf. S. Teitel and F.C. Sercovich, 'Exportación de Tecnología Latinoamericana', El Trimestre Económico, vol LI, no. 204 (1984), pp. 811-41, and C. Dahlman and F.C. Sercovich, 'Exports of Technology From Semi-Industrial Economies and Local Technological Development', Journal of Development of Economics, vol. 16, no. 1 and 2 (1984), pp. 63-99.

TABLE VI.13
PERCENTAGE COMPOSITION OF TRADE FLOWS AMONG SELECTED LATIN
AMERICAN COUNTRIES
(In percentage of total regional trade)

ARGENTINA	EXPORTS		IMPORTS	
	1970	1987	1970	1987
Food	63.3	36.3	20.6	11.8
Agricultural and raw materials	--	2.8	25.6	6.9
Fuel	1.5	2.5	9.0	20.1
Mineral and metals	--	5.9	25.3	19.6
Manufactures	35.3	52.5	19.5	41.58
Chemicals	8.9	14.1	2.7	16.3
Machinery and transport equipment	16.1	18.2	9.9	16.9
Other manufactures	10.4	20.2	6.9	8.4
Total	100	100	100	100

BRAZIL	EXPORTS		IMPORTS	
	1970	1987	1970	1987
Food	26.0	12.5	46.5	25.8
Agricultural and raw materials	18.9	2.7	1.4	3.8
Fuel	0.7	3.6	19.5	13.7
Mineral and metals	21.1	18.3	12.9	25.4
Manufactures	33.3	62.8	19.7	31.4
Chemicals	3.0	13.8	5.4	11.8
Machinery and transport equipment	21.6	35.4	6.6	7.1
Other manufactures	8.7	13.5	7.7	12.5
Total	100	100	100	100

Source: R, Baumann, 'Economic Blocs and Intra-Industry Trade', unpublished paper, ECLA, Santiago, 1990, pp. 52-3.

It can be expected that this pattern of trade enhanced the interest of the private and public sectors in the regional market. The literature has observed and duly emphasised that regional trade was more intensive in skills and technology than extra-regional trade ¹. But the implications of this for the political economy of regional integration has not been correspondingly underlined. The focus on the resistance to liberalisation in LAFTA negotiations has somewhat obscured less visible but still relevant indications that industrial interests and 'developmentalist' objectives on industrial exports were served by an opening of the regional market - albeit partial and controlled.

These benefits were not overlooked by policy-makers, at least until the late seventies. LAFTA had succeeded in recovering trade from the crisis of the late fifties ². By mid-1967, when the failure of LAFTA to achieve its objectives was already clear, the Institute of Latin American Integration (INTAL) recalled the 'hidden benefits' (beneficios ocultos) that integration had produced: 'the

¹ J. Tavares de Araujo Jr., 'Mudança Tecnológica e Competitividade das Exportações Brasileiras', Texto Para Discussão N. 8, Universidade Federal de Rio de Janeiro, Rio de Janeiro, 1982.

² In a late recollection, R. Alemann, former Economic Minister of Frondizi, observed that the 'emergence of LAFTA (was) a suitable instrument for encouraging Argentine industrial exports (...) About half of Argentina's industrial exports went to LAFTA countries for many years - our critics are not justified in alleging that the policies begun in 1958 had an anti-export bias'. Cf. 'Roberto T. Alemann', in G. Di Tella and C. Rodríguez Braun, Argentina, 1946-83: The Economic Ministers Speak, p. 67.

products exchanged (within Latin America) present a much higher value added and incorporate more qualified workforce and entrepreneurial abilities' than extra-regional trade ¹. This was in turn consistent with the measures taken to foster 'non-traditional' exports since the early sixties ². Some Latin American observers also saw in the rise of the new protectionism in the seventies an evidence of the wisdom of the integration initiatives ³. However, after the failed effort of E. Frei in 1967 to revive integration, LAFTA was increasingly losing political importance ⁴. This lack of

¹ Cf. 'Editorial: Integración y Cooperación Latinoamericana, Los Beneficios Ocultos', Integración Latinoamericana, vol.1, no. 6 (September 1976), pp. 1-3. In addition, INTAL emphasised the steps that had been taken to create regional enterprises and promote technological cooperation (ibidem., p. 3).

² Cf. R. Mallon and J. Sourrouille, Economic Policy-Making in a Conflictive Society, pp. 79-82. These authors also present regressions showing a significant association between LAFTA and the expansion of manufactured exports in the sixties.

³ Cf. 'Editorial: El Nuevo Proteccionismo y la Integración', Integración Latinoamericana, vol. 4, no. 35 (1979), p. 1-2. The editorialist pointed out 'that it is evident that the dynamism of Latin American exports tends to fall. In this circumstances the idea of integration as a means for Latin American development gains special significance' (author's translation; cf. ibid., p. 1). The rapid growth of intra-regional trade in the seventies reinforced this perception. Cf. 'Editorial: Revalorización del Mercado Latinoamericano', Integración Latinoamericana, vol.4, no. 37 (1979), pp. 1-2, in which it is stated that 'the international economic context, characterized by recession and the new protectionism in the developed countries, in combination with the size and potential for future growth of the Latin American markets, suggest that the regional market should be re-valorised' (author's translation).

⁴ Cf. A. Casas González, 'Reflexiones Sobre el Futuro de la ALALC', Integración Latinoamericana, vol. 4, no. 40 (1979), pp. 7-34, who speaks of the 'distant attitude of

governmental support - already visible in the early years of LAFTA ¹ - would become more evident as the international economy expanded ² and regional rivalry increased in the sixties.

Concurrently, private firms took an active part in shaping negotiations and in setting the (slow) pace of integration that would prevail, in accordance with their interest in a cartelized market. This pattern was reinforced by the governments indifference, which facilitated the 'capture' of LAFTA by the private sector. The advance of liberalisation would thus become a function of the interest of private firms in exchange concessions. The fact that negotiations were conducted on a product-by-product basis facilitated the control of the process of liberalisation by vested interests ³. A study conducted by J. Campos in 1973 ⁴,

governments', which had been unable to 'generate, for instance, a special meeting of presidents or common actions by the Foreign Ministers' with a view to supporting LAFTA. This occurred 'despite the explicit decision, taken in 1975, of gathering the Council of Foreign Ministers at least once a year' (ibid., p. 15).

¹ Cf. section IV.

² INTAL observed that 'it was paradoxical that the idea of Latin American integration emerged in the sixties, when it was less necessary than now because the industrialised countries were then in a process of expansion' and had 'managed to reduce tariffs in the Kennedy Round' (author's translation). Cf. 'Editorial: El Nuevo proteccionismo y la Integración', Integración Latinoamericana, vol. 4, no. 35 (1979), pp. 1-2. In fact, the idea emerged in the late fifties, and not in the sixties, out of the conflict between accelerated industrialisation and the post-war international economic order. It began to work, however, in the early sixties, when the international economy rapidly expanded.

³ Cf. G. Salgado, 'The Latin American Regional Market: The Project and the Reality', Cepal Review (April 1979), especially p. 99. See also ibid., pp. 110-122, for a general

based on the participation of entrepreneurs at the sectoral meetings of LAFTA, observed the active role they played in the definition of concessions, especially in the oligopoly 'new' sectors. The chemical, electro-mechanical and metal-mechanical industries provided most of the representatives to the sectoral meetings, while traditional sectors had a very small representation ¹. In turn, the demand for concessions was higher in the new ² than in the traditional sectors ³. Finally, most of the firms represented at the

discussion of the barriers faced by LAFTA in the late seventies.

⁴ Cf. J. Campos, 'La Participación Empresarial en el Proceso de Integración: Las Reuniones Sectoriales', Revista de la Integración, vol. VII, no. 16 (May 1974), pp. 147-88. Similar conclusions were obtained by C.V. Vaitzos, Crisis en la Cooperación Regional: La Integración Entre Países Subdesarrollados (Mexico, 1978), especially pp. 42-49.

¹ The chemical industry contributed with 27.4 % of the representatives, the metal-mechanical and electric-mechanical industries with 20.7 % and the textile industry with 2,5 %. Cf. J. Campos, 'La Participación Empresarial en el Proceso de Integración: Las Reuniones Sectoriales', p. 158. As can be expected, the more industrialised countries in the region (Argentina, Brazil and, to a lesser extent, Mexico) were those with more representatives in the meetings. These countries represented 61 % of total regional trade in 1973 and provided 64 % of the representatives. Cf. *ibid.*, p. 151.

² Chemicals, metal-mechanical and electro-mechanical industries responded for 85 % of the total concessions requested. Cf. *ibidem.*, p. 167.

³ The higher demand for trade preferences in metal-mechanical and chemical goods probably reflected the rapid growth of these industries in the sixties (which cushioned the impact of competition) and the existence of more opportunities for intra-industry trade (which reduced resistances to liberalisation), as will be shown below. In the opposite pole were sectors like textiles and autos, which firmly resisted liberalisation and in which the concession of preferences was very reduced. Cf. E. Baldinelli, 'Las Negociaciones en la Mira Argentina', p. 18. In the case of textiles, the industrial organisation of the

sectoral meetings were multinational enterprises which had subsidiaries in more than one LAFTA country ¹.

In sum, the region provided an outlet for exports by the new sectors of the ISI-2. If some policy-makers realised the qualitative importance of the regional market, political commitment with LAFTA steadily eroded from the late sixties. The private sector, in turn, negotiated a selective opening which (within the limits of its aim of protecting the

sector - made up by a large number of producers and low entry barriers - prevented an agreement among producers, who feared that competition could drive many firms out of the market. In the case of autos, the most likely reason for the persistence of high barriers lies on the powerful lobby of subsidiaries of multinational firms, which benefited from protection in closed markets.

¹ Cf. J. Campos, 'La Participación Empresarial en el Proceso de Integración: Las Reuniones Sectoriales', pp. 178-79. In a study conducted in the early seventies on the attitude of the Argentine elite with respect to economic integration, it was observed that 63 % of the union leaders, 50 % of senior bureaucrats, 36 % of the entrepreneurs, 33 % of politicians and 14 % of high rank military were in favour of integration as against those who believed that conditions for integration were not adequate and/or opposed regional cooperation. Cf. E.R. Catterberg, 'Actitudes de las Élités Argentinas Hacia la Creación y Desarrollo de un Mercado Latinoamericano', Revista de Integración, vol. VII, no. 17 (September 1974), pp. 105-121. The opinion of union leaders may have been biased by the Peronist traditional support to Latin American integration, and it may not reflect actual support to the idea. The small proportion of the military in favour of integration was indicative of the significance that rivalry with Brazil had acquired in the sixties and seventies. It suggests that the higher the influence of the military in politics the lesser would be the interest in cooperation. Finally, the reduced proportion of entrepreneurs in favour of integration seems to contradict the evidence provided by Campos and Vaitzos of an active participation of firms (especially multinational firms) in LAFTA. The contradiction is only apparent as far (i) the participants to the sectoral meetings did not necessarily support a free trade area, but managed trade; (ii) support to a (limited) regional market was concentrated in a group of modern, capital-intensive sectors whose representation in the sample of 'elite entrepreneurs' is not discriminated in the study.

internal market and cartelizing the regional market) facilitated some specialisation and an increase in trade .

III.3. The Growing Significance of Intra-Industry Trade

It was suggested in chapter I that intra-industry trade implied (relatively) lesser costs of adjustment to competition and therefore was more conducive for cooperation in trade matters. Higher levels of intra-industry trade within the region can then be expected to be associated with more regional cooperation. Table VI.14 and VI.15 presents the existing evidence for different periods, as calculated by Bela Balassa (World Bank) in the mid-seventies and by Renato Baumann (ECLA) in the eighties ¹.

¹ Cf. B. Balassa, 'Intra-Industry Trade and the Integration of the Developing Countries in the World Economy', in H. Giersch (ed.), On the Economics of Intra-Industry Trade: Symposium 1978 (Tubingen, 1979), pp. 245-270, and R. Baumann, 'Una Evaluación del Comercio Intra-Industrial en la Región', Cepal Review, no. 48 (December 1992), pp. 87-99.

TABLE VI.14.
MEASURES OF INTRA-INDUSTRY TRADE FOR TRADE IN MANUFACTURED
GOODS, 1975

	World	DC	LAFTA	LDC
Argentina	0.675	0.874	0.573	0.908
Brazil	0.689	0.828	0.597	0.796

DC = Developed Countries

LDC = Less Developed Countries (except LAFTA)

Index of Intra-Industry Trade defined as the adjusted weighted index:

$IIT = \frac{\sum |X_{ei} - M_{ei}|}{\sum (X_{ei} + M_{ei})}$, where

$X_{ei} = X_i \left[\frac{1}{2} \frac{\sum (X_i + M_i)}{\sum X_i} \right]$ and

$M_{ei} = M_i \left[\frac{1}{2} \frac{\sum (X_i + M_i)}{\sum M_i} \right]$

Source: B. Balassa, 'Intra-Industry Trade', p. 250.

TABLE VI.15.
PERCENTAGE OF TRADE WITH IIT > 0.5 IN INDUSTRIAL AND TOTAL
TRADE, SELECTED YEARS a/
(In percentage)

Countries	Industrial products		Total trade	
	1980	1988	1980	1988
ARGENTINA				
with North America	20.5	12.6	17.8	7.7
with Western Europe	1.9	4.9	1.3	2.1
with Latin America	20.2	23.2	15.2	14.0
BRAZIL				
with North America	30.2	22.3	20.0	15.6
with Western Europe	12.0	2.6	8.2	1.6
with Latin America	16.8	31.3	11.2	14.7

a/ Intra-Industry Trade Index, defined as:

$$IIT = \frac{\sum \sum (X_{ijk} + M_{ijk}) - |X_{ijk} - M_{ijk}|}{\sum \sum (X_{ijk} + M_{ijk})}$$
where X_{ijk} represents exports of the product i by the country j to the country k and M_{ijk} are imports of the product i by country j from country k .

Source: R. Baumann, 'Una Evaluación del Comercio Intra-Industrial', p. 90.

The results of Balassa (Table VI.14) tend to confirm the existence of higher levels of intra-industry trade in the exchange of Argentina and Brazil with LAFTA than with the rest of the world¹. It also confirms that intra-industry trade was more intense within the region as compared with trade with developed countries. This can be deemed to support the argument that there was a stronger stimulus for

¹ The reader should observe that the construction of Balassa's intra-industry trade index implies that a lower value of the index represents higher intra-industry trade. Conversely, the index used by Baumann increases with the increase in intra-industry trade.

regional liberalisation than that for multilateral liberalisation. Moreover, Balassa argues that complementary agreements had an effect on the levels of intra-industry trade¹. Intra-industry trade was higher in industries and countries which had celebrated complementary agreements. This conclusion reinforces the hypotheses that - within its limits - LAFTA was instrumental for the expansion of regional trade.

The results of Renato Baumann for the 1980s (table VI.15) are less clear cut. Baumann calculated the percentage of the Argentina and Brazilian trade which exceeded a certain value of intra-industry trade in 1980 and 1988. He found that the trade of Argentina and Brazil with the USA had a percentage of intra-industry trade which was higher than or similar as that between Argentina and Brazil and Latin America. Moreover, the intra-industry trade of Argentina and Brazil with the USA subsequently decreased. This result is less consistent with the literature than those reported by Balassa. Intra-industry trade is expected to increase with the degree of development, the similarity of the industrial structures and the existence of integration agreements. The higher values of intra-industry trade between Brazil and the USA challenge this view. An explanation for the figures of 1980 might be found in the strict controls on imports applied by the Brazilian Foreign Trade Office (Carteira de Comércio Exterior, Portuguese

¹ Cf. B. Balassa, 'Intra-Industry Trade and the Integration of the Developing Countries in the World Economy', pp. 251-53.

acronym CACEX). It is likely that as far as protection was directed towards goods which could be produced domestically, only imports from centre countries found their way through CACEX restrictions (see more on this above). As regards the data for 1988, it may be argued that industrial restructuring and the fall of investment in the early eighties led to losses in the capabilities required for intra-industry specialisation in trade with the USA. On the other hand, intra-industry trade of Argentina and Brazil with Latin America continued to expand. This may be explained by the 1986 bilateral agreements between Argentina and Brazil which facilitated specialisation, especially in the capital goods sector.

In any case, the recover of intra-industry trade between Argentina and Brazil with Latin America in the late eighties implied that regional trade may have represented a less costly avenue for trade liberalisation and encouraged integration. This conclusion is confirmed by the evidence offered by a study of the Inter-American Development Bank on the evolution of intra-regional trade in manufactures between 1970 and 1990 ¹. This study shows that, in the case of Argentina, the IIT (unweighted average) for intra-regional trade in manufactures increased from 23.3 % (1970) to 52.1 % (1990). In the case of Brazil these figures were 20.1 % and 48.9 %, respectively. The increase was still more impressive in the case of intra-regional trade in

¹ Inter-American Development Bank, Economic and Social Progress in Latin America: 1992 Report (Washington, 1992), especially pp. 207-212.

manufactures which are human capital (or technology)-intensive. The IIT for this sector increased from 25.2 % (1970) to 58.2 % (1990) in Argentina, and from 19.6 % (1970) to 51.6 % (1990) in Brazil.

III.4. Conclusions

1. This section has reviewed the structural conditions shaping the interests in regional cooperation in the 1969-90 period. The account is still partial ¹, but some broad conclusions can nevertheless be drawn. If governments do not give up unilateral policies when positive results can be obtained with no sacrifice in sovereignty, then the international conditions discouraged the move towards economic integration in 1960-80. However, the trade position of Latin America was weak even in this favourable period and this was reflected in the growth of external debt in the seventies and the painful adjustment that followed in the eighties. The subsequent period was characterized by severe external constraints on growth and policy-making, associated with the debt crisis. The gains to be obtained from cooperation in these conditions increased and so did the readiness to cooperate in order to foster trade.

2. Industrial transformation from 1960 contributed to diversify trade towards industrial goods and encourage

¹ As mentioned, central problems related to the change in the international trade regime will be reviewed in the next chapter, along with a more detailed discussion of the emergence of the MERCOSUR.

intra-industry trade and regional foreign direct investment. This strengthened the interests in regional trade and in more open regional markets. However, the accumulation of industrial capabilities did not proceed smoothly. Divergent patterns of structural change developed in Argentina and Brazil in the seventies. There is no evidence so far that structural divergence have reduced the progress of diversification of regional trade and the importance of the region for certain industrial goods. The data suggests that in fact intra-industry trade increased in the seventies and eighties. But the assessment of costs and benefits of regional and multilateral liberalisation by regional actors can be affected by this trend. This will be discussed more attentively in the chapter VIII.

3. The literature most frequently emphasises the resistance of business interests in opening the market and the unwillingness of governments to share sovereignty. This assessment is correct as it accounts for the dismal inability of LAFTA to reach its objectives - the formation of a free trade area. However, the analysis of the trends in trade and structural change suggests that public and private actors benefited from the expansion of regional trade and that the role of LAFTA was not irrelevant.

4. The next section concerns itself with the evolution of regional cooperation policies from 1960. Different phases will be identified and related to the process of structural change presented in this section. In doing so, it aims at conveying a long term view on the determinants of the

intensity of trade in the region and that of cooperation and integration.

IV. THE EVOLUTION OF REGIONAL COOPERATION, 1960-90

IV.1. LAFTA and the Evolution of Trade Preferences

It was observed that in the period of consolidation of LAFTA conflicting signals came from the international economy and from industrial transformation. Gains from trade and the 'maturation' of ISI-2 provided an incentive for cooperation and integration. Conversely, the strong stimulus towards convergence in foreign policy of the late fifties receded and Argentina and Brazil gave priority again to promote national ISI. No long term commitment for a free trade area existed and the views on LAFTA were strictly 'commercialist'¹. The result was that strong elements of continuity remained between the regime of restrained bilateralism and the LAFTA regime.

The danger was early realised by ECLA. Prebisch hastened to warn against the sluggish progress of liberalisation in September 1962: 'the Free Trade Zone is not developing as we would wish, but at a dangerously slow and cautious pace. LAFTA activities could be reduced to just

¹ Cf. R. Barbosa, América Latina em Perspectiva: A Integração Regional, da Retórica à Realidade (São Paulo, 1991a), pp. 35-45.

a series of weak and timorous preferential agreements' ¹. Progress was relatively easy in the first three Conferences of the Contracting Parties as they comprised concessions for primary goods which in fact already existed under the old bilateral regime ². In addition, concessions were offered for those industrial goods whose production was insignificant in the region - and hence no opposition existed from local producers. However, when liberalisation had to be extended to products which could affect domestic production agreements became more difficult ³. Thus, the process by which trade would be liberalised by including 'substantially all trade' in the common list in four triennial stages stopped in the second stage because of the lack of consensus ⁴.

¹ Cf. FO371 162021 A1123/26, Mexico City, 13 September 1962.

² FO371 155769 A1123/18, Montevideo, 13 June 1961.

³ The unwillingness to liberalise regional trade was made it crystal clear at the moment of the negotiation of the Common List, aimed at freeing 25 % of regional trade. The importance of the Common List stemmed from the fact that concessions could not be revoked, as was the case of those granted in the National Lists. The result was a protracted negotiation in which the basic course of action was to water down commitments. Cf. E.B. Haas and P. C. Schmitter, The Politics of Economics in Latin American Regionalism: The Latin American Free Trade Association After Four years of Operation (Denver, 1965), pp. 18-22, on this point. The negotiations for composing the Common List dragged throughout 1964 and only in December an agreement was reached which reflected the 'most minimal of minimum common denominators' (cf. *ibidem.*, p. 22).

⁴ Cf. ECLA, 'ALALC: El Programa de Liberación Comercial y su Relación con la Estructura y las Tendencias del Comercio Zonal', Integración Latinoamericana, vol. 4, no. 40 (1979), pp. 54-56.

This trend can be seen in table VI.16, which shows the cumulative evolution of the number of preferences granted by LAFTA members between 1963 and 1979 in the National Lists. It can be seen that these concessions increased at a fast rate until 1966, then grew at a slower rate until 1969 (the data for 1968 is in fact inflated by the incorporation of Bolivia and Venezuela) and stagnated thereafter. The concessions granted by Argentina and Brazil followed the same pattern as the total concessions of LAFTA.

TABLE VI.16.
LAFTA: CUMULATIVE NUMBER OF CONCESSIONS GRANTED, 1962-79

Year	Total	Argentina	Brazil
1962	4268	699	910
1963	7601	1077	1250
1964	8248	1280	1312
1965	8474	1363	1352
1966	9054	1537	1511
1967	9393	1621	1603
1968	10382	1717	1710
1969	10869	1839	1802
1970	11017	1867	1842
1971	11042	1869	1851
1972	11079	1871	1859
1973	11110	1879	1865
1974	11157	1879	1877
1975	11165	1883	1878
1976	11164	1881	1874
1977	11174	1882	1876
1978	11238	1881	1880
1979	11242	1885	1881

Source: Elaborated from Instituto de Integración Latinoamericana (INTAL) Integración Latino-Americana (Buenos Aires, October 1979).

The evolution of trade preferences confirms this picture. Table VI.17 shows the tariff margins of preferences granted, weighted by the effective amount of exports and imports under LAFTA's preferential schemes ¹.

TABLE VI.17
LAFTA: TARIFF PREFERENCES, 1963-70
(In percentage)

	LAFTA	Argentina	Brazil
1963	19.6	9.2	36.2
1966	21.7	59.3	35.5
1968	27.3	39.6	28.8
1969	27.8	34.7	13.5
1970	11.2	10.7	8.7

Source: INTAL, Análisis de los Márgenes de Preferencia y el Comercio Intra-Zonal en el Marco de la ALALC (Buenos Aires, 1974), p. 72.

The stagnation in trade liberalisation that occurred in the late sixties is evident. The margins of preference conceded to the region in fact fell in 1970. Moreover, this fall was especially strong in the case of Argentina and Brazil, whose preferences were below the LAFTA average in 1970 ².

This trend should not lead to the conclusion that the progress achieved - even if far from satisfactory in the light of the original LAFTA programme - was innocuous. It

¹ It includes the goods that form part of the National Lists and also those that comprise the Special Lists which only benefits the least developed countries in the region.

² This picture conforms to the results obtained by Campos, who shows that the number of sectoral meetings increased steadily until 1969 and then stagnated. Cf. J. Campos, 'La Participación Empresarial en el Proceso de Integración', pp. 150-51.

was already mentioned that the chemical, metal-mechanical and electro-mechanical industries were privileged and oligopoly arrangements for specialisation achieved in the sectoral meetings. These sectors received more than 50 % of the total concessions granted in the first four Conferences of the Contracting Parties and more than 70 % of those granted in the 1965 Conference ¹. This had a significant influence on regional trade. A study conducted by the Institute of Latin American Integration (Spanish acronym INTAL) in the early eighties provides evidence for this ². In the study, intra-regional trade in different sectors was regressed on the tariff margins of preference provided by LAFTA. Two main conclusions emerged from the study, namely that (i) the margin of preferences had a positive effect on trade and that (ii) this effect was especially significant in the case of the metal-mechanical and chemical industries ³. Conversely, significant regressions coefficients were less frequent in sectors like vegetables and in the food industry.

This was reinforced by the complementary agreements, which were almost exclusively confined to the chemical,

¹ Cf. Comercio Exterior, vol. XVI, no. 4, April 1966, pp. 232-34.

² Cf. INTAL 'El Margen de Preferencia Arancelario y sus Efectos en el Comercio Intra-ALALC', Integración Latinoamericana, vol. 5, no. 49 (1980), pp. 5-12.

³ Cf. *ibid.*, p. 8.

electro-mechanical and metal-mechanical sectors ¹. Table VI.18 shows the participation of complementary agreements in total negotiated trade, which experienced an increase after 1963.

TABLE VI.18.

LAFTA: DISTRIBUTION OF LAFTA CONCESSIONS

(According to the programme of liberalisation, in percentage and millions of US\$ current dollars)

	NL(%)a/	SL(%)b/	C.A.(%)c/	Total d/
1962	96.7	3.3	xx	315.8
1963	96.1	3.8	---	429.6
1964	95.3	4.6	0.1	571.4
1965	94.7	5.0	0.3	677.8
1966	94.5	4.9	0.6	697.4
1967	94.1	4.9	1.0	672.2
1968	93.3	4.1	2.6	741.4
1969	93	4.3	2.7	894.4
1970	90.3	5.3	4.4	933.6
1971	89.7	5.6	4.7	950.8
1972	89.5	5.2	5.3	992.3
1973	89.5	5.4	5.1	1254.7
1974	88.2	6.1	5.7	1917.3
1975	88.4	6.8	4.8	1846.2
1976	88.2	4.5	7.2	2163.4
1977	88.2	5.2	6.6	2487.5

a/NL = National Lists b/ AL = Special Lists; c/ Complementary Agreements; d/ Total negotiated trade in current US\$ millions (cif).

Source: Elaborated from INTAL, Integración Latino-Americana (Buenos Aires, various years).

In sum, trends in negotiated trade and the conclusions of the INTAL study support the hypotheses that LAFTA effectively offered advantages for regional producers and

¹ During the LAFTA period 25 complementary agreements were signed, which covered a total of 2134 products of the NALAC classification.

played a role in facilitating trade in industrial goods. The achievement was modest if compared with LAFTA ambitious objectives, but it was nevertheless a significant one, especially considering that LAFTA countries had almost no previous experience in trade negotiations for industrial goods ¹. In due course, new evidence in favour of this hypotheses will be presented, in the context of the discussion of the determinants of regional trade.

IV.2. The Regional Payments System

A second significant contribution of the period to regional trade was the reciprocal payments agreements signed in 1965 by the central banks of the LAFTA countries, of which also participated Santo Domingo. The Mexico Agreement provided a system of compensation for regional trade through a net of bilateral payments agreements. In addition, the 'Santo Domingo Agreement' provided reciprocal credits to

¹ It was mentioned that in the Southern Cone countries some negotiation experience had been accumulated in the past and this was useful for advancing cooperation. However, the experience was by large confined to primary products. Much less experience existed as regards the negotiation of industrial liberalisation. This had a significant practical implication for LAFTA. Governments had to rely too heavily on information provided by the private sector. The lack of governmental capabilities in this field was not conducive to trade liberalisation. This was aggravated by the decision of giving more room to direct private sector negotiations, in the shape of sectoral meetings. Cf. on this point E. Baldinelli, 'Las Negociaciones en La Mira Argentina', pp. 17-18; José Melero, former Argentine representative at LAFTA and GATT, interview, Montevideo, 25 July 1993.

finance net positions in intra-regional trade ¹. This represented in practice the creation of a regional payments system. The success of this system was impressive. Table VI.19 shows that the effective use of dollars in regional trade was strongly reduced as a result of intra-regional compensations, and dollar transfers were always lower than one third of the total value of trade. In addition, the percentage of compensated trade increased from 13.6 % in 1966 to 41,4 % in 1970 and 79 % in 1981 ².

TABLE VI.19. LAFTA: THE OPERATION OF THE REGIONAL PAYMENTS AGREEMENT, 1966-75

(in thousands of US\$ current dollars and in percentage)

Year	Total a/	Transfers (%) b/
1966	106.4	30
1967	332.7	28
1968	376.5	33
1969	479.2	17
1970	560.5	20
1971	708.1	19
1972	984.4	19
1973	1403.1	20
1974	2288.3	17
1975	3396.3	26
1979	6420.7	25
1980	8663.1	23
1981	9331.4	27
1982	6553.0	29

a/ Total of credits and debits at the end of the period of compensation in thousands of current US\$ dollars.

b/ Percentage of dollars effectively transferred (the difference between 100 and the percentage of transfer represents the saving of dollars in this year).

Source: Elaborated from LAFTA, Síntesis (Montevideo, January-February 1976).

¹ Cf. IDB, Desarrollo Económico e Social (Buenos Aires, 1985), p. 60.

² Ibidem., p. 61.

It is somewhat ironical that the initiative for a regional payments system, resisted in 1960, was at the end of the day more successful than the (supposedly) consensual move towards a regional free trade area. This can be seen as an indication that the convertibility question in latin America had not been entirely resolved in the fifties and continued to haunt the region after 1960. This was another factor underlining the continuity of the cooperation effort in the sixties and seventies.

IV VI.3. LAFTA and the Limits to Cooperation

(a) The Weakening of LAFTA

The lack of political will of the national governments to accept closer cooperation was expressed in their resistance to transfer decision powers to LAFTA. In neo-functional terms, the degree of 'politization' and the transfer of loyalties to supra-national authorities remained at very low levels ¹. Cooperation continued to be restrained (even if then on a more diversified industrial and geographical bases). The tendency towards limiting the process of cooperation was already visible in late 1962. Rómulo de Almeida, then President of Executive Secretariat of LAFTA, explained the reasons that led him not to seek re-election:

¹ E.B. Haas and P. C. Schmitter, The Politics of Economics in Latin American Regionalism, p. 18.

'I have no hope that the current structure of LAFTA and the policy of most countries towards it could permit changes in the role of the presidency before the election of 1964, and I do not want to be reelected. I intend to endeavour in this period to strengthen the role of the Secretariat, which I am persuaded is highly necessary if any international organisation is to work properly' ¹.

Another Brazilian diplomat at LAFTA, Evandro Lins e Silva, observed that

'the characteristics of the representations (before the Permanent Executive Committee in Montevideo) do not permit any decision, even those most irrelevant, to be taken without previous consultation with the respective governments. Given the terrible precariousness of governmental support for the representatives, the result is that the regime of consultations have become an overwhelming obstacle for the activities of LAFTA. (...) We have to react promptly. Otherwise the Contracting Parties will be contented with these small, transitory advantages that do not correspond to the ambitious programme proposed in the Montevideo Treaty' ².

¹ Cf. the letter from Rómulo de Almeida to Foreign Minister Affonso Arinos, CDO, 'Diversos no Exterior, 1962-63', 800(20), no. 1302, 23 November 1962 (author's translation).

² Cf. CDO, 'Situação do Comitê Executivo Permanente', Confidential 96, 800(20), no. 1175, 15 August 1963 (author's translation). The description provided by Lins e Siva of the proceedings of the Committee in 1963 is illustrative enough.

High-level initiatives were launched in order to rescue LAFTA. In 1965 President Frei demanded critical political decisions and the formation of a panel of experts to propose solutions for LAFTA ¹. However, the unwillingness to negotiate prevailed, especially as a result of the opposition of Argentina and Brazil ². The creation in 1969 of the Andean Pact (Cartagena Treaty) by a group of countries which wished to accelerate integration (Bolivia, Chile, Colombia, Ecuador and Peru) represented the plain recognition that LAFTA had ceased to offer prospects for

In the first month of the year the typing correction of the National Lists was made. Another month was taken to discuss whether the Committee would be allowed to exceed in eight days the deadline established by the Conference for the definition of a planning meeting. The timetable for sectoral meetings was defined only in May. Then it was realised that the 'LAFTA secretary did not have the necessary means to take care of the tasks demanded by the Committee' (ibid., author's translation). When eventually the sectoral meetings began, the Uruguayan government imposed an indiscriminate duty of 20 % on all exports. This created an impasse which led the Committee to suspend its activities for two months, until the Uruguayans withdrew their decision. Still, the impasse created impeded the celebration of a meeting of Foreign Ministers in Montevideo, which had been called for Presidents Alessandri and Goulart.

¹ The panel was formed by a group of distinguished Latin American experts (Raúl Prebisch, Felipe Herrera, Carlos Santamaría and José Mayobre), who should elaborate a plan of action. Cf. Boletim ALALC, vol. II, no. 1 (May 1965), pp. 6-8. This plan (many of whose suggestions would be later used by the Andean Pact) were then presented to the Latin American presidents. Cf. R. Prebisch et al, Hacia la Integración Acelerada de América Latina (Mexico, 1965), especially pp. 36-38.

² R. Barbosa, 'O Brasil e a Integração Regional: a ALALC e a ALADI', mimeo, paper presented to the Second National Seminar on 60 Years of External Policy, São Paulo, USP, 1991, p. 5.

progress ¹.

In 1969 the LAFTA timetable was reformulated and the deadline for the formation of the free trade zone was extended until December 1980. In the mid-seventies it was again clear that the new deadline would not be reached, and steps were taken to adjust the discourse to reality ². It was considered that the rigidity of the regional MFN clause was hindering cooperation and that a move towards higher flexibility (in terms of the liberalisation programme and in terms of the geographical scope of the agreements) was necessary ³. Regional integration was then seen more explicitly as the creation of an area of trade preferences

¹ Venezuela joined the Andean Pact in 1973 and Chile abandoned it in 1976. An important question, whose analysis however exceeds this work, is why certain countries opted for a new project of integration while others preserved LAFTA in its narrow scope. Clearly, the limits posed on industrialisation by the size of the market was much stricter in the case of the Andean countries than in large countries like Argentina, Brazil and Mexico. Ideological and political factors also influenced this. The Andean Pact was founded by reform oriented governments led by democratic Chile. Cf. R. French-Davis, 'Integración Económica', Integración Latinoamericana, vol. 12, no. 142 (1989), pp. 35-51. Argentina made a short-lived approach to the Andean Pact during the Peronist government in the early seventies, which would not progress because of political instability after 1974. Cf. C.J. Moneta, 'La Política Exterior del Peronismo', in R.M. Perina e R. Russell, Argentina an el Mundo, 1973-1983 (Buenos Aires, 1988), pp. 87-90.

² Already in 1974 negotiations began to restructure LAFTA. Cf. G. Salgado, 'The Latin American Regional Market', p. 120.

³ Cf. The speech at LAFTA of the Argentine Ambassador C.G. Martínez, 'La Crisis del Monismo Integrador', Integración Latinoamericana, vol. I, no. 8 (1976), pp. 4-21.

¹. LAFTA gave way to the Latin American Integration Association, created by the 1980 Montevideo Treaty. This was based on higher flexibility, clearing the ground for the new bilateral agreements that would emerge in the late eighties
².

(b) The Revival of Regional Rivalry

The installation of military governments in Argentina (1966) and Brazil (1964) reinvigorated power competition in the region and limited the willingness of governments to share sovereignty. The predominance of a Cold War perspective in foreign policy (which debilitated the 'autonomist' stance of the early sixties) and of a rivalry perspective in regional policy were not conducive to regional cooperation. This was reflected in the bitter Argentine-Brazilian disputes about the utilisation of the Parana River for the production of hydroelectric power. Argentina was a downstream country and considered that the Brazilian-Paraguayan Itaipu project would affect her ability

¹ Cf. 'Editorial: El Futuro de la ALALC', Integración latinoamericana, vol. 4, no. 40, pp. 1-2, and 'Editorial: ALADI Como un Area de Preferencias Económicas', Integración latinoamericana, vol. 5, no. 52 (1980), pp. 1-3, in which the 'enabling clause' conceded by the GATT on 28 November 1979, allowing developing countries to form areas of tariff and non-tariff preferences, is invoked in favour of the new approach. On the 'enabling clause' see R.E. Baldwin, The Multilateral Trade Negotiations: Towards Greater Liberalization? (Washington, 1979), pp. 20-21.

² Cf. R. Barbosa, América Latina em Perspectiva, pp. 5-6.

to use hydroelectric resources. This dispute was permanent source of friction in the sixties and seventies and contributed to hinder the progress of cooperation ¹.

Moreover, the quest for influencing neighbouring countries increased. Argentina sought to secure agreements with smaller countries as a form of counter-balancing the impressive economic development achieved by Brazil in the sixties ². Concerns with regional equilibrium reinforced the Argentine opposition to Itaipu, which would lead to the incorporation of Paraguay to the Brazilian orbit ³. Brazil, in turn, saw Latin America as the natural area for expanding her political role. A tacit agreement with the USA was sought, in which Brazil's alignment with the USA in the Cold War would be reciprocated by US support for Brazil's role in Latin America ⁴. As a result, the dynamic initiatives adopted in relation with smaller neighbours contrasted with the

¹ Cf. A. Lanús, De Chapultepec al Beagle, pp. 297-302. The Treaty of the River Plate Basin, signed in April 1969 and created to promote cooperation in the use of natural resources among Argentina, Bolivia, Paraguay and Uruguay, became just another arena of conflict in which divergent views prevailed. Cf. Moneta, 'La Política Exterior del Peronismo', p. 86.

² Ibidem., pp. 84-85.

³ Cf. I. Almeida Mello, 'Argentina, Brasil e a Balança de Poder Regional: Equilíbrio, Preponderancia e Hegemonia', unpubl. Doctorate Theses, University of São Paulo, 1991, p. 15.

⁴ Cf. L.I. Almeida mello, 'Brasil, Argentina e a Balança do Poder Regional', p. 17. The views of the military government on geopolitics can be found in G. do Couto e Silva, Geopolítica do Brasil (Rio de Janeiro, 1967, 2nd edition), especially pp. 55-60.

sluggish pace of Argentine-Brazilian negotiations ¹.

Divergence of views persisted in the seventies. If Brazil then emphasised the 'diplomacy of development' and sought a more active role in Africa and the Middle East (on which she was strongly dependent for oil) ², the Argentine military government privileged strategic ³ and territorial objectives ⁴, after the timid attempts of the early years of the Peronist government to set forward a more articulated external policy ⁵. Divergences began to be ironed out in

¹ Uruguay benefited from significant trade concessions granted by Argentina in the Argentine-Uruguayan Convention for economic Cooperation (CAUCE) of 1974 and by Brazil in the Protocol for the Expansion of Trade (PEC) of 1975. Cf. N. Berretta, 'Las ventajas de ser Pequeño: Apuntes Para una Política Comercial Estratégica Frente al MERCOSUR', Revista Paraguaya de Sociología, vol. 29, no. 33 (1990), pp. 90-95. Argentina also signed an agreement with Paraguay to construct a dam on the Parana (Yaciretá-Apipé) and negotiated with Bolivia the exploration of iron in El Mutún.

² R. Ricúpero, 'A Diplomacia do Desenvolvimento', mimeo, Programa de Política Internacional e Comparada, University of São Paulo, October 1991, pp. 14-15. Brazil also strengthened her links with Europe and especially with Germany through an agreement on nuclear cooperation in 1975.

³ R. Russell, 'Argentina y la Política Exterior del Régimen Autoritario', in R.M. Perina and R. Russell, Argentina en el Mundo, pp. 105-7. Argentina believed that she should occupy the spaces that the declining hegemony of the USA left in the region, by playing a more active role in fighting communism. This included support to the Garcia Meza coup d'état in Bolivia and the participation of Argentine military in training anti-guerrilla forces in Central America. In addition, in many cases, the military of Argentina, Brazil, Chile and Uruguay cooperated in the abducting and assassination of political oppositors.

⁴ In 1978 Argentina and Chile almost went to war because of the dispute for the Beagle Islands in the South Atlantic.

⁵ Policies in the May 1973-March 1976 period were disrupted by conflict within the peronist government. C. Leyba, Under-secretary of Economic Programming and Coordination, observed that 'for almost five months (from

October 1979, when a solution was eventually reached for the Itaipu problem ¹. The rapprochement was also encouraged by the Malvinas/Falklands War of 1982 ² and the external crisis of 1982, which gave rise to perceptions of high vulnerability in the international system. However, it was the transition towards democracy in 1985-86 which would confer momentum to the redefinition of Argentine-Brazilian relations and sustain a new wave of economic integration, as will be discussed in the next chapter.

October 1973) we were backed by Perón and the social alliances, although the government team was caught in the crossfire between government factions. Politically speaking, this was our golden age, when we succeed in the conclusion of the Triennial Plan, drawing-up sectoral acts, a commercial opening to the Eastern bloc, discussion of foreign capital proposals, projects for Latin American integration and the lifting of the Cuban blockade'. Cf. 'Carlos Raúl Gabriel Leyba', in G. Di Tella and C. Rodríguez Braun, Argentina, 1946-83, p. 127. However, the gradual control of the government by the right-wing groups led by Isabel Perón and José López Rega, and the political unrest and economic crisis that followed the sharp devaluation adopted by Economic Minister Celestino Rodríguez in June 1975, impeded the implementation of coherent economic and foreign policies. Cf. 'Guido Di Tella', in G. Di Tella and C. Rodríguez Braun, Argentina, 1946-83, p. 147.

¹ M.Hirst, 'La Participación de Brasil en el Proceso del MERCOSUR: Evaluando Costos y Beneficios', Documentos e Informes de Investigación N. 135, FLACSO, Buenos Aires, December 1992, p. 4.

² Brazil provided broad commercial and diplomatic support to Argentina during the war. Argentine exports to the CEE were channel through Brazilian ports in order to circumvent the European commercial boycott. Brazil also assumed the representation of the Argentine interests in the UK. C.A. Moniz Bandeira, Estado Nacional e Política Internacional, p. 245, reports that Brazilian planes and crew participated of observation flights in the South Atlantic coast during the war.

(c) Trade Policy and Industrial Policy in the Seventies

It was already mentioned that international lending allowed Latin America to sustain growth and trade in the seventies, even in a context in which the terms of trade of non-oil producers fell and markets in the central economies experienced recession and increased protectionism (cf. table VII.3 and VII.4.). This was a period in which state autonomy increased in Latin America ¹, stemming from the willingness of private banks to recycle the so-called petro-dollars. National governments thus became less dependent on the conditionality imposed by official agencies as they had resources to apply in their they preferred policies. There was less stimulus for 'sharing sovereignty' through regional integration. The room for manoeuvre made possible by external financing reinforced the unilateral approach to trade and industrial policy in Argentina and Brazil ².

In effect, both countries set out to promote significant changes in the economic structure. The direction of this effort was divergent. Brazil moved towards further import-substitution, while Argentina made a bold attempt at trade and financial liberalisation. Both policies had in common that they gave little attention to regional

¹ Cf. P. Evans, 'The State as a Problem and Solution: Predation, Embedded Autonomy and Structural Change', pp. 150-55.

² Cf. R. Ffrench-Davis, 'Integración Económica', pp. 36-37.

integration. The conditions seemed to be favourable enough to go alone and regional integration was not deemed necessary for fostering structural change.

In the case of Brazil, the Second National Development Plan (PND II, 1974-8) represented a kind of ISI-3, aimed at 'deepening' ISI towards new intermediate and capital goods¹. The import coefficient of the economy contracted while industrial transformation accelerated. Spurred by the disequilibrium provoked by the first oil crisis, a thorough system of non tariff protection was set up and managed by CACEX, while generous subsidies were granted to priority sectors². In order to compensate for the anti-export bias of the new protectionist policies, export subsidies were provided³. In turn, international lending financed the implementation of this new phase of industrialisation. The results were impressive in terms of growth and structural change in the period 1974-79, as discussed in section II. However, Brazil would begin the eighties in a delicate position in the external and fiscal fronts.

Clearly, the new Brazilian policy left no place for

¹ Cf. A.C. Barros de Castro and P.F. Souza, A Economia Brasileira em Marcha Forçada (Rio de Janeiro, 1985) and B.K. Becker and C.A.G. Egler, Brazil: A New regional Power in the World Economy (Cambridge, 1992), pp. 92-98.

² Cf. On the policies of the II PND see J.C. Batiste, Debt and Adjustment Policies in Brazil (Boulder, 1992), pp. 36-51.

³ Cf. R. Bonelli et al, 'Macroeconomic Instability and Trade Liberalization: Lessons From the 1980s to the 1990s', IDB Working Paper Series N. 101, Washington, March 1992, PP. 11-14.

regional specialisation. The policy was inward-looking and stretched ISI to its limits, thereby reinforcing the bias against regional imports implicit in the ISI pattern. Only the most essential primary goods or complex capital goods (which could not be substituted) were imported ¹. The overwhelming objective of furthering ISI was not softened by the opportunities offered by regional trade to avoid costs and inefficiency. This was the period of the diplomacia da gaveta, in which CACEX controlled intra- and extra-regional imports with equal zeal ².

Conversely, Argentina used the abundance of international financial capital to implement a comprehensive programme of trade and financial liberalisation since 1977/8. The objective was to move away from the dominant ISI pattern of growth and achieve unrestricted integration in the world economy ³. With this objective, trade barriers were reduced (slowly in 1976-78, quicker from early 1979) and

¹ For an analysis of how the structure of effective protection operated in favour of these imports see P. Malan, 'Política Econômica e Teorias do Balanço de Pagamentos: Relações Internacionais do Brasil no Período 1946-79', unpublished. Professoral Theses, Federal University of Rio de Janeiro, 1981, part III.

² The diplomacia da gaveta (diplomacy of draws) refers to the delays with which CACEX considered the concession of import permits, even for regional imports. Cf. José Melero, interview, Montevideo, 25 July 1993.

³ Cf. 'José Alfredo Martínez de Hoz', in G. di Tella and C. Rodríguez Braun, Argentina 1946-83: The Economics Ministers Speak, p. 151, in which he emphasised that '(O)ur programme intended to implement a structural reform of the economy and not only to overcome a crisis. We had to reinsert Argentina within the framework of the international economy'.

full financial liberalisation implemented¹. In December 1978 a tablita fixing the exchange rate for a certain period was established, with a view to controlling expectations in the exchange market and to bringing about 'convergence' in domestic and international prices².

As in the Brazilian case, regional integration had no role to play in this policy. Trade liberalisation should not distinguish between regional and extra-regional producers and in fact the neutrality of incentives was supposed to be at the basis of the new policy and would be enough to secure the most efficient allocation of resources³. As unilateral liberalisation advanced from 1978, regional preferences were

¹ Nominal protection in Argentina was 210 % in 1976, with an average of 55 %. This was firstly reduced to 100 % with an average of 41 % and in January 1979 a programme for quarterly reductions of tariffs was set out, with the aim of achieving a maximum of 20 % and an average of 18 % in five years. For an interesting analysis of the association between economic and political variables in the 1976-82 period see J. Schwarzer, La Lógica Política de la Política Económica (Buenos Aires, 1982).

² Cf. 'José Alfredo Martínez de Hoz', p. 170.

³ The sources of the Argentine problems, according to Martínez de Hoz, were 'statization and regulations (which) had stifled individual initiative, pushing private enterprises into wooing public officials for their favours' (ibid.), p. 152. This clearly applied to the industries which had been dynamic in regional trade in the sixties (especially metal-mechanical and electro-mechanical industries). However, despite the official discourse of elimination of public subsidies and protection, some sectors continued to receive a special treatment, especially capital- and resource-intensive intermediate industries (steel, paper, petrochemicals), which expanded their role in industrial production and exports in the eighties. Cf. D. Aspiazu, 'La Promoción de la Inversión Industrial en la Argentina: Efectos sobre la Estructura Industrial', in B. Kosacoff and D. Aspiazu, La Industria Argentina: Desarrollo y Cambios Estructurales (Buenos Aires, 1989).

eroded.

In sum, neither the ambitious Brazilian ISI-3 effort nor the Argentine radical liberalisation programme demanded a specific regional policy. Both countries used the enlarged autonomy then provided by international lending to set forward their own programmes of economic restructuring. If the objectives of these programmes were divergent (the quest for semi-autarky in Brazil and the quest for a drastic exposition of the economy to world competition in Argentina), both reserved a very minor role to be played by regional cooperation.

IV.4. The Creation of Latin American Integration Association (LAIA)

The creation of LAIA in 1980 was the formal recognition that the ambitious objectives of LAFTA could not be fulfilled. LAIA sought to preserve the limited advances so far made by LAFTA, which had been the core of the trade regime in 1960-80, while setting a more flexible framework for regional cooperation¹. To be sure, LAIA mentioned the formation of a common market as a long term objective, but no concrete programme to advance in this direction was presented. The practical objective of LAIA was to create a

¹ Cf. 'Texto del Tratado de ALADI', Integración Latinoamericana, vol. 4, no. 47 (1980), pp. 4-14.

zone of partial trade preferences¹. It was as if structural conditions and institutional arrangements, the reality and the letter of the regional agreements, had at last been reconciled. Moreover, the principle of regionalism was dropped and room was made for flexible bilateral preferences, by which tariff reductions between two members of LAIA would not be required to be extended to other members².

The principal instruments of LAIA are the Regional Tariff Preference, the Programme for the Expansion of Trade, the Lists for Opening the Market and the Partial Agreements³. The 'Regional Tariff Preference' was to provide a basic preference of 5 % in 1984, 10 % in 1987 and 20 % in 1990 for the 'big three' (Argentina, Brazil and Mexico). Countries of intermediate development (Chile, Colombia, Peru, Uruguay and Venezuela) would receive a preference of 38 %, while Bolivia, Ecuador and Paraguay would receive 40 % (plus an additional 8 % in the case of hinterland countries). These

¹ Cf. R. Barbosa, 'O Brasil e a Integração Regional', pp. 5-8, and B.M. Macadar and T.S. Bello, 'A Integração Latinoamericana Frente as Transformações da Economia Mundial', Ensaio FEE, vol 10, no. 22 (1989), pp. 189-211.

² Cf. In 'Editorial: ALADI, Una Esperanza Renovada', Integración Latinoamericana, vol. 4, no. 47, p.1, INTAL suggests that 'LAFTA was frozen in a multilateral approach which demonstrated to be ineffective. The new LAIA Treaty, more realist, makes possible partial actions in which it would not be necessary the participation of all the members of the Association' (author's translation). However, a principle of convergence remained, through which preferences should be 'regionalised' so as to gradually conform a free trade area in Latin America.

³ Cf. 'Texto del Tratado de Aladi', pp. 5-10.

benefits would not apply to a negative list of exceptions. The 'Programme of Recover and Expansion of Trade' (created in January 1989) was intended to divert trade from third countries through tariff reductions on a positive list of products. The 'List for Markets Opening' would completely eliminate barriers in favour of less developed countries for a positive list of products. Finally, 'Partial Agreements' (Spanish and Portuguese acronym AAP, Acuerdos de Alcance Parcial) can be celebrated bilaterally or among a small group of countries, which would be allowed to offer non-extensible concessions to each other.

The new instruments provided by LAIA were in practice mostly ineffective. No-one of them had significant influence in regional trade up to now, either because the list of exceptions was too large or the positive list too short. Frequently less developed countries had no adequate supply capabilities to take advantage of the concessions received¹. On the other hand, LAIA did lead to new developments that fostered integration. By introducing flexibility, LAIA facilitated agreements. Partial Agreements (AAP) provided the institutional framework for the new, more dynamic phase of cooperation that begun in 1986. LAIA permitted a timely flexibility which would be used in the new structural and

¹ The Regional trade Preference programme embraced so many exceptions that its relevance has just been symbolical. The Programme for the Expansion of Trade came to include very few products in the positive list. The percentage of imports of the major countries favoured by the preference was of 10 % with respect to other major countries, 15 % with respect to intermediate countries and 20 % with respect to the less developed ones.

political conditions of the mid-eighties. The 1986 Programme for Economic Integration and Cooperation Between Argentina and Brazil (PICE) would represent the first step towards this new, more dynamic phase of cooperation.

V. STRUCTURAL AND INSTITUTIONAL CHANGE: AN OVERVIEW

The discussion above has considered several variables affecting the evolution of regional trade. Some of them were related to the structure of the international system and the domestic economy - reflected in constraints on growth and policy-making, and in the transformation of industrial capabilities. Other variables were institutions, which contributed to shape the policy of regional cooperation. Which was the role of these variables in shaping the economic relations of Argentina and Brazil?

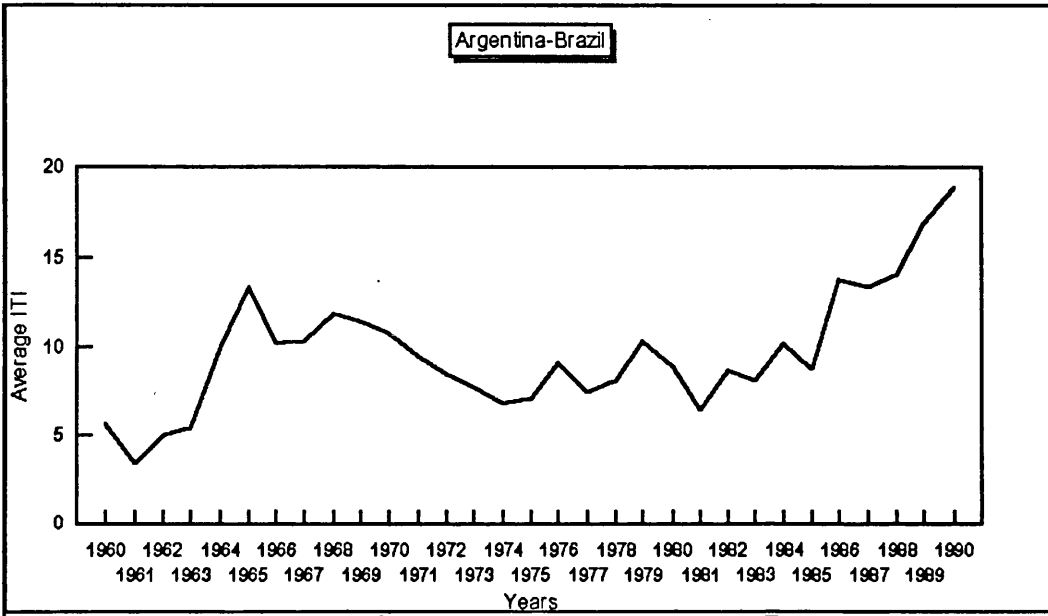
The index of trade intensity (ITI), presented in chapter V, can be used to answer this question. From one hand, the ITI is related to the international specialisation of the country and thus changes with the structure of supply and demand of the domestic and the international economy. On the other hand, the ITI also reflects trade discrimination and transaction costs. If economic cooperation and integration lead to a fall in transaction costs, the ITI would increase. A study on the evolution of the ITI can thus permit to identify different phases in regional economic relations and the role of structural and institutional change.

First, an 'impressionistic' view of the evolution of the ITI will be offered in this section. Secondly, an admittedly crude effort for quantifying the influence of structural and institutional variables in shaping the ITI is offered.

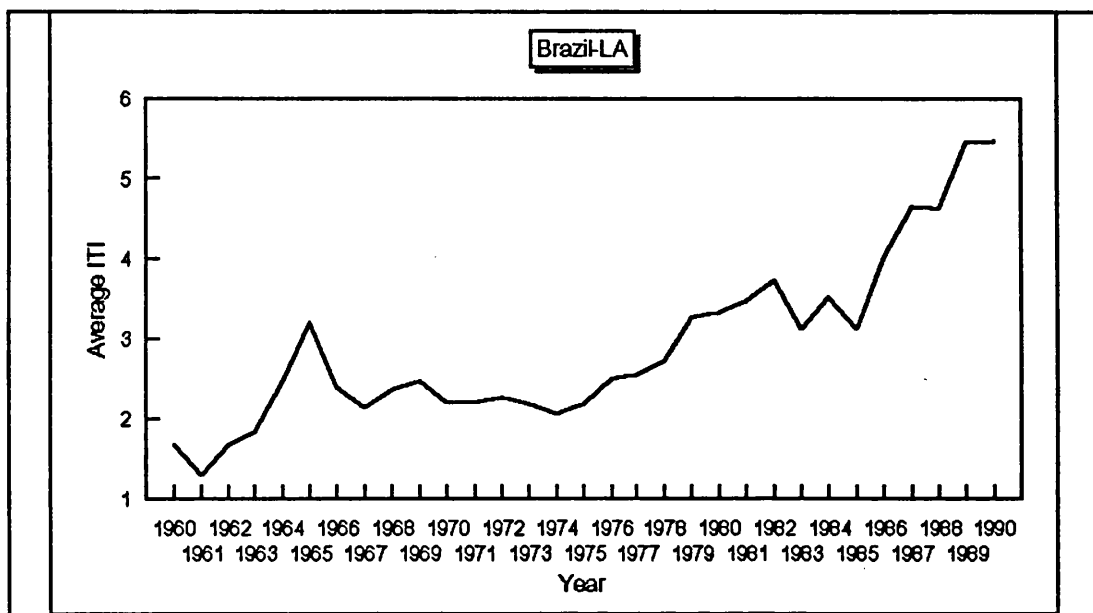
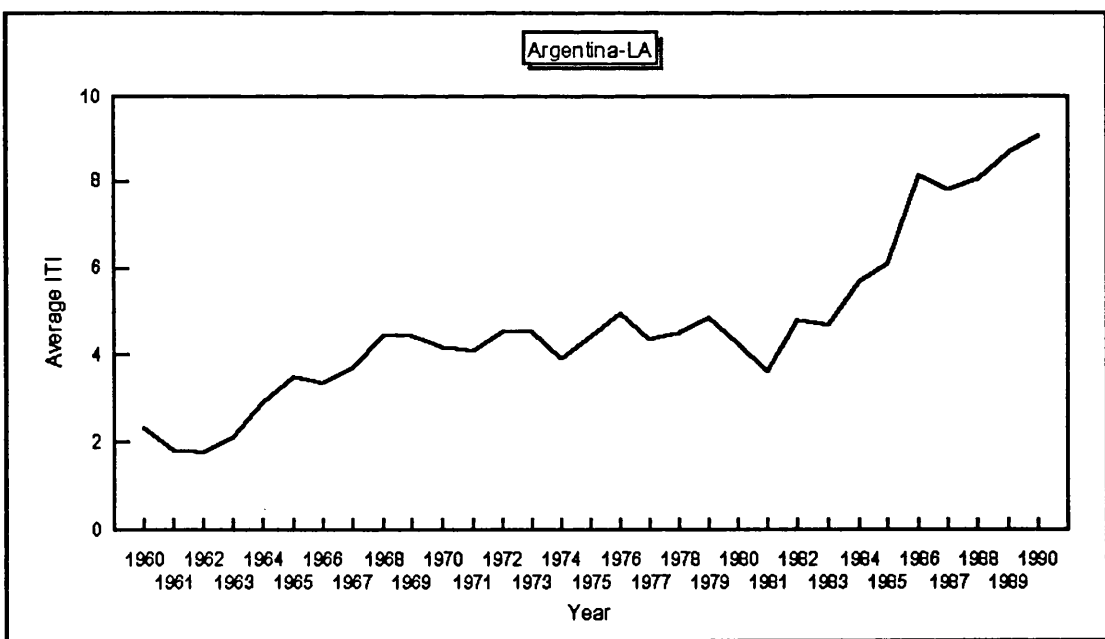
V.1. The Evolution of the Index of Trade Intensity

The evolution of the average index of trade intensity for the period 1960-90 is presented in graphs VI.3, VI.4 and VI.5. The index has been calculated for trade between Argentina and Brazil (graph VI.3), Brazil and Latin America (graph VI.4), and Argentina and Latin America (graph VI.5).

Graph VI.3. Average ITI, Argentina and Brazil, 1960-90



Source: Cf. Table IV.1.

GRAPH VI.4. Average ITI, Brazil-Latin America, 1960-90GRAPH.VI.5. Average ITI, Argentina-Latin America, 1960-90

Source: Cf. Table IV.1.

The graphs show at least three phases in regional trade: (i) a phase of increase in the ITI until the mid-sixties/late sixties; (ii) a phase in which the ITI remained stable or suffered a modest decline from the late sixties to the mid-eighties; (iii) a phase of rapid increase of the ITI in the second half of the eighties. Table VII.20 presents the ITI for imports, exports and the average ITI in different sub-periods. The coefficient of variation for the average ITI is also presented.

TABLE VI.20
EVOLUTION OF THE INTENSITY OF TRADE INDEX (ITI), 1958-93

(a) ITI Argentina-Brazil

Period	Exports	Imports	Average	C.V. (%)
1958-1960	5.1	7.2	6.1	10.5
1960-1964	5.4	6.4	5.9	41.0
1965-1973	11.1	9.7	10.4	23.0
1974-1980	9.2	7.2	8.2	15.2
1981-1985	6.2	10.5	8.4	14.2
1986-1990	14.9	14.6	14.7	17.2
1958-1990	10.0	9.0	9.5	35.8

(b) ITI Argentina-Latin America

Period	Exports	Imports	Average	C.V. (%)
1958-1960	2.0	2.7	2.4	5.0
1960-1964	2.2	2.2	2.2	20.5
1965-1973	4.0	4.2	4.1	11.2
1974-1980	4.3	4.7	4.5	8.0
1981-1985	4.9	6.9	5.9	7.6
1986-1990	7.5	9.3	8.4	5.8
1958-1990	5.0	4.2	4.6	41.3

(c) ITI Brazil-Latin America

Period	Exports	Imports	Average	C.V. (%)
1958-1960	1.1	2.3	1.7	10.0
1960-1964	1.1	2.4	1.8	24.7
1965-1973	2.2	2.5	2.4	13.8
1974-1980	3.1	2.2	2.7	18.7
1981-1985	3.4	3.4	3.4	7.0
1986-1990	4.3	5.4	4.8	11.3
1958-1990	2.7	3.0	2.8	38.2

Source: Calculated from IMF, Direction of Trade (Washington, various years) and IMF, International Financial Statistics, (Washington, various years).

It can be seen that the ITI increased sharply between 1960-64 and 1965-73 (it practically doubled in all cases, except in the case of trade between Brazil and Latin America), remained more or less stable in 1974-85 (it experienced a modest increase in the case of Brazil-Latin America and Argentina-Latin America in the seventies and eighties, and fell in the case of Argentina-Brazil in the seventies) and again experienced a significant increase after 1986. Table VI.20 also presents the ITI for the pre-LAFTA 1958-60 years as a point of reference for the study of its subsequent evolution.

The analysis of the different phases of the ITI suggests some preliminary comments on the factors explaining its behaviour (these will later be explored through a simple econometric model). The rise of the ITI after 1965 suggests an impact of both the trade preferences provided by LAFTA and the new industrial capabilities of Argentina and Brazil.

They complement each other, since preferences offered opportunities, and supply capabilities were already in place to use them.

The fact that the ITI remained stable or fell in the seventies (1974-80 period) suggests that either industrial capabilities and preferences remained stable or that they move in opposite directions and cancelled each other. Observing the ITI between Brazil and Latin America, it can be realised that the small rise in the average ITI accrued from an increase in the ITI for exports and a decrease in the ITI for imports. This may reflect Brazil's protectionist policy, which discriminated against regional goods - or at the very least reduced the preferences of the sixties ¹. It may also reflect the impact of the increase in oil prices in 1973 and 1979. The 1973 and 1979 oil crises amounted to a shift in international specialisation (Brazil then became more 'complementary' of Middle East oil producers than on non-oil producing countries) ². In addition, Brazil endeavoured to promote industrial exports towards the Latin

¹ If Brazil's protectionist policy had been applied with the same rigour to all producers in the world (with no discrimination in terms of products and sources), the ITI Brazil-Latin America would have not been affected: Brazil would have imported less from Latin America but she would also have reduced imports from the rest of the world in exactly the same proportion, and therefore the ITI would have remained constant. The fact that the ITI fell suggests that protection was applied more severely to regional imports.

² Clearly, this change in the pattern of specialisation resulted from a price effect and not from change in the productive structure, since Brazil in fact substituted imports of oil by domestic production and in this sense became relatively less complementary to Middle East producers.

America and other peripheral areas. This suggests that Brazil became more complementary to Latin America on the export side (higher industrial exports) and less complementary on the import side (more dependent on extra-regional oil imports). The eventual outcome was a slight increase in the average ITI in the seventies.

The ITI Argentina-Brazil, on the other hand, was reduced in both directions in 1974-80 and the result was a relatively significant fall of the average ITI. The Argentine policy of unilateral liberalisation deprived Brazilian exporters of former advantages in the Argentine market. Concurrently, the fall of Brazil's ITI for Argentine imports confirms the negative impact on regional trade of the Brazilian move towards a semi-autarkic economy in the seventies.

The early eighties witnessed a slight increase in the ITI in all cases. To some extent, this may have accrued from an interest in saving dollars in face of the debt crisis. As trade in the region was covered by payments agreements, there was a stimulus to divert trade towards the region. The strengthening of quantitative controls in a period of acute dollar shortage (1981-85) gave rise to ad hoc preferences to imports from the region. This behaviour is consistent with patterns observed in earlier periods. But its significance should be qualified. In fact, the debt crisis led to a disarray in the regional payments system in 1982. Some countries temporally cancelled payments and the working of

the agreement was affected ¹. In addition, the regional trade system had been reformulated with the creation of LAIA in 1980 and the framework for cooperation was still weak. The debt crisis encouraged cooperation, but the effective shift in patterns of behaviour was not immediate. Moreover, Brazil's especially high ITI for imports from Argentina may reflect a conjunctural variable, namely Argentine exports to Europe through Brazilian's ports during the Malvinas/Falklands war. Therefore, even if the general results for the early eighties are broadly consistent with the hypotheses that external constraints encouraged cooperation, a more detailed analysis of the period does not allow to establish this causality.

The evolution of ITI in the late eighties, on the other hand, reflects more clearly the new cooperative framework that emerged from the debt crisis. The substantial increase of ITI after 1986 was associated with the Argentine-Brazilian bilateral agreements of 1986-90 (PICE). The crisis led to regime transformation, the fall in transaction costs and the promotion of bilateral trade. These figures also confirm the evidence provided by Baumann showing an increase in intra-industry trade between 1980 and 1988 ². In effect, the PICE agreements provided for complementary preferences in capital goods, a sector which usually presents high

¹ IDB, Desarrollo Económico e Social, pp. 64-6.

² Cf. R. Baumann, 'Una Evaluación del Comercio Intra-Industrial', p. 90.

levels of intra-industry trade ¹.

In sum, the evolution of the ITI in the 1958-90 period allows preliminary speculations about the behaviour of structural and institutional change. The discussion of these variables will be now assessed in terms of a simple econometric model.

¹ The capital goods sector includes electrical and non electrical machinery. These were the industries that presented the highest levels of intra-industry trade in the Balassa's study on LAFTA. Cf. B. Balassa, 'Intra-Industry Trade', p. 253.

V.2. Structural Change, Institutional Change and the
Direction of Trade

(a) A Simple Test on the Determinants of the ITI

The use of 'proxies' for structural and institutional change as independent variables in a multiple regression model in which the ITI is the dependent variable, permits to have an idea of (i) whether these variables were associated in the 1958-1990 period and (ii) which the specific contribution was of structural and institutional change in shaping regional trade. This can complement the historical analysis presented above, bearing in mind the usual caveat that association does not imply causality.

Perceptions on constraints on growth and policy-making. This variable is most difficult to quantify as it depends strongly on expectations and ideas ¹. Still, the rate of gross investment in fixed capital as percentage of the GDP seems to be an adequate 'proxy' for this, since investment decisions are related to expectations about future growth and (in economies heavily dependent on external financing and exports for importing the capital goods they need) about

¹ This chapter has provided data on rates of economic growth and trade, investment, trade balance and terms of trade to describe the conditions that shape these perceptions. However, qualitative analysis is critical and more of this will be provided in the next chapter.

the evolution of the international economy ². In accordance with the hypotheses raised in chapter I, a fall in the rate of investment would be related to the perception that constraints on growth and policy-making have increased and thus with a stimulus to regional cooperation. This would lead to an increase in the ITI as a result of trade diversion and/or the reduction of transaction costs in regional trade through cooperation. Clearly, there is a temporal lag between the perception of external constraints and the fall in investment. This can be ignored, however, by assuming that this lag is the same as that required by the governments to change policies in response to new conditions, and for cooperation to have an impact on regional trade.

The maturation of ISI-2. The impact of structural change on regional cooperation was related to diversification and industrial learning in the sectors installed in the late fifties. In the following regressions the index of manufacturing production of Argentina and Brazil will be used as a proxy for learning. It is assumed that the growth manufacturing production opened new opportunities for specialisation and trade in the region,

² This is the result provided by models that relates rates of growth to the long term performance of the Balance of Payments. Cf. G. Amendola et al, 'The Dynamics of International Competitiveness', pp. 455-65.

leading to a higher ITI ³.

Institutional Change. As argued by Keohane, institutions tend to persist and sustain cooperation even after a change of the structural conditions in which they were created in the first place ⁴. As experience develops and the benefits of cooperation increases, institutions keep the actors together despite of short term changes in interests. They also facilitate the adjustment of cooperation to new structural conditions. In this sense, institutions have a 'once and for all effect', which is to set cooperation at a higher level. In order to assess the impact of institutional change two dummy variables will be used. The first one (LAFTA) takes the value of 1 from 1964, the first year after the liberalisation of trade promoted by LAFTA. The second variable (PICE) takes the value of 1 from 1986, when Argentina and Brazil began the 'second wave' of integration agreements.

The regression equations used logarithms and hence they provide an assessment of the elasticity of the ITI to a change in the independent variables. The period considered was 1960-89, for which there exist comparable data of

³ Admittedly, this variable is unsatisfactory. The literature mentioned in chapter III suggests that learning cannot be considered an automatic process that follows production, and hence the index of manufacturing production misses the impact of formal and informal R&D on competitiveness and trade opportunities. Still, this index is a reasonable proxy as far as there is no time series of formal and informal R&D activities in Argentina and Brazil for the period considered in this work.

⁴ Cf. R. Keohane, After Hegemony, pp. 14.

manufacturing production. The results of the regression equations were as follows ⁵:

ORDINARY LEAST SQUARES ESTIMATION

Dependent Variable: ITI(Ar)

Regressor	Coefficient	t-ratio	Probability
C	-0.7304	-1.3376	(0.193)
LAFTA	0.4208	4.4093	(0.000)
PICE	0.3825	4.0481	(0.000)
INV(Ar)	-0.3516	-2.7327	(0.011)
MAN(Ar)	0.6440	4.6741	(0.000)

R-squared = 0.92807 F(4,25) = 80.6457 (0.000)
 Durbin-Watson statistic = 1.7366

Diagnostic tests.⁶

1. Serial correlation: $\text{Chi}^2(1) = 1.8482$ (p = 0.667);
 $F(1,24) = 0.1488$ (p = 0.703)
2. Functional Form: $\text{Chi}^2(1) = 0.49315$ (p = 0.483);
 $F(1,24) = 0.4011$ (p = 0.533)
3. Normality = $\text{Chi}^2(1) = 0.5859$ (p = 0.746)
4. Heteroscedasticity: $\text{Chi}^2(1) = 1.7156$ (p = 0.190);
 $F(1,28) = 1.6984$ (p = 0.203)

'p' stands for probability

Dependent Variable: ITI(Br)

Regressor	Coefficient	t-ratio	Probability
C	1.2822	2.7284	(0.011)
LAFTA	0.4311	4.4164	(0.000)
PICE	0.4239	5.0261	(0.000)
INV(Br)	-0.5087	-3.5283	(0.002)
MAN(Br)	0.2092	3.2941	(0.003)

R squared = 0.8528 F(4,25) = 36.2123 (0.000)
 Durbin-Watson statistic = 1.6352

⁵ All the series were tested for unit roots (Dickey-Fuller test for residuals) and they were stationary. The statistical programme used for the regression and diagnostic tests was Microfit 3.0.

⁶ See the key for diagnostic tests below. The figures between brackets are the probability values of the statistics.

Diagnostic tests.

1. Serial correlation: $\text{Chi}^2(1) = 0.6658$ ($p = 0.415$);
 $F(1,24) = 0.5447$ ($p = 0.468$)
2. Functional Form: $\text{Chi}^2(1) = 2.7775$ ($p = 0.096$); $F(1,24) = 2.4487$ ($p = 0.131$)
3. Normality = $\text{Chi}^2(1) = 3.1322$ ($p = 0.209$)
4. Heteroscedasticity: $\text{Chi}^2(1) = 0.079218$ ($p = 0.778$);
 $F(1,28) = 0.074132$ ($p = 0.787$)

'p' stands for probability

Key for the Diagnostic Tests

1. Lagrange Multiplier Test for Residual Serial Correlation. The hypotheses tested is that the disturbances, u_t , are serially uncorrelated against the alternative hypotheses that they are autocorrelated of order 1.
2. Ramsey's RESET test for functional form misspecification, using the square of the fitted values;
3. Based on a test of skewness and kurtosis of residuals (Bera and Jarque test);
4. Based on the regression of squared residuals on squared fitted values.

Key for the Variables

ITI(Ar) = index of trade intensity between Argentina and Latin America;
 ITI(Br) = index of trade intensity between Brazil and Latin America;
 MAN(Ar) = index of Argentine manufacturing production;
 MAN(Br) = index of Brazilian manufacturing production;
 LAFTA and PICE = dummy variables;
 INV(Ar) = gross investment in fixed capital as percentage of the GDP in Argentina;
 INV(Br) = gross investment in fixed capital as percentage of the GDP in Brazil.

Source: The index of trade intensity was calculated from data provided by the International Monetary Fund, Direction of Trade (Washington, various years). The index of industrial production was obtained from the United Nations Industrial Development Organisation (UNIDO) Data Bank, and elaborated taking 1980 as the data base. The series for the rate of gross investment in fixed capital was obtained from IMF, Financial Statistics Yearbook (Washington, various years).

The results presented above do not contradict the hypotheses that the institutional and structural variables

presented in this chapter contributed to shape the evolution of the index of intensity of trade. All the variables are very significant and have the expected signals. Although the Durbin-Watson test is in the range of indeterminacy, the other diagnostic test perform remarkably well, suggesting that there are no serious problems in the specification of the equations ⁷.

The negative association between the ITI and investment rates in fixed capital is consistent with the hypotheses that the region played an anti-cyclical role when prospects on growth and policy-making were pessimistic. Clearly, favourable international conditions fostered regional trade as the Latin American economies were able to grow at higher rates. But less favourable conditions encouraged negotiations to facilitate trade in the region and avoid a more intense fall in trade and growth.

With this in mind, it is interesting to analyze again the evolution of ITI. The ITI of Argentina and Brazil with the region remained high in the unfavourable international conditions of the eighties. This anti-cyclical pattern is still more clear if the ITI for exports and imports are considered. If both the ITI for exports and imports increased, such an increase was especially pronounced in the case of the ITI for imports. Thus, the contraction of imports from the region was less pronounced than with respect to the rest of the world, in a context in which the

⁷ The exception is the test for the functional form in the case of the regression for Brazil, suggesting that the variables may have a non-linear relation in this case.

import capacity of Argentina and Brazil had been severely curtailed. Conversely, in the seventies the ITI for imports fell. In this case, abundant external credit led to increase imports from centre countries at higher rates than from the region, and hence the role of the region was reduced.

The positive association between manufacturing production and the ITI suggests that learning effects were significant and the expansion of industry favoured regional specialisation and trade. But the relationship between structural and institutional variables is most difficult to establish in this case. If the new industrial capabilities sustained exports, the existence of preferences offered a source of demand which 'pushed' manufacturing production. In any case, the results confirm the role of the regional market as an outlet for industrial exports, either as a result of growing economic complementarity or as a result of the stimulus provided by trade preferences.

Institutions seem to have had a lasting and significant effect in sustaining cooperation. The two institutions considered (LAFTA and PICE) were negotiated in periods of perceived external crisis (the late fifties and the mid-eighties), but they remained in place and played a role in stimulating regional trade when the external conditions changed. The results, thus, give support to the hypotheses of R. Keohane.

Clearly, the results have to be interpreted very cautiously. As mentioned, the specific impact of structural and institutional variables on the ITI cannot be entirely

separated. Strictly speaking, these variables are not independent ⁸. Most of this work has been concerned with the inter-relation between structures and institutions, and the two-faced role that institutions play, as both a dependent and an 'intervening' variable. It was suggested that an 'evolutionary' model is more adequate to analyze this kind of process. Thus, the regressions presented should be seen as a complementary exercise, which offers a simple test for the existence of an association among the variables shaping regional cooperation.

(b) Regional Integration as a Collective Good

It was suggested above that LAFTA was less ineffectual - albeit far from successful - in encouraging regional trade than it had been usually acknowledged. This may contribute to explain the persistence of LAFTA, despite the fact that it failed to make further progress since the late sixties. Clearly, other factors may have contributed as well to explain this persistence. From a 'state as a predator' point of view, LAFTA may have offered an opportunity for the government to distribute jobs and assignments. Bureaucrats may have resisted to abandon their positions and set out to produce conferences and rhetoric in order to convey the

⁸ It was already mentioned that, if industrial transformation leads to more regional trade, then the interest in regional trade and therefore the efforts for reducing transaction costs would also increase. Concurrently, a reduction in transaction costs would encourage industrial exports and accelerate industrial transformation.

impression that they were doing a significant job. Even if these factors played a role, nevertheless the evidence presented in this chapter suggest that there was a 'public good' rationale in sustaining regional integration institutions.

To be sure, a higher ITI did not necessarily represent a gain in welfare. It may arise from higher barriers against the rest of the world than from a reduction of barriers in the region. Vested interests supported the concession of preferences in a relatively closed regional market and opposed a free trade area, strengthening trade diversion. But if the counter-fact to partial regional liberalisation was national ISI and not multilateral liberalisation, then LAFTA did make a contribution to regional efficiency and welfare. This question already emerged in chapter V in relation with the 1939-60 period. Given the dominant trends in economic policy and in the international economy, regional liberalisation acted in such a way as to partially 'correct' the distortions provoked by indiscriminate import-substitution.

Clearly, the context of the forties and fifties was very different from that of the sixties and seventies. The costs of import-substitution were much higher after 1960. Still, the predominant policies continued to be highly protectionist and the participation of Latin America in world trade relatively weak. LAFTA achievements should be seen in the light of this. Regional trade liberalisation was a collective good whose production was clearly below its

optimal. But it is very likely that LAFTA allowed for a higher supply of this public good than if no institutional arrangement had existed.

VI. CONCLUSIONS

1. If the late fifties witnessed a strong convergence of perspectives in Latin America, the international conditions of the sixties and seventies facilitated the adoption of unilateral policies and reduced the governments' willingness to share sovereignty or challenge vested interests. The revival of power competition between Argentina and Brazil also restrained mutual agreements, while both countries sought to increase their influence over smaller neighbours. Conversely, industrial learning sustained regional trade and stimulated an interest in cooperation, as the regional market became the principal destination for the exports of the 'new' industries. In addition, the position of Latin America in international trade system remained weak. This weakness was reflected in the rapid growth of the external debt and the ensuing external crisis, which heightened constraints on growth and policy-making. At the first moment each country sought a way out of the crisis individually. But gradually in the early eighties, and at an accelerated pace after the election of the new democratic governments of Argentina and Brazil, the efforts for regional economic integration gained momentum.

2. LAFTA seems to have been instrumental in promoting trade and the diversification of industrial exports in the region. LAFTA clearly failed to produce the collective good of a regional open market. But it avoided still higher inefficiency in industrial production by offering an expanded regional market for some industrial goods (based on trade preferences and regional oligopolistic arrangements), in a context still dominated by indiscriminate protection. Governments perceived this role of LAFTA (at least until the late sixties), and the private sector participated actively in securing limited concessions, with a view to reducing microeconomic inefficiency.

3. Institutions are both dependent and intervening variables, and the relative importance of these roles change through time. In very simple terms, institutions appeared as dependent variables especially at the moment of their creation, shaped by changes in the international system, in the domestic economy and the basis of 'shared knowledge' of the actors involved. The creation of LAFTA in the late fifties and the PICE agreements of the mid-eighties are examples of this. Subsequently, the role of institutions as intervening variables was enhanced, as they continued to influence behaviour, even after the change of structural conditions and ideas. Cooperation was then sustained because institutions had strengthened interests in favour of cooperation and because the costs of renegotiation of the trade regime was (until the late seventies) considered high. Moreover, the experience and interests developed within

LAFTA facilitated the transition towards a new generation of regional agreements in the mid-eighties/late eighties.

CHAPTER VII. MERCOSUR: TOWARDS A NEW REGIONAL TRADE REGIME?INTRODUCTION

In the previous chapter the very significant increase in cooperation that took place from 1986, four years after the debt crisis triggered by the Mexican default, was highlighted. Data about the impact of the external crisis, namely the fall of investment and growth, the contraction of the import coefficient and losses in the terms of trade were presented. In this chapter the association between cooperation and external crisis in the eighties will be considered in more detail by looking at how the crisis reshaped perceptions and constraints on economic policy-making.

The chapter is organised as follows. Section I addresses external constraints on growth and policy-making. Section II discusses the first move towards closer cooperation, represented by the 1986 PICE (Protocol of Economic Integration and Cooperation) Treaty between Argentina and Brazil. Section III studies the MERCOSUR as a new trade regime and compares it with the LAFTA regime. Section IV presents the conclusions of the chapter.

I. EXTERNAL CONSTRAINTS ON GROWTH AND POLICY-MAKING

I.1. Structural Change in the International System and Regional Cooperation

The PICE and MERCOSUR initiatives developed in a transitional period in the international system. Transitions are periods of high uncertainty as regards the rules that would regulate trade and payments relations. There is a similarity, in this sense, between the late eighties/nineties and the late fifties. In the late fifties the post-war international order gradually consolidated, on the basis of what would be known as the Bretton Woods regime of fixed exchange rates, convertibility and multilateral trade negotiations. Cooperation in Latin America was encouraged by the perception that the rules had been asymmetrically shaped, leaving Latin America in a marginal position when she was striving to promote industrialisation.

The eighties and early nineties were a transitional period too, marked by external disequilibrium. The main trends in the international economy were the following: (i) the weakening the multilateral trading system; (ii) the trend to include a growing number of policy areas in international negotiations; (iii) the consequences of the debt crisis, which reduced policy options in a context of fiscal crisis. The impact of these trends on regional cooperation will be analyzed in the rest of this section.

(a) The Weakening of the Multilateral Trading System

An open, multilateral trade system is the most advantageous framework for international negotiations in the case of small global traders ¹. The weakening of the GATT discipline since the mid-seventies therefore aroused concern in Latin America ². If the international system never worked in full accordance with multilateral principles, the so-called 'new regionalism' and 'aggressive unilateralism' weakened the role of the GATT in the international economy.

The new regionalism refers to the formation of economic blocs connected by intense flows of trade and investment and by policy coordination. Intra-bloc cooperation is necessary to enhance competitiveness in a world which has become more competitive and inter-dependent ³. The creation of the European

¹ Cf. J. Baghwati, 'Regionalism and Multilateralism'. P. Katzenstein offers evidence in favour of this view in his study of the international insertion of the small European countries. Cf. P. Katzenstein, Small States in World Markets: Industrial Policy in Europe (Ithaca, 1985), pp. 22-30

² C. Diaz-Alejandro and G.H. Helleiner, Handmaiden in Distress: World Trade in the 1980s (Ottawa, 1982), especially pp. 2-8. See also M. Corden, 'The Revival of Protectionism in Developed Countries', in D. Salvatore, The New protectionist Threat to World Welfare (New York, 1987), especially pp. 53-56.

³ Cf. D. Tussie and G. Cassaburi, 'Los Nuevos Bloques Comerciales: A la Búsqueda de un Fundamento Perdido', Desarrollo Económico, vol. 31, no. 121 (1991), pp. 3-27. The growth of inter-dependence can be observed by comparing the relative rates of growth of the GDP, international trade and investment. GDP grew at a rate of 2.8 % per annum in the eighties as against 4 % per annum of international trade and 9.3 % per annum of international investment. Cf. P.M. Veiga, 'O Brasil Frente aos Macroblocos Comerciais e o GATT', unpubl. paper for the 'Study on the Competitiveness of the Brazilian Industry', State University of Campinas, 1993, p. 27. As observed by R. Cooper, 'Worldwide Versus Regional Integration: Is There an Optimum Size of the Integration Area?', in F. Machlup (ed.), Economic

Union in 1992, the alleged existence of an informal trading bloc in East Asia and the creation of the North American Free Trade Agreement (NAFTA) in 1993 are examples of this trend towards bloc formation¹. In particular, some authors have observed that the adoption by the USA of a regionalist approach was a central new variable, which brought about defensive responses in the same direction².

Aggressive unilateralism was related to the rise of the new protectionism of the seventies, when most developed countries increased non-tariff barriers despite of the efforts of the Tokyo Round of the GATT to curb them³. In the case of the USA, the new unilateralism took shape in the Super and Special 301

Integration: Worldwide, Regional, Sectoral. Proceedings of the Fourth Congress of the International Economic Association Held in Budapest, Hungary (London, 1976), especially pp. 44-45, the increase in the international mobility of factors stimulates the creation of international institutions in order to expand the jurisdiction of the government.

¹ Blocs can be either formal or informal. Japan and the SE Asian countries are considered an informal bloc linked by Japanese investments and technology transfers. Cf. Y.C. Park and W.A. Park, 'Changing Japanese Trade Patterns and the East Asian NICs', in P. Krugman (ed.), Trade with Japan (Chicago, 1991), pp. 85-120. In the case of the North American Free Trade Area (NAFTA), bloc formation seems to have largely focused on the concession of trade preferences and curbing US protectionism by establishing clearer rules for anti-dumping measures. Cf. C. Vaan Grassek and G. Vega, 'The North American Free Trade Agreement: A Regional Model?', in S. Saborio, The Premise and the Promise: Free Trade in the Americas (New Brunswick and London, Transaction Publishers, 1992), pp. 157-177.

² Cf. R. Baldwin, A Domino Theory of Regionalism (Cambridge, Mass., 1994), pp. 2-7, suggests that the US initial move towards regionalism was limited and based on strategic rather than economic objectives, but this provoked a 'domino effect' which led to regionalist responses in other countries.

³ Cf. R.E. Baldwin, 'Multilateral Trade negotiations', pp. 20-21.

legislation, aimed to secure 'reciprocity'. This led to growing uncertainty as regards access to the US market and weakened multilateral fora.

(b) Reduced Room for Manoeuvre in International Negotiations

A large number of national policies are now subject to international scrutiny. As tariff barriers play a less significant role in trade policy, international negotiations have been extended to non-tariff barriers and other policy instruments. Rules for public procurement, foreign investment, technical standards, social legislation, environment, intellectual property, business practices and public health, are all aspects of domestic policy now brought to the negotiation table ¹. In this sense, international negotiations became more 'intrusive', embracing areas that had formerly been the province of national governments ². In some cases the strategy of development followed by some countries is called into question as incompatible with a smooth working of the international system

¹ An example of this broader scope of international negotiations is the USA-Japan 'Structural Impediments Initiative', launched in July 1990 as a result of the 1989 US Super 301 investigations. Patterns of saving and investment, private business practices, the organisation of keiretsus and more generally the 'illiberal' features of Japan's business culture were identified by the USA as key topics affecting trade between Japan and the USA.

² In addition, negotiations also became more complex. Non-tariff barriers are less transparent and mensurable than tariffs, and hence commitments more difficult to define and control.

¹. The weaker members of the system therefore may have to face an denser agenda in a setting that is less favourable than that provided the by GATT ².

(d) Latin America and the GATT

While in the past the GATT had been seen as a rich-country club, in the nineties Latin American countries developed a growing interest in multilateral liberalisation ³. Latin America

¹ As observed by P.M. Veiga, 'Brasil Frente aos Macroblocos Comerciais e o GATT', unpubl. paper, project 'Study on the Competitiveness of the Brazilian Industry', Campinas, 1993, p. 31, 'if (...) the existence of different models of economic development - with several strategies very distant from liberalism - has not bothered the developed countries, this attitude change when 'alternative' models began to generate aggressive export policies which modified the game in favour of the new participants. In face of the confrontation of different socio-economic systems - and even cultural ones - acquires relevance the concept of reciprocity' (author's translation).

² An example of this is the legislation on intellectual property rights. While the USA succeeded in including the theme in multilateral negotiations and new rules were set up in the Uruguay Round, the US is pressing at a bilateral level as well for a more comprehensive legislation. This has become a key condition for being qualified for accession to the free trade agreements promoted by the USA (NAFTA and EAI, see below). At this bilateral level, conditions of negotiations (and the agreements that result) are bound to be less favourable for Latin America. Cf. 'NAFTA, Patents, Skyhawks', Latin American Regional Report, Southern Cone - Newsletters (therefrom RS), 17 March 1994.

³ Small global traders benefit in a multilateral system because (i) they can form alliances to resist pressure from larger members; (ii) in a system in which concessions are automatically extended to third parties (as implicit in the MFN principle of the GATT), small countries benefit from the agreements of the big countries; (iii) the increasing importance for the region of manufactured exports boosted its interest in the GATT. Cf. W. Fritsch, 'Brazil's Changing Trade Strategy', unpubl. paper, Conference on the New International Order sponsored by Foro Nacional, Rio de Janeiro, 13-14 April 1992.

and other developing countries sought to obtain a special treatment in the 1960s and 1970s on the basis of the specific problems posed by development ¹. These countries collectively pressed for a change in international rules so as to transfer economic and political resources from the North to the South and accelerate the process of development ². This move gained momentum in the mid-seventies, in the shape of demand for a 'New International Economic Order' (NIEO) ³. Still, if some concessions from centre countries were secured, in the late seventies the so-called North-South dialogue was in a stalemate and pessimism prevailed ⁴. The failure of the NIEO strategy, and the efforts to restructure the economy after the debt crisis, prompted a new approach in Latin America towards the multilateral trade system ⁵.

¹ The role of the GATT for Latin America was ambiguous in the past. The GATT failed to supply the collective goods that Latin America demanded (like open markets for agriculture and textiles), but it did not prevent the region from applying its protectionist industrial policies (and thus to continue 'free riding' the system).

² J.G. Ruggie, 'Another Round, Another Regime? Prospects for the Global Negotiations', in J. Bhagwati, Power, Passions and Purpose: Prospects for North-South Negotiations (Cambridge Mass., 1984), p. 34, observes that while in the sixties the emphasis was on 'closing the gap', in the seventies the 'distributivist' stance became stronger. This new stance was boosted by the success of the OPEC in the cartelization of the oil market.

³ Cf. R. Ffrench-Davis, 'Latin America and the NIEO: An Introduction', in R. Ffrench-Davis and E. Tironi, Latin America and the New International Economic Order (London, 1982), pp. 1-11.

⁴ See on this point C. A. Jones, The North-South Dialogue: A Brief History (London, 1983), especially pp. 84-111.

⁵ Cf. P.M. Veiga, 'Brasil Frente aos Macroblocos Comerciais', pp. 36-7.

The GATT is now seen - with all its shortcomings - as a defence against unilateral actions and trade discrimination by trading blocs. The Latin American policy of unilateral trade liberalisation of the nineties reinforced this view, as the region became more open to trade and more interested in promoting exports. The Latin American countries have sound reasons for their new, more favourable approach to multilateralism and for their (cautiously) optimistic view on the conclusion of the Uruguay Round ¹. The recently created World Trade Organisation (WTO) would fill in a crucial gap that existed in the international economic system since the dismissal of the ITO and its provisional substitution by the GATT ², and Latin American countries have given great significance to the WTO ³. If the risk of a fragmentation of world trade and unilateral actions has not been not completely averted ⁴, the Uruguay Round placed international negotiations on more solid grounds by including the 'old' (agriculture and textiles) and the 'new' themes (trade in

¹ In April 1994 120 governments signed the Uruguay Round in Marrakesh, regarded as a significant achievement after protracted negotiations that extended for more than eight years. Cf. Guy de Jonquieres, 'Survey of World Economy and Finance. Trade and the World Economy: A Test of Resolve', Financial Times, 30 September 1994.

² Cf. F. Williams, 'World Trade News: Nations Queue to Join WTO', Financial Times, 01 November 1994.

³ The former president of Mexico, Carlos Salinas, and the former Brazilian Ambassador in Washington and former Economic Minister, Rubens Ricupero, both with an outstanding political projection in their countries, were disputing the presidency of WTO. Cf. A. Foster, 'Brazil Angered by WTO Choice', Financial Times, 18 June 1994.

⁴ See D. Harbrecht et al, 'Top of the News'. See also Guy de Jonquieres, 'Survey of World Economy and Finance'.

services, intellectual property rights and foreign direct investment), within a multilateral framework ¹.

I.2. The debt crisis and regional cooperation

(a) The Impact of the Debt Crisis

In the late seventies it was believed that private financial markets had successfully replaced public agencies in international lending, enhancing the autonomy of the governments. However, the rise of the US interest rates from 1979, the 1982 Mexican default, the contraction of private lending and the valorisation of the dollar in 1980-85, brought about the largest external crisis in Latin America since 1930. Inflows of official capital after 1982 were just aimed to avoid a discontinuity in debt negotiations and not to sustain economic growth ². As a result, the government room for manoeuvre was drastically curtailed. The need to obtain trade surpluses to service the debt became the dominant objective and no room was left for other objectives and policies.

The external crisis prompted major exchange and financial

¹ For an analysis of the results of the Uruguay Round from a Brazilian point of view see J.B.M. Machado, 'Rodada Uruguai: Principais Resultados e Impactos Sobre a Política Comercial Brasileira', Balança Comercial, no. 126 (April-June, 1994), pp. 9-22, and E.A. Guimarães and L. Naidin, 'GATT 1994: On Novos Acordos sobre Dumping, Subsídios e Salvaguardas', Revista Brasileira de Comércio Exterior, no. 39 (April-June, 1994), pp.45-54.

² Cf. M. Baer, O Rumo perdido: A Crise Fiscal e Financeira do Estado Brasileiro (Rio de Janeiro, 1993), p. 70.

crisis in the public sector ¹. The government had to service the debt with dollars generated by the private sector and it was forced to raise capital in the domestic market, thereby increasing interest rates ². This in turn reduced public and private investments and aggravated fiscal problems, since the cost of financing the public debt rised. Finally, inflation was fuelled by public deficits, recurrent devaluations and the deterioration of the infrastructure and productive equipment.

The weakness of the Latin American governments was enhanced by the pattern of negotiation. Creditors negotiated as a cartel while the position of the Latin American countries was analyzed on a 'case by case' basis. The creditors position was strengthened by liquidity crisis that obliged the Latin American governments to urgently seek for inflows of capital in order to re-finance the debt. Moreover, the close connection between foreign and domestic capital markets, and the high liquidity of the private sector portfolio, reduced the ability of the government to implement fiscal and monetary policies and resolve the problem of the fiscal crisis. High liquidity implies a much larger destabilising potential of shifting expectations as regards the evolution of the exchange rates ³. External

¹ Cf. Baer, O Rumo perdido, p. 84.

² Cf. V. Bulmer-Thomas, Life After Debt: The New Economic Trajectory in Latin America, (London, 1991), pp. 7-8. An exception to this rule were Mexico and Chile, whose states owe basic export sectors, which generated foreign currency to service the debt.

³ The implications of the high liquidity of the private agents financial portfolio on policy-making has been emphasized by M. Baer, O Rumo perdido, pp. 66-69, in the case of Brazil, and by J. Sourrouille (1990), 'Las Reformas de la Economía y el Crecimiento de Largo Plazo', unpublsh. paper, Conference on the

constraints on policy-making therefore reached a maximum in 1982-89.

The debt crisis strengthened common perceptions in Latin America as regards external constraints on growth. As in the late fifties, Latin American perceptions converged towards a defensive direction. If the initiatives adopted to create a common front of debtors did not progress, the region did set out to analyze problems and discuss solutions collectively ¹. The divergent experiences of the seventies ended up in the eighties in a common policy deadlock and this would shape a new view on regional cooperation.

(b) New Directions in Economic Policy and Regional Cooperation

The external crisis of the early eighties challenged the industrial and trade policies that Argentina and Brazil had adopted in the seventies. In the case of Brazil, the combination of protectionism with export subsidies raised complains from Brazil's trade partners and complicated negotiations in the GATT. In addition, heavy export subsidies aggravated the fiscal deficit

Argentine Economy, Oxford-London, in the case of Argentina.

¹ In June 1985 eleven highly indebted Latin American countries met in Cartagena to discuss the debt problem. A declaration - the so-called 'Cartagena Consensus' - was issued, in which it was argued that the debt should be treated as a political problem. Concurrently, a mechanism for regional consultations was established in Buenos Aires, the Committee for the Regional External Debt.

¹. In the case of Argentina, trade barriers were re-established (including a system of previous import licenses) in the early eighties, reversing the former liberalisation process. She thus returned to the model of the sixties, based on an ad hoc combination of protectionism, tax exemptions and export incentives. In sum, in the early eighties both countries returned to the former semi-closed model, now challenged by external debt, high inflation and falling rates of investment. The task to be addressed was by necessity twofold: stabilise the economy and promote structural change in the direction of higher international competitiveness, so as to move out of the vicious circle of recession and inflation of the 'lost decade'. Regional integration was seen as an instrument for economic recovery, as will be discussed below.

In the mid-eighties, the democratic governments of presidents Alfonsín (Argentina) and Sarney (Brazil) applied 'heterodox' plans aimed at stabilising the economy without recession. However, the failure of the heterodox plans in 1988-89 prompted more decidide action in 1990-93, after the election of presidents Menem in Argentina and Collor de Mello in Brazil. A new strategy had to be devised as the room for manoeuvre of the economic policy had been increasingly reduced ². The new strategy initiated in 1990 was based on trade liberalisation and the use

¹ A work by the Brazilian Bureau of External Trade, FUNCEX, 'Instrumentos de Política Comercial', unpublsh. paper, Project 'Study on the Competitiveness of the Brazilian Industry', Campinas, 1993, p. 63, concluded that 'by the end of 1988 the system of (exports) financing have reached a situation of collapse, because of lack of resources'.

² Cf. J. Sourrouille, 'Las Reformas de la Economía', especially pp. 5-6.

of the exchange rate for taming inflation.

The reduction of trade barriers gained momentum in 1990-93. Menem in Argentina and Collor-Franco in Brazil eliminated quantitative barriers and reduced the level and dispersion of nominal tariffs. Several special regimes of industrial and export promotion were abolished. In January 1991 quantitative restrictions were abolished in Argentina. In April 1991 three tariff levels were adopted in Argentina: zero, 11 and 22 %¹. In 1989, the regime of industrial promotion was eliminated, basically for fiscal reasons. The automobile industry, however, remained protected through a special regime.

In Brazil, a major trade reform began in March 1990. Most export incentives and tax exemptions were eliminated (except draw-back arrangements) and the BEFIEEX import-to-export program terminated. Subsidised export credit lines were in turn reduced in June 1990². In March 1990 the list of forbidden imports was terminated and so was the system of import permits (July 1990). A timetable of tariff reductions was subsequently announced to begin in 15 February 1991. While certain sectors remained with relatively high tariffs (autos, trucks, and computer equipment), the aim was to reduce the average tariff level from 32.2 % in 1990 to 14.2 % in 1994. The standard deviation of tariffs should fall from 40 % (1990) to 7.9 % (1994)³. Tariff reductions were

¹ Imports subject to a zero tariff subsequently received a tariff 5 % in November 1991, while capital goods remained exempted. Cf. Kosacoff, 'El Sector Industrial Argentino', p. 45.

² Cf. on this point Bonelli *et al* (1992), pp. 21-2.

³ Cf. Bonelli *et al*, 'Macroeconomic Instability and Trade Liberalization', p. 22.

accelerated in September 1994 with a view to reinforcing the impact of the new anti-inflationary plan. The maximum tariff would fall from 35 % to 20 % and the average tariff would fall to 14 % (as compared with 20 % in 1992) ¹.

Trade liberalisation has been accompanied by the use of the exchange rate as an 'anchor' for prices and expectations. In Argentina, the 'Convertibility Plan' of April 1991 fixed the exchange rate with respect to the dollar and since then inflation in Argentina led to the valorisation of the Argentine peso. In Brazil, the Real has been gradually appreciating since it was launched in July 1994 ². This has raised concerns about the compatibility between the stabilisation and liberalisation policies in the long term, as the exchange rate could not be used to stimulate the export sector. The large trade deficit of Argentina attracted the attention of economic observers and brought about complaints from exporters, and pressure for change increased ³. Moreover, if recent inflows of capital facilitated the process of stabilisation, this could be sending the 'wrong' signals about which the sustainable levels of exports and imports

¹ Cf. These tariff reductions were originally due for 1 January 1995. Cf. A. Foster, 'Brazil to cut wide range of tariffs', Financial times, 14 September 1994.

² The appreciation of the Real was estimated in 15 % by September 1994. Cf. A. Foster, 'Brazil to Cut Wide Range of Tariffs'.

³ Cf. J. Barham, 'Argentina struggles in World League: High Costs and Poor Quality Compound Widening Deficit', Financial Times, 05 July 1994. Although the new currency in Brazil would not be associated with a fixed exchange rate, most observers expect that it would valorize as part of the stabilisation strategy. Cf. Banco Nacional de Desenvolvimento (BNDES), Merco Indicadores, December, p. 3.

were in the long term. Brazil, on the other hand, has advanced at a much slower pace towards stabilisation and she still has a comfortable position in the trade balance. It is likely and desirable the reduction of Brazil's large positive trade balances as a result of the new stabilisation plan. But this means more pressure by industrial interests on a government which has traditionally been more sensitive to industrialists demands ¹.

What were the implications of these trends for regional cooperation? First, multilateral trade liberalisation boosted economic integration ². The general move towards trade liberalisation facilitated the removal of regional trade barriers, as protectionist demands lost legitimacy. In addition, it encouraged regional foreign investment and the rationalisation of production ³. Secondly, since economic integration progressed

¹ On the concerns expressed by Brazilian industrialists of the National Confederation of Industries (CNI), cf. 'Setor de Bens de Capital Representa Quase 30 % do Total Importado', Gazeta Mercantil, 23 July 1993, and 'Importações Aumentam e Fabricantes Pedem Investigações sobre dumping', Gazeta Mercantil, 23 July 1993.

² Cf. A. Foster, 'The New Economic Order: Latin Americans Rediscover Their Neighbours' Markets', Financial Times, 22 July 1994.

³ The big Argentine conglomerates, Pérez Companc, Bunge & Born and Techint are reported to have increased investments in Brazil since the first bilateral agreements of 1986. Cf. 'Argentina and Brazil Integration Makes (Gradual) Progress', RS, 86-09, 20 November 1986. A regional strategy was also implemented by Autolatina (an association between Volkswagen of Brazil and Ford of Argentina) and by Saab and Scania. Cf. 'Autolatina: Latest Bid to rationalise', RS, 87-01, 5 February 1987. In January 1994 the big Brazilian beer producer, Brahma, inaugurated a factory in Argentina. Cf. A. Foster, 'The New Economic Order: Latin American rediscover their neighbours' markets'. Moreover, regional foreign direct investment has also come from Chile, whose pensions funds have had an important participation in Argentine public utilities, especially power generation and distribution in Buenos Aires. Cf. 'Integration: What Future for Common Market?', RS, 93-02, 11 March 1993.

in a context of multilateral trade liberalisation, the central role that trade preferences had played in the past was reduced and emphases on the production of other public goods (related to stabilisation and international competitiveness) increased. In effect, more attention has recently been devoted to the problem of coordination of exchange policies. Concurrently, there is an increasing awareness of the need to adopt competitiveness-enhancing policies. This topic will be addressed in detail in section III.

I.3. The Enterprise for the Americas Initiative (EAI): Its Potential Impact on Regional Cooperation

The so-called new regionalism has not been confined to the formation of trade blocs among central countries. The North American Free Trade Area (NAFTA) created a zone of trade preferences including central and periphery countries¹. In addition, the US 'Enterprise for the Americas Initiative' (EAI) has placed in the agenda the possibility of an hemispheric free trade area. In effect, on 27 June 1991 the MERCOSUR countries and the USA signed a framework agreement (the so-called 'Rose Garden' or '4 + 1' agreement) setting broad guidelines for discussing the creation of a free trade zone in the context of the EAI. The agenda of the '4 + 1' addressed the problem of trade in services

¹ Mutatis mutandis, it has been observed that this can be seen as a new version of the old UK system of 'imperial preferences'. Cf. A. O'Connell, 'La Iniciativa de las Américas y el Cono Sur de América Latina: Un Punto de Vista Argentino', unpublsh., paper presented to the Seminar 'International Transformations and Hemispheric Restructuring; New Patterns of US-Southern Cone Relations', Miami, 7-8 December 1992.

and foreign investment, themes emphasized by the USA. It also referred to the link between debt and trade problems - a significant point for Latin America. But the substance of the initiative was the constitution of a free trade area from 'Alaska to Tierra del Fuego'¹.

A considerable degree of uncertainty still surrounds the EAI. It is not yet clear whether the USA is prepared to give solid political backing to the EAI, given the protectionist inclinations that have gained strength in this country, the opposition of labour unions to competition from cheap labour countries, and the predominance of US interests in other regions (in a context of limited resources)². Concurrently, the convenience of the EAI for Argentina and Brazil is still a matter of debate, especially in Brazil³. However, the EAI is already a significant variable in the discussion of the evolution of regional cooperation. This section focuses on the potential impact of the EAI for regional cooperation - that is, whether it is likely to encourage the MERCOSUR or to strain the relations

¹ Cf. S. Saborio, 'The Long and Winding Road from Anchorage to Patagonia', in S. Saborio (ed.), The Premise and the Promise, p. 5-6.

² Moreover, the recent effort of US President Bill Clinton to obtain the support of the Congress for the Uruguay Round seem to have reduced the possibility of obtaining the 'fast track' procedure for new free trade agreements. This would make still more unlikely the celebration of free trade agreements with Latin American countries. Cf. R. Dornbusch, 'Economic Viewpoint: What's Missing at the Latin Summit', Business Week, 17 October 1994. For a critical appraisal of the factors that led to the EAI see A. Hurrell, 'El Espejismo de un Bloque Regional Hemisférico', FLACSO, América Latina Internacional, vol. 8, no. 30 (1991), pp. 14-21.

³ Cf. R. Barbosa, 'Regional Common Markets', p. 3.

among the MERCOSUR countries and compromise the process of integration.

(a) The Benefits and Costs of the EAI

The EAI potentially implies a significant redefinition of the structure of preferences among Latin America, the USA and the rest of the world. The relative impact of the EAI on MERCOSUR exports and imports depends on the structures of trade, protection and investment in the USA and MERCOSUR countries. From the point of view of trade, the EAI is not especially appealing for the MERCOSUR. Argentina and Brazil are global traders and direct only a small proportion of their total exports to the USA. Argentine exports to the USA were only 10.4 % in 1991¹. The corresponding figure for Brazil, Paraguay and Uruguay were 20.2 %, 4.7 % and 10.1 %, respectively. According to standard integration theory, the potential for trade diversion is high in this case and so are potential welfare losses. Moreover, existing estimations for the impact on regional exports of an hemispheric free trade area only show modest increases², although in some

¹ Conversely, Mexico sent almost 65 % of her total exports to the USA in 1991. Cf. ECLA, El Regionalismo Abierto en América Latina y el Caribe: La Integración Económica al Servicio de la Transformación Productiva con Equidad (Santiago, 1994), p. 19.

² Cf. R. Erzan and A. Yeats, 'US-Latin America Free Trade Areas: Some Empirical Evidence', in S. Saborio (ed.), The Premise and the Promise, pp. 139-40, who estimated that if all US tariffs are removed and non-tariff barriers relaxed, Argentina would increase her exports to the USA in US\$ 65 millions, Brazil in US\$ 943.7 millions, Paraguay in US\$ 1.6 millions and Uruguay in US\$ 24.5 millions. E. Bianchi e J. Robbio, 'Tratado de Libre Comercio de América del Norte: Desvío de Comercio en Perjuicio de Argentina y Brasil', unpubl. paper, Centro de Economía Internacional -Ministerio de Relaciones Exteriores, Comercio

sectors the impact can be significant ¹.

However, the assessment of the EAI should include other variables alongside static allocation effects. It is necessary to consider (i) the risk of being "marginalized" in a world divided in rival trade blocs and (ii) dynamics impacts of the EAI on trade and foreign direct investment (FDI).

Some authors have suggested that a free trade agreement with the USA is necessary to avoid 'marginalisation' in a fragmented world economy ². From this perspective, it is in the region's interest to encourage the EAI and make the necessary side-payments to curb domestic opposition in the USA ³. The far the international system moves away from the ideal multilateral type, the higher the benefits of the EAI. This will be particularly so

Internacional y Culto, Buenos Aires, July, 1993, obtain results similar to those obtained by Erzan and Yeats and also observe that the gains from trade to Argentina and Brazil would be much higher with a successful conclusion of the GATT Uruguay Round.

¹ The impact on Latin American exports of free trade with the USA is reduced because tariff barriers are already low in the USA and many Latin American countries benefit from the GSP (General System of Preferences). But the impact of the removal of non-tariff barriers in sectors like textiles and apparel, footwear and leather goods, steel and certain agricultural products would be large. Cf. S. Saborio, 'The Long and Winding Road from Anchorage to Patagonia', p. 26.

² Cf. L.C. Bresser Pereira and V. Thornsten, From Mercosul to American Integration (Washington, 1992), especially pp. 10-14. The key assumptions are that world trade is in a process of fragmentation in rival trade blocs and that membership to one of these blocs is required to avoid discrimination. As neither Europe nor Japan consider Latin America as a priority area, the USA is the only great trading power that have manifested an interest in the region.

³ This side-payments are related to stricter regulations for environmental protection, social legislation, property rights and liberalisation of rules for foreign investment and trade in services.

if the USA opens selectively her economy to some Latin American countries and raises barriers to others ¹. The potential for trade diversion would increase in this case and so would the differences in location advantages for foreign investment. In particular, if rules of origin are especially stringent, the potential for investment diversion will be very significant.

Thus, the EAI presents a challenge to Latin America. If the multilateralist approach is the 'first best' policy for the region, it might not be enough, and thus an 'insurance' policy towards the EAI would be required. This point will be addressed in the following sub-section, from the point of view of the potential impacts of the EAI on regional integration.

(b) The EAI and the Move Towards Regional and Sub-Regional Cooperation

b.1. The Stimulus for Cooperation and the EAI.

The EAI would favour regional integration if it encourages a defensive response aimed at avoiding the consolidation of a 'hub and spoke' structure in hemispheric trade. Such a structure would emerge if individual Latin American countries sign free trade agreements with the USA but do not form a free trade zone among themselves. In this case there would be some Latin American 'spokes' with the USA as the 'hub'. The USA would have preferences in the Latin American markets, but the Latin American

¹ The dislocation of Brazilian manufactures in the US market has already generated protests by Brazilian industrialists. Cf. D. Pilling, 'World Trade News: Peril of Fragmentation Over Free Trade Area Pacts', Financial Times, 02 September 1994.

exporters would only have preferences in the US market. The potential for trade and investment diversion is the highest in this case, as the USA would be the only location with preferential access to both the Latin American and the US market. Trade liberalisation within Latin America can prevent this from happening and, in this sense, the EAI may act as a stimulus for a more decided move towards free trade in the region.

Brazil's proposal for the creation of a South American Free Trade Area (Spanish and Portuguese acronym ALCSA) can be seen as a step in this direction. Brazil considered that the MERCOSUR could provide the basis for attracting the rest of South America towards a free trade area¹. The opportunity of the initiative is reinforced by the fact that several sub-regional trading blocs have been created since 1986 in such a way that the regulation of trade is becoming increasingly confused and complicated². Moving faster to sub-regional agreements has also been a reaction to the sluggish pace taken by the US promise of an extension of NAFTA southwards³. Even Mexico, which already participates in

¹ Cf. 'Pólo Irradiador Para A Integração', Gazeta Mercantil, 18 January 1994.

² G. Rosenthal, the Executive Secretary of ECLA, observed that there were more than 30 multilateral and bilateral accords in Latin America and thus the administration of tariffs is now extremely complicated. The tariff on a product could change enormously depending on the country of origin and the phase of implementation of the liberalisation agreement. Cf. D. Pilling, 'World Trade News'.

³ As pointed out by US observers, 'Latin American countries are already hedging their bets. Chile belongs to the Asia-Pacific Economic Cooperation Group and trades more with Japan than with the US. Argentina is moving toward Brazil in a new economic union, MERCOSUR, which is cutting deals with Europe. Indeed, Washington appears almost unaware of the October Brazilian election' which may 'set the US\$ 500 billion economy on a new course of rapid growth'. Cf. 'Editorial: Don't Let Latin America

NAFTA, has sought to preserve a high profile in Latin American trade and diplomacy ¹. Table VIII.4 presents a list of the bilateral agreements of the past ten years. To this list the MERCOSUR should be added, along with efforts to revive the Cartagena Agreement and the Central American Common Market.

slip away', Business Week, 03 October 1994.

¹ Cf. Ann Chartes and Ken Dermota, 'International Business (Latin America): They're Knocking on NAFTA's Door', Business Week, 27 June 1994.

TABLE VIII.
Bilateral Agreements in Latin America, 1982-93

Countries	Year of the agreement	Positive list of tariff reductions	General liberalis. with exceptions
Arg-Uru	1982 (ACE 1)	yes	
Braz-Uru	1982 (ACE 2)	yes	
Arg-Ecuador	1984 (ACE 3)	yes	
Chile-Uru	1985 (ACE 4)	yes	
Mexico-Uru	1986 (ACE 5)	yes (Uru)	yes (Mexico)
Arg-Mexico	1986 (ACE 6)	yes	
Arg-Braz	1986 (ACE 7) a	yes	
Mex-Peru	1987 (ACE 8)	yes	
Arg-Peru	1988 (ACE 9)	yes	
Arg-Venez	1988 (ACE 10)	yes	
Arg-Colombia	1988 (ACE 11)	yes	
Arg-Braz	1988 (ACE 12)	yes	
Arg-Paraguay	1989 (ACE 13)	yes	
Arg-Bolivia	1989 (ACE 19)	yes	
Arg-Braz	1990 (ACE 14)		yes
Bolivia-Uru	1991 (ACE 15)	yes	
Arg-Colombia	1991 (ACE 16)	yes	
Chile-Mexico	1991 (ACE 17)		yes
Bolivia-Peru	1992		yes
Arg-Venez	1992 (ACE 20)	yes	
Arg-Ecuador	1993 (ACE 21)	yes	
Bolivia-Chile	1993 (ACE 22)	yes	
Chile-Venez	1993 (ACE 23)		yes
Chile-Colombia	1993 (ACE 24)	yes	

Source: ECLA (1994), El Regionalismo Abierto en América Latina y el Caribe: La Transformación Económica al Servicio de la Transformación Productiva con Equidad, p. 43.

Note: ACE stands for Acuerdo de Complementación Económica, 'Partial Agreements' at a sub-regional level, whose benefits are not extensible to other LAIA members.

Clearly, the expansion of regional agreements has been impressive ¹. The quality of the agreements also improved. After 1986 some of them were aimed at general trade liberalisation with exception lists (the ACE 14 between Argentina and Brazil, the ACE 17 between Chile and Mexico, the ACE 23 between Chile and Venezuela, the agreement between Bolivia and Peru and the MERCOSUR), rather than at liberalisation of a positive, narrowly defined list of products.

The importance of the MERCOSUR as a 'pole of attraction' to other Latin American countries is confirmed by the recent association of Bolivia and Chile to the MERCOSUR. Although the USA have repeatedly declared that Chile was 'first in line' ² for a free trade agreement with the USA, and the former Chilean government declined an invitation to participate in the MERCOSUR, a new attitude has been adopted by the government of President E. Frei ³. The expansion of regional trade in the last years, the rise of Chilean investments in Argentina and the fact that most

¹ The ACE 12 and 7 between Argentina and Brazil were absorbed by the ACE 14.

² Cf., for example, 'Chile First in Line if NAFTA Partners Open the Door to Others in The Americas', RS, 93-10, 23 December 1993. For a Chilean assessment of the benefits of a free trade agreement with the USA, cf. A. Butelman and P. Meller, Evaluación de un Eventual Acuerdo de Libre Comercio Chile-Estados Unidos (Washington, 1992).

³ Cf. 'Chile's New Government Wants and Understanding With the MERCOSUR', RS-94-02, 17 March 1994. Chile and Bolivia signed Protocol Agreements in August 1994 order to become 'associates' to the MERCOSUR.

Chilean manufactured exports go to Latin America obliged Chile to abandon its reluctant initial stance¹. If Chile still expects to join NAFTA in the future, she realised that the diversification of her external economic relations was crucial for her export-oriented policies and that a successful MERCOSUR cannot be ignored. In the case of Bolivia, and despite her early interest in joining the MERCOSUR, the group with which she has her more intense commercial links, full membership could not be granted because of Bolivia's participation in another trading bloc, the Andean Pact². Still, the association scheme now approved would permit Chile and Bolivia to receive preferential treatment by the MERCOSUR.

Another stimulus for integration that the EAI may provide is associated with asymmetries in bargaining power between the USA and the MERCOSUR countries. The USA has sought to obtain concessions at a bilateral level which would be more favourable than those provided by the GATT. The MERCOSUR countries have tried to minimise this by adopting the commitment of not to negotiate individually with the USA. The '4 + 1' framework agreement of June 1991 was negotiated between the USA and the MERCOSUR as a group. In addition, the MERCOSUR is negotiating as a bloc with Chile and Bolivia and it would act in the same way in other international fora.

¹ Cf. D. Pilling, 'World Trade News: Chile and Bolivia Wait in the Wings', Financial Times, 05 August 1994. In addition, the new Chilean government is especially interested in a 'second phase' in Chile's export-led growth, based on manufactures. Cf. O. Rosales, interview, ECLA consultant and adviser for the Concertación, Santiago de Chile, October 1994.

² On the Bolivian interest in joining MERCOSUR see 'No Early Entry Angers Bolivians', RS, 93-04, 27 May 1993.

b.2. Centrifugal forces in the region.

On the other hand, the EAI may trigger centrifugal forces in the MERCOSUR. The strategy for cooperation presented above is, arguably, the one that maximises the gains of the region in the long term. However, each country has an incentive to defect and to obtain benefits in the short term, even if this represents a loss for the region in the long term. The first Latin American countries to enter the EAI will be in a privileged position to attract US foreign direct investment and benefit from trade diversion. They would have an initial advantage in the competition for FDI and market shares in the USA, and hence a stimulus to abandon collective negotiations ¹.

This attitude is favoured by the US emphases on a case by case approach to the EAI and on the conditions of 'readiness' required for accession. The bargaining power of the USA would be enhanced in a case by case negotiation and so would the side-payments by the free trade candidates in line. Moreover, the political impact of Latin American competition on US low-wage sectors would be reduced if a gradual approach is adopted. Thus, the USA have a strong stimulus to move gradually, and the 'first in line' in Latin America have significant gains to obtain from joining earlier. This may trigger centrifugal forces in regional integration and compromise the region's first-best strategy, namely the negotiation as a group which already formed a free trade area and advanced in multilateral liberalisation.

¹ If increasing returns are a significant variable in industrial production, the initial advantage can even become a permanent one.

In fact, seeking individual accession to NAFTA was the first response of the Latin American countries in a condition to do so - namely Mexico, Chile and Argentina ¹. This trend to respond unilaterally has been aggravated in the case of Argentina and Brazil by divergent objectives in foreign policy. It is interesting to observe that, from the point of view of trade, Brazil apparently has more to gain than Argentina with the EAI, as the USA is a more significant trade partner for Brazil than for Argentina. However, while Argentina hurried to offer a positive response to the EAI and tried to iron out any political and economic friction with the USA, Brazil has privileged the ALCSA. This indicates that trade is only part of the bargaining set and other variables should be taken into account to understand the impact of the EAI on MERCOSUR.

b.3. Centrifugal Forces in Argentina and Brazil.

Divergent perceptions and objectives in Argentina and Brazil explain these different attitudes. In the economic field, Argentina has stressed stabilisation and subordinated other objectives to this, reflecting the traumatic experience of the hyper-inflationary processes of 1989 and 1990 ². The accession to

¹ Cf. Ann Charters and Ken Dermota, 'International Business: They're Knocking on NAFTA's door'.

² G. Smith and P. Green, 'International Business: Will Argentina Stay the Course?', Business Week, 10 October 1994. The relatively little stress that has been given to the trade argument is illustrated by the fact that Brazil is the country to whom (according with available estimations) would accrue the largest gains from a free trade agreement with the USA after Mexico. In the share of total estimated export gains to latin America, Mexico obtains 50 %, Brazil 30 % and Argentina 2 %. Cf. R. Erzan and A. Yeats, 'US-Latin America Free Trade Area', pp.

the EAI would make a key contribution to the stabilisation programme as it represents a vote of confidence by the USA on the Argentine economic policy. This would boost business confidence and stimulate the inflows of foreign direct investment that Argentina needs for sustaining the convertibility plan and modernising the economy ¹. The production of a more stable framework is a 'collective good' which the MERCOSUR had so far failed to provide, given the instability of the Brazilian economy before the Real Plan. This does not dismiss the role of the MERCOSUR for the Argentine economy, as the large Brazilian market is an asset in the Argentine efforts to attract foreign direct investment ². Moreover, President Menem has made public statements in favour that negotiations with the USA should be conducted at a sub-regional level ³. But, clearly, the unilateral approach adopted by Argentina towards NAFTA raised tensions

139-40.

¹ Foreign Affairs Minister G. Di Tella referred to NAFTA as a 'seal of quality for investors to invest in Argentina. Trade-wise it was never very important, even detrimental', in S. Fidler, 'Survey of Argentina: NAFTA Option Shelved', Financial Times, 13 July 1994. In effect, in a context of fiscal crisis and with very little room for manoeuvre in terms of policy instruments, the Argentine government has a limited capacity to offer incentives or directly carry out the investments required by economic restructuring. Hopes are thus placed on foreign capital.

² Cf. 'Argentina Interested in NAFTA Links But not Pulling Out of the MERCOSUR', RS, 92-08, 15 October 1992.

³ Cf. M.R. Soares de Lima and M. Hirst, 'Particularidades e Dilemas das Relações Entre o Brasil e os Estados Unidos Sob O Impacto de Novas Conjunturas', unpubl. paper, project 'Perspectives on the Relations Between Brazil and the United States', FUNAG/FINEP, August 1993, p. 57.

within the MERCOSUR¹, has contradicted the formulae of the '4 + 1' agreed with the USA, and aroused doubts on the Argentine commitment to the MERCOSUR process².

Moreover, industrial divergence in the seventies and eighties contributed to reshape the political economy of trade liberalisation and the perspectives on the desirable international insertion of Argentina and Brazil. Deindustrialization in the late seventies reduced the costs of adjustment to external competition in Argentina. She faces less domestic opposition to trade liberalisation with the USA than Brazil, as the Argentine industrial sector already went through a painful adjustment. Conversely, Brazil is more concerned with the preservation of her industrial capabilities, especially in the capital goods sector. This divergence of views has been especially visible in the negotiation of the common external tariff³, aggravated by the fears of the smaller MERCOSUR members (Uruguay and Paraguay) of becoming 'captive' markets for the

¹ Cf. 'MERCOSUR Partners Worried About Argentina's Stance in NAFTA', RS, 94-03, 28 April 1994.

² Cf. José Serra, 'NAFTA: A Hora da Verdade para o MERCOSUR', Folha de São Paulo, 10 December 1992. Serra, one of the most influential deputies at the Brazilian Congress in economic matters, observed that 'As Mexico, Argentina uses trade as a sweetener for attracting investments and financing from the USA, so as to consolidate the adjustment and lock-in the reforms, which then appear as irreversible' (...) 'It would be necessary to show that we do not play only in the MERCOSUR and that they need more our market than we need their market' (author's translation).

³ Cf. M. Garriga and P. Sanguinetti, 'El Arancel Externo Común y el Compromiso Competitivo del MERCOSUR', Centro de Economía Internacional-Ministerio de Relaciones Exteriores y Culto, Buenos Aires, June 1993.

industrial goods of the big countries ¹.

In effect, during the negotiations of December 1992 in Montevideo, Brazil wished a 35 % common external tariff for capital goods, automotive, informatics and chemical industries, and about 20 % for oil, plastics, cotton and spare parts for airplanes. In turn, Argentina spoke of a 20 % ceiling for the common external tariff (admitting 35 % for some sectors), Paraguay spoke of 10 % and Uruguay of 15 % ². The solution was to set up a new list of exemptions which would continue beyond the deadline of December 1994. This list would include sectors like non-electrical and electrical machinery, transport equipment, informatics, organic chemicals and pharmaceutical products ³, while a common external tariff of 20 % would apply for the rest of the products. As a result, about 85 % of the universe of items would be liberalised within the MERCOSUR and subject to a common external tariff from December 1994. The other 15 % would be liberalised during a transitional period of 10 years, so that only by the year 2006 the common market would be completed ⁴.

In addition, Brazil is more apprehensive than Argentina about the loss of autonomy that an agreement with the USA may imply. Argentina considers that her relative declination requires a 'pragmatic' approach based on cooperation with the USA, which

¹ Cf. 'MERCOSUR Problems With External Tariff', RS, 93-05, 1 July 1993.

² Cf. 'MERCOSUR Problems With the External Tariff'.

³ Cf. 'MERCOSUL', Gazeta Mercantil, 2 July 1993, p. 7.

⁴ Cf. R. Barbosa, 'Regional Common Markets', p. 10.

would boost her role in regional and international politics ¹. The Argentine alignment with the USA is seen as an instrument to increase Argentina's prestige in the international system ². On the other hand, Brazil has followed a more assertive stance since the mid-seventies, based on the expansion of industrial exports and the diversification of her political relations with Third World countries. As an aggressive exporter, Brazil was a preferential target for US unilateral protectionism in the eighties ³. Although some conflictual issues in the bilateral relations have been removed (the law of informatics was dropped, trade liberalisation advanced, export subsidies reduced and a new legislation on intellectual property approved), Brazil considers that her size, population and degree of industrialisation now allow her to play a more significant role in the international system. This consideration underlies the cool response of Brazil to the EAI, her move towards the promotion of new free trade areas in the region and her approach to the countries of the

¹ Cf. J.C. Cooper and K. Madigan, 'Business Outlook: Argentina's Turnabout', Business Week, 12 Sept 1994.

² Cf. M.R. Soares de Lima and M. Hirst, 'Particularidades e Dilemas', pp. 61-65. The rewards of the new Argentina foreign policy are not yet clear. Cf. 'No Apparent Rewards for Argentina's Military Involvement in the Gulf Crisis', RS, 90-08, 18 October 1990. See also S. Fidler, 'Survey on Argentina: NAFTA option shelved'.

³ A peak in trade friction between Brazil and the USA was reached in October 1989 when the USA imposed a tariff of 100 % to a set of Brazilian exports - paper, pharmaceutical and electronics goods - under Special 301. This tariff was intended to force Brazil to change her legislation on protection of intellectual property. Brazil was also mentioned in the Super 301 list of priority countries in May 1989 because of her system of import licences. Another significant 301 investigation affecting Brazil began in 1985 concerning software legislation and the 'market reserve' for national firms of informatics goods.

Amazon rim ¹.

Still, current Argentina-Brazil-USA relations should not be seen as a reprisal of the triangle of the forties in which actors changed positions. From the Argentine point of view, misunderstandings between Brazil and the USA have reinforced Argentina's bargaining position with respect to both partners ², but it is unlikely that this would represent substantial economic advantage in the conditions of the nineties. Friction between Brazil and the USA are not related to a context of war (as it was in the forties), while US trade and financial interests in Brazil remain very high ³. Moreover, the regional market can play a key role in the Argentine efforts for stabilisation and industrial restructuring. The long term success of the Argentine economic policy depends on a substantial expansion of exports, and regional cooperation can contribute to this, as will be discussed in the next section.

(c) Conclusions

The EAI poses a challenge to the capacity of the MERCOSUR countries to offer a common response towards change in the international system. In the long term, the political economy of

¹ Cf. Gazeta Mercantil, June 2 1993, p.5.

² M.R. Soares de Lima e M. Hirst, 'Particularidades e Dilemas', p. 63.

³ This has been enhanced by the prospects of stabilisation of the Brazilian economy prompted by the Real Plan. Cf. G. Smith and B. Hinchberg, 'International Business (Brazil): Is the Recovery for Real', Business Week, 03 October 1994.

the EAI implies a stimulus for the acceleration of integration in Latin America, with a view to avoiding a 'hub and spoke' structure in hemispheric trade. But in the short term the structure of incentives for both the USA and the Latin American countries 'first in line' to enter the EAI might lead to separate competitive efforts for an earlier accession to the EAI. This would fragment regional trade in the future.

The fact that the EAI has so far failed to make progress and that prospects are now pessimistic, largely because of the resistance that the US congress places on the free trade projects, have reduced the impact of the EAI and contribute to keep Argentina and Brazil together. But divergent objectives respecting the pace of stabilisation and international specialisation in Argentina and Brazil have generated tensions within the MERCOSUR and could generate difficulties in the future.

I.4. Conclusions

1. The previous chapter provided some quantitative data about how structural change and the debt crisis affected the economies of Argentina and Brazil. However, it is also necessary to consider trends in international trade policy and changes in the room of manoeuvre for policy-makers.

2. The debt crisis of the eighties implied a drastic reduction of the degrees of freedom that Argentina and Brazil had

enjoyed in the seventies. This prompted a defensive move which shaped the efforts for regional cooperation and integration since 1986. In addition, this was associated with negative trends in the international economy, already visible from the mid-seventies. The weakening of multilateralism and the new protectionism (and, subsequently, the new regionalism) heightened uncertainty and stimulated defensive reactions in the eighties.

3. The EAI can act as a stimulus for regional integration, which may be accelerated so as to avoid a 'hub and spoke' structure and reduce the impact of power asymmetries in bilateral negotiations. But the incentives for the 'first in line' to negotiate individually with the USA are high, and therefore the EAI can have a significant centrifugal impact (if it is effectively implemented by the USA). However, the relatively successful conclusion of the Uruguay Round and the progress of the Latin American process of multilateral liberalisation would, at least, reduce the potential trade-diverting effects of the EAI.

II. THE DEVELOPMENT OF THE MERCOSUR REGIME

The previous section reviewed in detail the structural conditions that shaped the emergence of the new phase of regional economic integration initiated in 1986. This section will focus on how institutions for regional cooperation changed. First, the 1986-89 period is analyzed. This may be characterised as a period in which the predominant approach would be to increase industrial specialisation in the region, while trade liberalisation received less attention (II.1). Next, the MERCOSUR regime is addressed and the changes that it implied with respect to past experiences of integration highlighted (II.2). It will be suggested that while trade liberalisation was largely successful, efforts for the coordination of economic policy and the promotion of competitiveness had made little progress, and this posed a challenge to the MERCOSUR. Finally, the main conclusions of this section are presented (II.3)

II.1. The First Stage of Argentina-Brazil Economic Integration: The Neo-Industrialist Approach, 1986-89

(a) The New features of Economic Integration in 1986-89

The administrations of Alfonsín (1984-89) and Sarney (1986-90) consolidated the rapprochement between Argentina and Brazil and initiated a new phase of economic integration

¹. The distinctive features of this new phase were its bilateral nature (reciprocal benefits would not be extended to other latin American countries) and the fact that it was based on a sectoral approach (selected industrial and agricultural activities were targeted for trade liberalisation) ². The objective was to create new opportunities for trade in economies heavily affected by the external debt and by the fall in the rates of growth and investment ³. The initiative also sought to facilitate industrial restructuring in the context of the timid process of trade liberalisation initiated in 1986 ⁴.

As a result, the development of industrial and technological capabilities assumed a relevance that was absent in past integration efforts. The initiative privileged the capital goods sector because of its ability to generate technological spill-overs and to encourage

¹ Cf. F. T. Flores, 'Rumbo a la Integración', Integración Latinoamericana, Vol. 12, no. 122 (1987), pp. 3-6.

² G. P. Rubio, 'Integración Latinoamericana: De la Crisis a la Madurez?', Integración Latinoamericana, vol. 14, no. 148 (1989), especially pp. 78-80.

³ Cf. O. Camilión, 'Integración Argentina-Brasil: Realidades y Proyecciones', Integración Latinoamericana, vol. 12, no. 122 (1987), especially pp. 14-15.

⁴ For an early assessment of the process of integration see N. Huci and E. Jacobs, Primeros Pasos de la Integración Argentina-Brasil-Uruguay (Buenos Aires, 1989), especially chapter 1. On the gradual process of trade liberalisation initiated by Brazil in April 1988, see I. Danway, 'World Trade News: Brazil Lifts Ban on 1250 items', Financial Times, 23 November 1988.

economic restructuring and competitiveness ¹. In addition, the new phase of integration contemplated the production of 'public goods' aimed at the diffusion of new technologies, namely biotechnology and informatics.

Thus, bilateral cooperation in the period 1986-89 was based on sectoral integration and pioneer steps to foster technological learning, along with very cautious steps towards trade liberalisation.

(b) The PICE Agreements

Initially, economic integration was launched in the shape of a series of protocols signed in July 1986, denominated the Argentina-Brazil Programme of Integration and Cooperation (Spanish and Portuguese acronym PICE), covering several sectors and issue-areas ². The protocols signed were the following.

Protocol no. 1 on the capital goods sector ³. This protocol provided for the elimination of tariff and non tariff barriers for a positive 'Common List' of capital

¹ This sector was seen as especially convenient for expanding intra-industry trade and thus would not rise fears of further de-industrialisation in Argentina. Cf. H.R. Gertel and H.G.M. Marega, 'Características del Intercambio entre Argentina y Brasil', Integración latinoamericana, vol. 12, no. 122 (1987), p. 29.

² Cf. 'Documentación: Acta de Amistad Argentino-Brasileña. Democracia, Paz y Desarrollo', Integración latinoamericana, vol. 12, no. 122 (1987), p. 71.

³ Cf. 'Documentación: Acta de Amistad Argentino-Brasileña', pp. 73-78.

goods, on the basis of 'offer lists' provided by the suppliers in each country. The inclusion of new items in this list would be extended through semestral negotiations. The original list of 244 items in 1987 was expanded in subsequent negotiations ¹.

Protocol N. 1 was envisaged as a central instrument in this new phase of bilateral cooperation ². If the protocol offered a new outlet for Brazilians producer of capital goods, opportunities were still higher for Argentina. The agreement with Brazil could contribute to recover an industry which had been severely affected in the late seventies, and the Argentine conglomerates were reported to favour it ³. On the other hand, asymmetries in industrial capabilities between Argentina and Brazil implied that Argentine producers only offered a narrow 'Offer List'. This was a barrier to trade, as equilibrium was one of the objectives of the agreement ⁴. Moreover, the mechanism of negotiation (based on the cumbersome 'product-by-product'

¹ An appendix to Protocol 1 was signed in Viedma, Argentina, in July 1987, extending the list of capital goods to be exchanged. Cf. 'Documentación: Programa de Integración y Cooperación Económica Entre la República Argentina y la República Federativa del Brasil. Informe de la Comisión de Ejecución del programa', Integración Latinoamericana, vol. 12, no. 129 (1987), pp. 56-59.

² F. Porta and J. Fontanals, 'La Integración Intra-Industrial: El Caso del Acuerdo Argentino-Brasileño en el Sector de Bienes de Capital', Integración latinoamericana, vol. 15, no. 158 (1990), pp. 14-25.

³ Cf. 'Argentina and Brazil: Integration Makes (Gradual) Progress', RS, 68-09, 20 November 1986.

⁴ Cf. *Ibidem*.

approach already tried by LAFTA) facilitated protectionist pressures, especially from the Argentine side ¹.

Protocols no. 2 and 3 established quotas for wheat exports from Argentina and allowed for complementary food exports in case of a supply crisis in either country ². Wheat exports should increase from 1,375.000 metric tones in 1987 to 2,000.000 metric tones in 1990 ³.

Protocol no. 4 aimed to encourage liberalisation in items not specifically contemplated by the PICE, and was negotiated in the LAIA Partial Agreement N.1. It provided

¹ If multinational firms showed a small representation in the capital goods agreement, highly cartelized schemes for bilateral trade in motor vehicles were implemented by firms like Autolatina, Sevel and Renault in Argentina and Fiat, General Motors and Autolatina in Brazil. Cf. 'First capital Goods Traded Under Argentina-Brazil Integration', RS, 87-01, 5 February 1987. In some cases this took the form of intra-industry trade, like in the case of Autolatina and Scania. Cf. 'Autolatina: Latest Bid to rationalise', RS, 87-01, 5 February 1987. In other cases, like that of Renault and Volvo, the exchange was organised on the basis of existing international agreement between the two firms. As in the case of LAFTA, differences in the attitude of multinational firms in the capital goods and motor vehicles industries may be related to problems of industrial organization. It is likely that in the more concentrated motor vehicles sector oligopoly agreements were more easily obtained. Cf. D. Chudnovsky and F. Porta, 'La Trayectoria del Proceso de Integración Argentino-Brasileño: Tendencias e Incertidumbres', unpublished paper, CENIT DT/5, Buenos Aires, 1990, pp. 7-11.

² Cf. 'Documentación: Acta de Amistad Argentino-Brasileña', pp. 79-80.

³ Cf. These goals were not achieved because of the policy of Brazil of subsidising domestic production and the competition of imports from the USA and Canada. However, this obstacle was removed when in 1989 Brazil phased out her policy of subsidies. Cf. J. Tavares de Araujo Jr., 'A Política Comercial Brasileira e a Integração Latinoamericana', Instituto de Economia Industrial-UFRJ, Texto Para Discussão, no. 233, Rio de Janeiro, 1990, pp. 5-6.

for a linear increase of 10 % in the margin of preference granted by the creditor to a debtor one when the yearly deficit in the trade balance was higher than 8 % of trade. This protocol would be used subsequently to establish the new timetable for trade liberalisation defined in the Buenos Aires Act of July 1990 (see below).

Protocol no. 5 provided for the creation of binational enterprises which would enjoy national treatment in both countries ¹. This was devised to encourage the association of Argentine and Brazilian firms with a view to exploiting the opportunities opened by economic integration.

Protocol no. 6 provided for mutual credits, managed by the Central Banks of Argentina and Brazil. *Protocol no. 7* created an Investment Fund (initial capital of US\$ 200 millions) to finance export activities in the debtor country ².

Protocol no. 8 addressed cooperation in the energy field, including the construction of a dam in Neuquen, Argentina, and a pipeline to transport Argentine natural gas to the Rio Grande do Sul province of Brazil.

Protocol no. 9 set forth the creation of an Argentina-Brazil Centre of Biotechnology ³. In addition, common research efforts were initiated in the agricultural, health

¹ Cf. 'Documentación: Acta de Amistad Argentino-Brasileña', pp. 82-83.

² Cf. Ibid., p. 83. Like in protocol no. 4, the aim was encouraging exports to balance trade deficits, preventing the use of restrictions and safeguard clauses.

³ Cf. Ibid., pp. 85-86.

and energy fields, like the creation of the binational research programme in informatics and the Argentine-Brazilian School of Informatics ¹.

Protocol no. 12 called for cooperation in civil and military aeronautical research and production. The basic component of the programme was an association between EMBRAER (Brazil) and FAMA (Argentina) to manufacture a 19-passenger airplanes, appropriate for mid-range travel, with a view to competing in the international market.

Protocol no. 13 provided for the reduction of trade barriers in the steel and iron sectors ².

Protocols no. 11 and 17 addressed the strategic problem of cooperation in the nuclear sector, providing for immediate communication and assistance in case of nuclear accidents, and for cooperation in research and supply of nuclear equipment ³. By the end of 1989 trade in 32 items of the nuclear industry had been liberalised. This also gave more transparency to Argentina and Brazil's nuclear programmes, reducing suspicions about the development of nuclear technology ⁴.

¹ Cf. 'Brazilian-Argentine Integration Takes Another Step Forward', RS, 87-06, 6 August 1987.

² Cf. 'Documentación: Acta de Amistad Argentino-Brasilña', p. 88.

³ Cf. *Ibid.*, pp. 89-90.

⁴ In August 1987 Brazilians were invited to visit the Argentine nuclear research centre of Picanieyu, where Argentina developed her uranium-enrichment technique. Cf. 'Brazilian-Argentine Integration Takes Another Step Forward', RS, 87-06, 6 August 1987.

Protocol no. 14 and 15 addressed the development of surface and maritime transportation ¹.

Protocol no. 21, signed on 7 April 1987, provided for trade in the motor vehicles and parts industries ². For AUTOLATINA the agreement was instrumental in the specialisation of its subsidiaries and in facilitating the exchange of cars and parts. Annual quotas for vehicles (from 5000 vehicles in 1989 to 10000 in 1990) and auto parts (US\$ 150 millions) were agreed. An annexe to protocol N. 21 was signed in July 1990, allowing for an increase in the exchange of parts to US\$ 300 millions in 1992, 500 millions in 1992, and complete liberalization thereafter ³.

Protocol no. 22 aimed to facilitate trade in the agroindustrial sector. Trade barriers would be eliminated for a common list of agroindustrial products, initially composed of 200 items. Health controls on fruits and vegetables in both countries would in turn be made compatible, so as to avoid non tariff protectionism.

A new step in the integration process occurred in November 1988, when the Argentina-Brazil Treaty of Integration, Cooperation and Development was signed and

¹ Cf. 'Documentación: Acta de Amistad Argentino-Brasilña', pp. 88-89.

² Cf. 'Documentación: Programa de Integración y Cooperación Económica Entre la República Argentina y la República Federal del Brasil', Integración Latinoamericana, vol. 13, no. 136-137 (1988), pp. 114-116.

³ Cf. 'Documentación: Argentina-Brasil: Comunicados, Declaraciones, Acuerdos y Protocolos', Integración Latinoamericana, vol. 13, no. 159 (1990), pp. 69-72.

subsequently approved by the respective congresses (August 1989). While keeping the idea that integration should be based on a flexible, pragmatic and gradualist approach, a specific programme for the reduction of trade barriers and the achievement of a common market was set forth. The Treaty was aimed at forming a common market in two stages. In a first stage (from August 1989 to August 1999) tariffs would be eliminated and macroeconomic and competitive policies coordinated and harmonised. In a second stage (for which no timetable was proposed) a common external tariff would be adopted and the rest of economic policies harmonised ¹. The 1988 Treaty, despite its generality and the lack of definition of certain important topics ², represented an effort for preserving the momentum of cooperation. It reasserted its strategic value in a moment in which both countries were going through major short-term difficulties as inflation had returned to high levels.

In sum, the protocols to PICE aimed to enhance both bilateral trade and technological cooperation in selected areas. A great emphasis was placed on the capital goods

¹ Cf. 'Documentación: programa de Integración y Cooperación Económica entre la República Argentina y la República Argentina de Brasil: Informe de la Comisión de Ejecución', Integración Latinoamericana, vol. 14, no. 152 (1989), pp. 52-60.

² There was no clearly definition of what coordination and harmonisation of policies should entail. Moreover, as the second stage of integration was not subject to a specific timetable and required parliamentary approval, the objective of forming a common market remained open as regards its pace and instruments. Cf. ECLA, El Tratado de Asunción del Mercado Común del Cono Sur (MERCOSUR): Algunas Consideraciones (Santiago, 1992), p.7.

sector, which would foster learning and intra-industry trade. PICE also contemplated sectors in which economic complementarity (wheat, agroindustries) or economies of scale were significant (steel and motor vehicles). Initial steps were taken for cooperation in the diffusion of technology (binational training and research centres in biotechnology and informatics) with a view to foster the process of catching-up with the international technological frontier. In the case of cooperation in the aeronautical and nuclear sectors, strategic objectives played a role alongside with technology. Finally, the formation of binational enterprises and an investment fund would facilitate restructuring and reduce protectionist responses to integration. Moreover, the objective of forming a free trade area in ten years, as a first stage towards a common market, was accorded in the 1988 Treaty of Integration, reflecting the strategic value that Argentina and Brazil had granted to economic integration since 1986.

(c) The Limits of the Neo-Industrialist Approach

The process of integration in the period 1986-1989 to some extent represented a revival of the gradual, state-oriented pattern proposed by ECLA in the late fifties. This placed significant demands on the governments administrative and financial capabilities which were in contradiction with the fiscal crisis and the constraints on policy making that prevailed in the late eighties. The failure of the heterodox

stabilisation plans, sudden fluctuations in the exchange rate and weak economic growth compromised the role of the regional market.

The government purchasing power had been seen as a key instrument to sustain trade in capital goods ¹ and this was challenged by the economic crisis of 1989. The crisis also compromised the financial contributions to common projects in technological development (like in biotechnology, informatics and the aeronautical sector), which had to be delayed. While the PICE emphasised the capacity of the state to regulate and promote, the fiscal crisis and the priority of short-term macroeconomic problems made this projet largely inviable. In mid-September the representatives of heavy machinery and civil engineering companies demanded an acceleration of negotiations with a view to expand the market, then heavily contracted by the fall in public investment ².

¹ Monica Hirst, 'Integração e o MERCOSUR', lecture given at the University of São Paulo, April 1993.

² Roberto Vidigal, representative of the Brazilian association of Producers of Capital Goods (Portuguese Acronym ADBID), observed that the fall in government demand for capital goods had a large impact on the industry, and that the regional market could play a stimulating role. Cf. I. Dawnay, World Trade News: Move on Brazil-Argentina Trade', Financial Times, 15 September 1989.

II.2. The Southern Common Market (MERCOSUR): Regional Integration in a Context of Openness

The process initiated with the PICAB in 1986, and which culminated with the 1988 Treaty of Integration, Cooperation and Development, brought to the negotiation table a highly complex, diversified and ambitious bilateral agenda. It represented a path-breaking change with respect to past dominant perceptions in Argentina and Brazil. Most relevant steps were given in the direction of deactivating rivalry, which had been a stumbling block since the mid-sixties. The inability of the state to lead this process, however, imposed a rectification of policies. Cooperation would not recede, but it would take new directions, in accordance with the new liberal agenda of the nineties.

(a) The Move Towards the MERCOSUR

In July 1990 Menem and Collor de Mello signed the Buenos Aires Act ¹, which established a new scheme for the constitution of the common market between Argentina and Brazil ². It was then agreed that in December 1994 all barriers to the movement of goods, capital and labour between the two countries would be eliminated. This

¹ Collor de Mello had visited Alfonsín in October 1989 and reaffirmed his intention of giving continuity to bilateral cooperation. Cf. 'Argentina-Brazil Links Strengthened', RS, 89-08, 12 October 1989.

² Cf. 'Documentación: Argentina-Brasil: Comunicados, Declaraciones, Acuerdos y Protocolos', pp. 67-68.

drastically reduced the transitional period defined in the 1988 Treaty of Integration. The common market would be achieved through automatic and linear reductions of all trade barriers and the coordination of macroeconomic policies ¹. At the same time, sectoral integration would continue on the basis of existing protocols and special agreements in highly sensitive or technologically dynamic areas. Finally, a Common Market Group was created with executive functions, in charge of promoting the harmonisation and coordination of policies ².

The move towards a common market between Argentina and Brazil raised concerns in Paraguay and Uruguay ³. Paraguay and Uruguay had substantial part of their trade with Brazil and Argentina and they therefore feared trade discrimination ⁴. In fact, very early in the integration process Uruguay had

¹ Cf. G. Mead, 'World Trade News: Collor and Menem Seek Closer economic Ties', Financial Times, 06 July 1990.

² The new timetable for bilateral trade liberalisation was subsequently translated into the Partial Agreement N.14 of LAIA (ACE-14). This incorporated all previous agreements between Argentina and Brazil (PICE and subsequent protocols), the decisions of the Buenos Aires Act of July 1990 and the resolutions of the first meeting of the Common Market Group in Buenos Aires, in September 1991. The latter included a protocol for the Solution of Controversies, sanctions for the falsification of certificates of origin, terms of reference for the sectoral agreements and the internal regime for the workings of the Common Market Group. Cf. ECLA, 'El Tratado de Asunción', pp. 37-38.

³ Cf. J. Barham, 'World Trade News: Argentina and Brazil in Common Market Move', Financial Times, 06 September 1990.

⁴ Cf. J.M. Quijano, 'Los Casos de Uruguay y Paraguay, Dos Economías Pequeñas el MERCOSUR', unpubl. paper, Montevideo, 1993, especially pp. 12-20.

sought her inclusion ¹, and this was reinforced by the new timetable ². Paraguay in turn joined the process from the beginning of the democratisation process in September 1990. As a result, the Asunción Treaty of 26 March 1991 established the MERCOSUR, a common market project based on the instruments of the second phase of the Argentine-Brazilian bilateral process, namely the programme for automatic trade liberalisation during a transitional period ³.

An important step towards the implementation of the project was the so-called Cronograma de las Leñas ('Las Leñas Timetable', June 1992), aimed at the coordination and harmonisation of policies. According to this timetable, the Working Groups of the MERCOSUR (see below) would identify existing difficulties for policy coordination and propose policy measures. The statute for the constitution of binational enterprises (agreed in the Buenos Aires Act, granting national treatment for firms established with

¹ Cf. 'Sanguinetti: Likely to Join In Argentine-Brazilian Integration', RS, 86-06, 7 August 1986.

² Uruguay enjoyed preferential access to the Argentine and Brazilian markets as a result of the CAUCE (Argentina) and PEC (Brazil) agreements signed with her neighbours in the seventies. The Treaty of Integration between Argentina and Brazil eroded these preferences, aggravated by the fact that the Uruguayan preferences were subject to quotas, while those of the 1988 Treaty would not be limited. Cf. G. Magariños, Uruguay en el MERCOSUR (Montevideo, 1992) and CINVE, En el Umbral de la Integración (Montevideo, 1990).

³ The transitional period was that defined between the moment in which the MERCOSUR came in vigour (29 November 1991) and the conclusion of the common market (31 December 1994). Cf. ECLA, 'El Tratado de Asunción', p. 11.

capital of both countries) was ratified ¹. The Asunción Treaty was incorporated to LAIA through the Partial Agreement N. 18 (ACE-18), which provides the legal covering of MERCOSUR within the framework of the Latin American regional regime.

(b) The MERCOSUR Regime

The principal components of the MERCOSUR regime are related to the programme of trade liberalisation, the coordination of external and domestic economic policies and sectoral policies aimed at enhancing competitiveness in the international economy.

The programme of trade liberalisation comprised an initial preference of 47 % at the moment in which the MERCOSUR started (November 1991) and an accumulative semestral increase of 7 %, which should be elevated to 11 % in December 1994, so as to reach a preference of 100 % within the sub-region. Although it was established that non-tariff preferences would be completely eliminated, no specific mechanism for its phasing out was established ². This should be subject to negotiations during the

¹ Paraguay and Uruguay, however, have not yet been incorporated to this statute, which remains bilateral. Still, the objective is to transform it in a sub-regional instrument.

² Non-tariff barriers could only be applied to a list of goods expressly defined in the Complementary Notes to the Complementary Agreement of the Programme of Trade Liberalisation of LAIA. See on this point ECLA, 'El Tratado de Asunción', p.14.

transitional period. The original list of exceptions for the tariff liberalisation process included 393 NALADI items in the case of Argentina, 324 for Brazil, 439 for Paraguay and 960 for Uruguay. The number of items in the exception list would be reduced at an annually rate of 20 %. Escape clauses could be applied during the transitional period, under certain conditions, but they could not be used after December 1994 ¹. For Uruguay and Paraguay a special timetable was adopted, by which these countries should reduce by 10 % the number of items in the exception list in November 1991, 10 % in December 1991 and 20 % at the end of the following years, therefore reaching the 100 % preference a year later than Argentina and Brazil. No special treatment, however, would be granted to the smaller MERCOSUR countries after that date.

The clear-cut schedule for trade liberalisation in the MERCOSUR removed the obstacle implied by the former product by product approach. The process of trade liberalisation has made steady progress. Conversely, advancing towards policy coordination, industrial restructuring and technological cooperation has been more difficult. Policy coordination in the external front made some progress ², in the shape of the common external tariff and the adoption of common anti-

¹ Cf. Anexo IV to the Asunción Treaty.

² Article I of the Asunción treaty explicitly states that the MERCOSUR would coordinate their positions 'in regional and international economic and trade fora'.

dumping and rules of origin legislation¹. As mentioned, the MERCOSUR signed as a group the '4+1' agreement with the USA and an agreement on technical and institutional cooperation with the EEC (April 1991).

On the other hand, advances in macroeconomic coordination and common sectoral policies have been insignificant. Valuable studies have been conducted and information on macroeconomic policies has been exchanged in recent years². In addition, progress towards the harmonisation of financial regulations was made, including a framework for investments in the stock market, the adoption of the Basilea rules for financial institutions³ and the approval of a Joint Investment Protection Agreement, based on the 'national treatment' clause⁴. But little has yet been done for the coordination of exchange rate policies. Stabilisation policies in Argentina and Brazil have been applied independently and with different degree of success. Still, important elements of 'spontaneous'

¹ The adoption of common anti-dumping rules are called for in Article IV of the Asunción Treaty and rules of origin are detailed in Anexo II to the Treaty. It is established that goods using inputs from outside the region would become original from the region if they suffer a transformation which place them in a new category of the NALADI classification. Until December 1994 there would be admitted products whose MERCOSUR content is no lower than 40 % of the FOB value of the final product.

² Cf. J.M. Aragão, La Armonización de Políticas Macroeconómicas en el MERCOSUR: La Construcción de un Mercado Común (Buenos Aires, 1993).

³ Cf. R. Barbosa, 'Regional Common Markets', pp. 8-10.

⁴ Cf. 'As Regras Para Proteger os Investimentos', Gazeta Mercantil, 19 January 1994.

convergence are already visible, as both countries have moved towards similar stabilisation programmes¹. Concurrently, the interest in controlling competitive devaluations by limiting the fluctuation of the exchange rates has gained strength in the MERCOSUR policy debate². This would allow the MERCOSUR to contribute to the stabilisation programmes in both countries.

While the efforts for stabilisation tend to facilitate macroeconomic coordination, the problem of the adoption of common policies in the technological and industrial field appears much more difficult. The promotion of sectoral and technological cooperation is expressly recommended in the Asunción Treaty, which calls for 'the adoption of sectoral agreements with the aim of optimising the utilisation and mobility of factors of production and the achieving of efficient scales of operation'³. Resolution N.3/91 of the

¹ After a meeting of the MERCOSUR Economic Ministers in August 1991, Cavallo observed that 'coordination will come almost automatically if we continue to pursue the same present policies and, fundamentally, maintain the fiscal discipline which we are all seeking to impose'. Cf. 'MERCOSUR Economy Ministers Discuss the Coordination of Policies', RS, 91-06, 8 August 1991.

² On the debate about a 'band of fluctuation' for the exchange rate, see M. Garriga, R. Etchegaray and P. Sanguinetti, 'Notas Acerca de la Aplicación de Bandas Cambiarias en el MERCOSUR', unpubl. paper, Centro de Economía Internacional, Ministerio de Relaciones Exteriores, Comercio Internacional y Culto, Buenos Aires, Preliminary Version, October 1993. The idea was originated in a Brazilian proposal of July 1993, which had positive reception among the MERCOSUR countries. Cf. Gazeta Mercantil, São Paulo, 2 July 1993. The band of fluctuation should be in vigour from January 1995, reducing the distortions of the 1991-93 period.

³ Cf. Letter "d", Article V, Chapter I of the Asunción Treaty (author's translation).

Common Market Group states that sectoral agreements should 'accelerate integration and favour intra-sectoral specialisation', and promote the association of firms to compete in third markets, subject to the condition that this would not imply the formation of cartels nor constrain free trade in the common market ¹. However, instruments for this have not been defined and the role of public policy in promoting restructuring remains unclear, as illustrated by the fact that no common financial fund has been approved.

Thus, specific initiatives in the field of sectoral and technological cooperation have lagged behind trade liberalisation. The Working Group no. 7 on industrial and technological cooperation selected priority sectors - steel, autos, electronics, oil, petro-chemical, chemicals, textiles, paper and agroindustries - for which complementary agreement were recommended, and some important steps were taken in this field ². A triennial plan for cooperation in education, research and training ³, and projects for

¹ Cf. MERCOSUR/CMC/DEC N.03/1191. See also J.A.E. Faria, MERCOSUL: Princípios, Finalidade e Alcance do Tratado de Assunção (Brasília, 1993), p. 66.

² Studies by the Working Group no. 7 are conducted in the areas of technology diffusion, environment, industrial quality and productivity, harmonisation of industrial policies and the promotion of small and medium enterprises. It also offers advice to the private sector in order to ensure that sectoral agreements are compatible with MERCOSUR norms. Cf. MERCOSUR/SGT N.7/REC N.04/92. In march 1993 a special meeting for the discussion of cooperation in science and technology was held in Brasilia, in which the financing of research and the formation of human resources was debated.

³ A Commission of Ministers of Education was created in December 1991, during the first meeting of Education Ministers of the MERCOSUR. In their second meeting (Buenos

technological cooperation in agricultural production, the pharmaceutical industry, environment and intellectual property have been approved¹. But so far its implementation have advanced very slowly and played a minor role in the integration process. This was due, in part, to the fact that they are more complex and 'institution-intensive' than other policy areas. In addition, it reflects the failure of industrial policies in the past (including that of the neo-industrialist integration approach of 1986-89) which made policy-makers suspicious of the role that the government could play in economic transformation. The implications of the different timing of trade liberalisation, macroeconomic coordination and industrial restructuring for the MERCOSUR will be addressed in sub-section (d).

(c) The Institutional Framework

Problems of policy coordination in the MERCOSUR are in part related to the fact that its institutional framework is still provisory. Decision power lies on the Council of Ministers, made up by the External Relations and Economy Ministers of the four countries, which at least once a year

Aires, June 1992), the Ministers accorded a triennial plan for the education sector, embracing cooperation in basic education, capacitation of human resources, research and graduate studies. The plan was subsequently ratified in a third meeting held in Brasilia in November 1992.

¹ These projects will be financed be financed by the IDB, FAO, FONPLATA (Funding for Investments in the River Plate Basin), OEA, CEE and WOIP (World Organisation of Intellectual Property). Cf. Gazeta Mercantil, 29 November 1993.

should meet with the presence of the Presidents. The executive functions are in the hands of the Common Market Group integrated with four representatives of each country. These representatives belong to the Ministry of Economy and Central Bank of their countries. Subordinated to the Common Market group there are eleven Working Groups in charge of the different areas of negotiation and the elaboration of technical proposals for the coordination and harmonisation of policies. The monitoring of the common external policy and trade-related mechanisms would be in charge of another inter-governmental body, the MERCOSUR Trade Commission ¹.

Thus, no supra-national decision body has been created and the eventual institutional framework of the common market would be defined in a special conference to be celebrated in the last semester of 1994. The power of taking policy initiatives is so far firmly in the hands of the member states, as it was in the case of LAFTA and LAIA ². The prevalence of the consensus criterion for adopting decisions in the MERCOSUR potentially implies less efficiency in decision making and generates problems, given the different population and GDP of the four MERCOSUR countries. Therefore, a major effort for institution-building is still

¹ Cf. R. Barbosa, 'Regional Common Markets', p. 10.

² J.A.E. Faria, MERCOSUL: Princípios, Finalidade e Alcance do Tratado de Assunção, p.72, observes that 'in conformity with the individualism that characterizes the relations among the Latin American countries, bound to an exclusive notion of national sovereignty which still dominates diplomacy in the continent, the Treaty does not grant the exercise of any fraction of the sovereignty of the member states to institutions established by themselves'.

to be done. Some important steps towards supra-nationality have already been taken, as the 'Protocol of Brasilia for the Solution of Controversies' ¹. The creation of the Joint Parliamentary Commission of the MERCOSUR as the embryo of a future parliament of the MERCOSUR suggests as well that an expanded role for sub-regional political bodies may emerge in the future ².

Chart VII.1 offers a comparative summary of the transitional MERCOSUR regime inaugurated in 1991 and the regime of restrained multilateralism of the period 1960-1980.

¹ MERCOSUR/CMC/DEC. n.01/1991. The protocol contemplates four instances in the negotiation of controversies. The first two are direct negotiations between the states concerned and consultations to the Common Market Group, and do not require any kind of supra-national power decision. But if the previous instances failed then an arbitrary panel is established, whose decisions are binding. In effect, article 21 of the protocol for the Settlement of Disputes establishes that 'the decisions of the Arbitral Panel cannot be appealed, (and) are obligatory for the parties in the controversy from the moment of the notification'. In addition, a more expedite procedure is contemplated to attend demands from the private sector. Clearly, such a mechanism is still very much an ad hoc arbitral procedure which lacks the formal institutionalisation of a sub-regional Justice Court. Yet it suggests that efforts have been committed to set up a regime in which member states would be prepared to accept decisions from supra-national bodies - in this case, an Arbitral Panel. In the Asunción Treaty, if direct negotiations were not successful, the controversy should be placed before the Common Market Group and, in case of the persistence of the disagreement, before the Council of Ministers (Annexo III).

² The Joint Parliamentary Commission of the MERCOSUR had its regulations approved in Montevideo in December 1991. The Commission already held two ordinary meetings, the first in Cordoba in May 1992 and the second in Brasilia a year later.

CHART VII.1. REGIONAL TRADE REGIMES, 1960-1993

Restrained Regionalism	MERCOSUR
<p><u>Principles</u></p> <p>(i) Cooperation subordinated to regional power competition; (ii) Regionalism; (iii) Expansion of industrial exports as a complement to import-substituting industrialisation (ISI-2); (iv) Saving hard currency; (v) Reciprocity and equilibrium in regional trade.</p>	<p><u>Principles</u></p> <p>(i) Regional power competition subordinated to cooperation; (ii) Sub-regionalism (towards regionalism?); (iii) Sub-regional trade liberalisation as part of a process of multilateral liberalisation; (iv) enhancing regional competitiveness in a context of external openness; improve the allocation of resources for a competitive insertion in the international economy.</p>
<p><u>Norms</u></p> <p>(i) Liberalisation limited to a set of primary and industrial goods; (ii) Regional trade preferences; (iii) Regional payments agreement; (iv) Special treatment for developing countries.</p>	<p><u>Norms</u></p> <p>(i) Common external economic policy; (ii) Liberalisation including most of trade (with limited exemptions); (iii) Regional trade preferences limited by the objective of international competitiveness; (iv) Sectoral and technological cooperation for the promotion of competitiveness.</p>

<p><u>Rules</u></p> <p>(i) Selective product-by-product trade liberalisation leading to a system of limited trade preferences; tariff and non-tariff reductions for a list of negotiated products; complementary sectoral agreements;</p> <p>(iii) Automatic compensation of regional trade (Santo Domingo Agreement);</p> <p>(iii) Non extensible preferences and special schedule of liberalisation for less developed countries; preferential bilateral agreements.</p>	<p><u>Rules</u></p> <p>(i) Common external tariff, anti-dumping and competitive policies; coordination of macroeconomic policies;</p> <p>(ii) Automatic, linear and progressive trade liberalisation; elimination of all tariff and non-tariff barriers; progressive phasing out of a list of exemptions;</p> <p>(iii) No special treatment to less developed country;</p> <p>(iv) Sub-regional initiatives for cooperation in education, research, formation of human capital and industrial quality and productivity.</p>
<p><u>Decision-making procedures</u></p> <p>High degree of formal institutionalisation; low degree of supra-nationality; strong influence of the private sector in negotiations.</p>	<p><u>Decision-making procedures</u></p> <p>Low degree of formal institutionalisation; low degree of supra-nationality; reduced influence of the private sector; stabilisation policies as a factor of policy convergence in the two countries.</p>

It can be seen in Chart VII.1 that the principle of rivalry and the regionalist approach of LAFTA were replaced by that of cooperation and sub-regional integration. While in LAFTA the regional market was seen as a complement for import-substituting industrialisation, in the MERCOSUR regional liberalisation is regarded as an instrument for the more efficient allocation of resources in a context of multilateral liberalisation. Reciprocity and equilibrium left place to the quest of efficiency and international competitiveness in the sub-region. Concurrently, saving hard

currency does not appear as a relevant principle in the MERCOSUR. This may be associated with the expectation that trade liberalisation and market-led restructuring would provide an adequate expansion of exports. In other words, it is expected that balance of payments difficulties would no longer be a barrier to growth in the Latin American economies in a context of higher productivity and efficiency¹.

Change in principles led to new norms. First, the principle of cooperation implied not to apply unilateral decisions in a wide range of policy areas, like tariffs (common external tariff), rules of origin, the settlement of disputes, anti-dumping and export-promotion practices and (if the proposal of a band of fluctuation is accepted) exchange rate policies. This contrasts with the loose commitments of LAFTA. Secondly, the emphases on efficiency led to abandon the norm of special trade preferences for less developed countries. Thirdly, the new context of openness implies that trade preferences would lose relevance. Conversely, sectoral and technological cooperation should acquire an enhanced role in the promotion of international competitiveness.

In turn, the rule of automatic and linear reductions in trade barriers replaced the product by product approach of LAFTA. All trade would be liberalised in the MERCOSUR

¹ Still, the objective of saving hard currency is somewhat contemplated by the LAIA Payments Agreement. The MERCOSUR belongs to LAIA, and this allows for a regional approach in certain policy areas.

(although a small albeit significant group of products would be included in the common market only by 2006), as originally proposed but never achieved in practice in the LAFTA project. The emphases on a market-led process in the MERCOSUR excludes the adoption of managed trade at a sectoral level, which were admitted in the LAFTA complementary agreements. New rules for cooperation in this field are discussed (although not yet implemented), with emphases on the formation of human capital and joint technological learning. But it is not yet clear the role that these agreements would play in the MERCOSUR.

Finally, the process of decision-making maintained a low degree of formal institutionalisation and supra-nationality. Governments have not yet accepted the transfer of sovereignty to sub-regional institutions. So far this has been compensated by convergence towards market-led policies and orthodox programmes of stabilisation. The emphases on market forces has also been instrumental in limiting the capacity of the private sector to resist liberalisation. But it is likely that institutional problems would become increasingly complex as the MERCOSUR countries advance to the common market, demanding more elaborated institutions and policies in the fields of coordination, harmonisation and the promotion of competitiveness.

(d) MERCOSUR: Towards Higher International
Competitiveness?

The results achieved by the MERCOSUR, a customs union for about 85 % of trade in only five years, contrasts markedly with the failure of LAFTA (considering LAFTA stated objectives). The adoption of an automatic process of liberalisation and the priority given to international competitiveness prevented sectoral demands for protection to hinder integration ¹. The MERCOSUR has also encouraged a significant expansion of regional trade and investments that have strengthened the interest in integration and made less probable a reversal of this process.

However, the difficulties to advance in macroeconomic coordination (especially in the management of the exchange rates) created tensions. Growing external imbalances led Argentina to apply trade restrictions which affected the MERCOSUR countries. Quotas were imposed on pneumatics, paper and textiles; anti-dumping duties applied to some metal-mechanical and metal products; the 1993 quotas for the automobile sector (accorded in Protocol 21) suspended; specific duties on textiles and garments imposed; and tariffs on capital goods set at a zero level, thereby eliminating the preferences formerly granted to Brazil with

¹ As observed by the Secretary of Economic Policy of Brazil, Winston Fritsch, 'the policy of liberalisation has so far worked because no exemptions have been made, avoiding the case-by-case approach'. Cf. Gazeta Mercantil, 30 June 1993, p. 3

respect the rest of the world ¹. Moreover, Argentina imposed the so-called "statistical tax" of 10% on imports - a thinly disguised new tariff ². Brazil reacted by suspending the preference granted to Argentine producers of capital goods and by reducing the Argentina quota for synthetic textiles (September 1993) ³. Although Itamaraty (which understood the difficulties of the Argentine economy and valued the benefits of the MERCOSUR in the long term) sought to minimise friction, opposition to the MERCOSUR became increasingly vocal in Brazil ⁴. Paraguay reacted angrily too to Argentine measures which were seen as violating the spirit and the letter of the MERCOSUR ⁵. In turn, Argentina saw the behaviour of Brazil as 'predatory' and only based on the lack of political will to implement a serious programme of stabilisation ⁶. Therefore, macroeconomic divergencies and

¹ Cf. Gazeta Mercantil, 3 December 1993, p. 3.

² Cf. 'Brasil Endurece Negociação Com a Argentina', Gazeta Mercantil, 30 July 1993.

³ Cf. Gazeta Mercantil, 23 November 1993, p. 5.

⁴ See, for instance, 'Editorial: Acertos a Fazer no MERCOSUL', Gazeta Mercantil, 31 July-2 August 1993; 'Brasileiros e Argentinos Discutem na Quarta-Feira Imposição de Salvaguardas', Gazeta Mercantil, 24 July-26 July 1993; 'Itamaraty Vai Consultar Setor Têxtil Para Avaliar Perdas Com Novas Tarifas', Gazeta Mercantil, 04 August 1993.

⁵ Cf. 'Paraguay Talks of Leaving MERCOSUR', RS, 93-03, 16 April 1993.

⁶ The Industrial Union of Argentina (UIA) was reported to feel 'harassed by the competition from Brazilian products favoured by Brazil's recession and exchange advantages'. Cf. 'Argentina Interested in NAFTA Links', RS, 92-09. The Argentine industrialists called for the postponement of the December 1994 deadline for the completion of the trade liberalisation process. Cf. 'MERCOSUL', Gazeta Mercantil, 1

lack of coordination in the management of the exchange rate have led Argentina to adopt measures that goes against the MERCOSUR programme of trade liberalisation.

If the need to stick to the rigid norm of the convertibility plan unleashed protectionist forces in Argentina, the threaten to the MERCOSUR timetable in Brazil comes from her interest in protecting strategic industrial activities. It was already shown that Brazil was much more successful than Argentina in preserving metal-mechanical and electro-mechanical activities in the eighties and that this led Brazil to ask for a relatively higher common external tariff than that preferred by Argentina, Paraguay and Uruguay. This represented the end of the 'shared industrialisation' project of the PICE period, which was aimed at the recovering the capital goods sector in both countries. The fact that the sectors left outside the common market until 2006 are critical in terms of the diffusion of technology and the creation of externalities suggests that differences in perspectives will need to be worked out in order to advance in the process of sub-regional integration.

The problems associated with macroeconomic divergences and asymmetrical preferences on industrial structures heighten the role to be played by sectoral and technological cooperation. Common efforts for enhancing competitiveness are necessary to reduce the stimulus for protection stemming from an overvalued exchange rate. There exists an association among these three variables - exchange rate

policy, openness and sectoral cooperation. Only a sharp increase in productivity would compensate exporters for the loss in price competitiveness due to the exchange rate policy. But the liberalisation drive of the eighties has not been accompanied by the reinforcement of state capabilities to promote structural change. The MERCOSUR has given important steps in the correct direction, but keeping the momentum of liberalisation effort might need a judicious stimulus to sectoral cooperation after 1994.

So far, orthodox views have engineered the bolder move towards trade liberalisation of the early nineties. But the perception that this may not be enough is growing and no set of ideas shaping a new response to the problem of competitiveness has become dominant ¹. It should also be recalled that heterodox and orthodox views have different weight in Brazil and Argentina - this in part a reflection of the different set of industrial interests in each country. Therefore, the lack of a consensual basis upon which to devise the policy of cooperation aggravates the problem of diverging views on international specialisation. This can limit the process of learning and institutional change in the MERCOSUR.

The factors shaping the MERCOSUR regime are summarized in charter VII.2, that presents the association between structures, ideas and institutions from 1960.

¹ The ECLA proposal of 'structural competitiveness' has not acquired the influence that the ECLA industrialisation project had in the fifties. Cf. Octavio Rodríguez, former ECLA Professor, interview, Montevideo, July 1993.

CHARTER VII.2. Structures, Ideas and Institutions from 1960

Variables/Period		1960-1980	From 1981
Structural Variables	Changes in the international system	Multilateral trade liberalisat. for manufactures; growth of international trade (60s); weak insertion in the GATT system; expansion of private external credit (70s); reduced systemic constraints on policy.	Weakening of the GATT system; external debt crisis; acceleration of technological change; globalisation and new regionalism; high systemic constraints on policy; Impact of the EAI(?)
	Changes in the domestic economy	Maturation of ISI-2; slow industrial learning, especially in the metal-mechanical sectors; growing intra-industry trade; regional rivalry.	Restructuring for trade liberalisat.; contraction or stagnation of electro-mechanical sectors; intra-industry trade in the region; regional cooperation encouraged by democratic regimes.

Ideas	Adaptation: ad hoc protection in face of BOP difficulties and private sector pressures	Learning (?): orthodox ideas instrumental for trade liberali- sation in the 80s. New industrialist syntheses in the nineties ('structural competitive- ness') (?).
Institutions	Restrained regionalism; failure of LAFTA.	Transition towards the sub-regional MERCOSUR regime; weak LAIA but growing interest in a regional approach.

It can be observed that the regime of restrained regionalism appears associated with the expansion of the international economy and a 'loose' Latin American insertion in the multilateral GATT regime. The economic complementarity and trade preferences associated with industrial learning in this period sustained a limited level of cooperation in the region, which also presented common demands for a special and preferential treatment in the GATT. Constraints on policy-making were less severe than in the late fifties and no stimulus to 'surrender' sovereignty existed, aggravated by regional power rivalry. This led to a regime of restrained regionalism, in which preferences were extended to several industrial goods, but cooperation could not progress towards a free trade area and

coordination in trade, technology and exchange policies.

Conversely, international conditions became less favourable from 1982. The weakening of the GATT, the emergence of the new regionalism and the debt crisis in Latin America prompted a defensive move towards cooperation. To this the return of democracy in Argentina, Brazil and Uruguay made a significant contribution. In addition, the rapid move towards trade liberalisation boosted regional liberalisation and encouraged new forms of cooperation, like policy coordination and restructuring for competition in the world economy. If it is unlikely that the achievements of the MERCOSUR would be reversed in the future, the lack of a shared view on industrial competitiveness, the vulnerability of the stabilisation programmes to changes in the international economy, and the potential impacts of the EAI on intra-Latin American relations still place a challenge for the advance of the process of sub-regional integration.

II.3. Conclusions

1. The revival of regional integration took shape in the 1980-89 period in a set of bilateral agreements which sought to encourage trade in agricultural and industrial products, facilitate the recover of the capital goods sector and promote the diffusion of technology in 'strategic' areas, like biotechnology and nuclear energy. It was a selective, state oriented process, based on the old

mechanism of product-by-product negotiations and which relied (in the case of capital of goods) in government purchases. Despite that the programme faced increasing difficulties in the late eighties, the PICE placed bilateral relations in a new phase of cooperation, that culminated with the 1988 Treaty of Integration.

2. Since 1990, Presidents Collor and Menem reduced drastically the timetable for trade liberalisation and adopted an automatic mechanism for reducing tariffs. This marked a new phase which, on the basis of the previous agreements and the expansion of trade then achieved, sought to accelerate the process of integration and curb the bureaucratic obstacles that the former system implied. Concurrently, emphases began to be given to problems of policy coordination, especially as regards fluctuations in the exchange rate, which had generated friction in the previous three years. If the results have been impressive in the liberalisation front, cooperation for macroeconomic coordination and sectoral restructuring has not advanced accordingly. This, along with the definition of the institutional framework of MERCOSUR, would shape the ability of the MERCOSUR to become an instrument for the integration of Latin America in the world economy.

CONCLUSIONS

1. The principal initiatives for integration of the period 1939-92 emerged in a context of external difficulties. The Pinedo-Aranha project of 1939 was prompted by the prospects of war in Europe which, especially in the case of Argentina, made necessary the diversification of international economic relations. The proposal for 'economic union' led by Perón in 1953-54 was related to the difficulties posed by the 'dollar shortage', the Argentine 1952 crisis and the experience of the US economic boycott. In the late fifties, the creation of LAFTA was associated with external imbalances and the perception of marked asymmetries in the post-war international system (which the return to convertibility in Europe had consolidated), heightened by the 'developmentalist' project for rapid industrialisation. Finally, the revival of integration in 1986 was related to constraints on growth, investment and policy occasioned by the debt crisis. Integration was also stimulated by the impact of the new protectionism and 'minilateralism' on the region's international position. Thus, the four major initiatives for economic integration were proposed in a context in which international economic events constrained growth and the ability to formulate development policies.

In addition, domestic economic transformation also shaped the incentives for cooperation and integration. Economic complementarity between Argentina and Brazil in

agricultural production provided a significant initial basis for trade and cooperation. Subsequently, the advance of the process of industrialisation expanded the scope for trade and the gains to be obtained through regional specialisation and intra-industry trade. This process sustained an interest in regional trade preferences, even when external constraints were eased and governments able to pursue unilaterally their preferred policies. The process of ISI-2 heightened the costs of national import-substitution and provided a stimulus for integration in the late fifties. In the sixties the maturation of industry and industrial convergence facilitated the growth of regional trade, which in turn led to greater efficiency in the manufacturing sector. Conversely, divergent patterns of industrial transformation from the late seventies redefined interests and created friction in economic integration, as the objective of 'shared industrialisation' receded and Argentine and Brazilian views of multilateral and hemispheric liberalisation diverged.

If the move towards regional integration was related to external constraints and industrialisation, this was neither automatic nor immediate. Domestic politics and ideas played a significant role in the timing and form of integration.

2. The failure of initiatives for economic and political reform in Argentina in the early forties (which led to the ultra-conservative Patrón Costas government and the subsequent coup of June 1943) compromised integration by raising friction in hemispheric relations. In the same vein, the unrelentless opposition of the UDN to Perón and Vargas compromised the ability of Brazil to give a favourable response to Argentine proposals for closer cooperation. Brazil began to play a more active role in the region only when the developmentalist alliance that supported Kubitschek was consolidated in the mid-fifties.

It may also be argued that democratic regimes favour economic integration in Latin America. Military governments tended to be more concerned with geopolitics while democratic regimes tended to give more attention to welfare. If the Pindo-Aranha initiative was launched by authoritarian governments, this occurred in the context of efforts to liberalise the political regime in Argentina. Rapid progress towards cooperation (leading to the creation of LAFTA) occurred during the democratic governments of Kubitschek and Quadros/Goulart in Brazil and Frondizi in Argentina. The links between democracy and regional integration were especially clear in the rapprochement of the Sarney and Alfonsín governments in 1986, which explicitly sought to create a framework of regional stability, conducive for the consolidation of the democratisation processes. In addition, military views of foreign relations tended to be dominated by a Cold War perspective which looked suspiciously at

'autonomist' positions in the international system. Even for democratic governments this was a divisive issue, and cooperation between Frondizi and Quadros had to confront opposition from those (especially in Argentina) who feared the adoption of a 'neutralist' policy.

3. New ideas were a significant variable in the initiatives for integration. When Pinedo launched his plan, including closer cooperation with Brazil, he relied on the 'learning' of the thirties, when his main advisers evolved from an orthodox position to a view which favoured a more active role for the state. Subsequently, ECLA was a catalyst in the formation of LAFTA, as it facilitated the convergence of perspectives on industrialisation amongst Latin America countries and offered a way out of the crisis in regional trade. More recently, orthodox ideas were instrumental in the successful move to a customs union in the MERCOSUR. These ideas facilitated the liberalisation of trade and (recently) the convergence of macroeconomic policies. However, tensions between stability and long term equilibrium in the balance of payments are visible, and it is not unlikely that a new approach, more favourable to a judicious role of the state in restructuring, will emerge in the future.

The role of ideas as a force for change has to be seen in the context of politics. When the Treaty for Progressive Free Trade was launched in 1941, vested interests in

industrial protection were not significant and the Pinedo-Aranha initiative could stress 'openness' in the process of integration. On the other hand, when ECLA launched its proposals, the objective was to curb indiscriminate protection. The cautious integration process that emerged in the sixties was intended to reduce the inefficiency of ISI. Its contribution to regional trade, if not negligible, did not lead to a substantial reduction in barriers to intra-regional trade. Vested interests, created by ISI, had become too powerful and were an important element of the dominant political coalition of the sixties.

The revival of orthodoxy in Latin America was in part a reaction to the indiscriminate protection of the past. But it should also be seen in the light of the challenge posed by the weakening of the public sector in the eighties. It is not clear in this sense whether Latin American orthodoxy is a real theoretical conversion or the understanding that the state is in bankruptcy and that private capital is now so 'internationalised' and 'liquid' that there is no space to pursue dirigiste policies. If the current stabilisation programmes in Argentina and Brazil succeed in restoring the financial position of the public sector, the space for the debate of ideas and policy innovation will broaden in Latin America.

It is within this space formed by political alliances and ideas that the impact of structural variables on regional integration and cooperation should be studied. Structural variables can give an idea about how interests

are shaped and the possible courses of action for states and political coalitions. But the adjustment of policies to international conditions can experience substantial delays and 'deviations' from the point of view of a 'rational' observer. Structural models are a useful starting point, but they need to be revisited in the light of a careful study of the political setting and the ideas shaping the 'strategies' of the 'game'. Politics and ideas are path-dependent and may not be easily adapted to structural change (which is frequently exogenous from the point of view of the peripheral economies). Moreover, once the behaviour of the actor moved away from a 'rational' decision, it changed structures and redefine the nature of the problem.

This can be illustrated by the cases of Argentine-US relations in 1942-55 and Brazil-US relations in 1946-52. Argentina and the USA faced a history of trade and political friction which complicated the Argentine adjustment to US hegemony. The process of adjustment was difficult because Latin American perceptions of the new international setting evolved slowly while political change was dramatic. Few policy-makers comprehended the nature of these events. President Dutra continued the foreign policy of Vargas, apparently unaware that Brazil's position in the international system had changed after the war. In the early years of his second government, Vargas also seemed to be unaware of these new conditions.

The policies followed by Argentina in the forties and Brazil in the early post-war period were more than temporary

'deviations' in the transition towards the kind of behaviour and outcomes predicted by structural models. 'Wrong' decisions redefined the nature of the problems. The failure to set up a free trade area in 1939-41 implied that when this initiative was relaunched in 1958-60, unilateral ISI had already made significant advances in each country and the domestic political economy had been redefined in favour of protectionism.

4. Politics and ideas are articulated in policies. This articulation may in some cases adopt the form of institutions which shape policy decisions and negotiations. Institutions are rules of behaviour which, given a context of inter-dependence of decisions, permit the players to achieve a better outcome (or avoid a worse outcome) than if they had acted unilaterally. The concept of regime was used in this work to give a systematic account of the conventions regulating bilateral and regional trade, to provide a hierarchy of conventions (principles, norms, rules and decision-making procedures) and to distinguish minor (changes within a regime) from major transformations (changes of regime) in trade relations.

Institutions can be seen as 'dependent' and 'intervening' variables. They are dependent variables in the sense that they reflect the structure of incentives for cooperation and hence condense the impact of the variables mentioned above - structures, politics and ideas. Three different regimes were identified, corresponding to a

certain combination of these variables, namely restrained bilateralism, restrained regionalism or LAFTA regime, and the transitional MERCOSUR regime towards 'open' sub-regional (and, perhaps, regional) integration. The moment in which the new regimes emerged corresponded to large changes in the underlying variables - the beginning of Second World War, the return to convertibility, the debt crisis, and the impact of ISI-2.

But the formation of regimes also implied establishing a path of cooperation which would continue after the 'normalisation' of the exceptional context that had prompted their creation. If LAFTA was created when Latin American terms of trade were deteriorating and balance of payments difficulties increasing, it survived into the sixties when external conditions eased, and made a significant contribution to the growth of regional exports. If capital flows in the seventies accommodated the ambitious unilateral strategies of restructuring adopted by Argentina and Brazil thereby leading to a fall in the intensity of cooperation, the accumulated experience of the LAFTA years and the framework provided by LAIA would allow for an impressive recovery of cooperation in the mid-eighties. If the revival of capital inflows in the nineties reversed the balance of payments difficulties that had encouraged the rapprochement of Argentina and Brazil in the eighties, the process initiated by Alfonsín and Sarney in 1985, and consolidated in 1988 and 1990, gave added impetus to cooperation and sustained its momentum when macroeconomic strategies

diverged. Clearly, in all cases the intensity of cooperation diminished when domestic and international conditions favoured unilateral policies. Nevertheless, even if early integration experiments failed to realise their full potential, or were frustrated, subsequent trade regimes started from a higher threshold, building on previous experiences and learning from past failures. In this sense, institutions were an intervening variable that allowed for the continuity of the achievements obtained during periods of close cooperation. As a link between the past and the future, institutions embody some degree of inertia. This enabled to play a role in shaping regional trade, and conferred on them a degree of autonomy.

5. The achievements of the MERCOSUR in the past four years are outstanding. In particular, cooperation has continued to progress despite the fact that centrifugal forces are stronger than in the past. Industrial divergence and the potential disruptive impact of the EAI, which might trigger individual negotiation with the USA, have not weakened the integration process.

So far, the MERCOSUR has overcome tensions associated with macroeconomic divergences and it is likely that the stabilisation of the Brazilian economy will cement trade and investment interests, thereby sustaining the momentum of cooperation. Although the economic strategies in Argentina and Brazil differ, integration can still play a significant

role in both countries. The regional market can play a role in facilitating restructuring towards a new form of insertion in the international economy for the two countries. A new strategy for reducing tariff barriers has been successfully applied and this may indicate a commitment to complete a customs union. However, the institutions of the MERCOSUR are yet to be constructed and much greater effort will be required to coordinate macroeconomic, industrial and social policies. This will be the next test for this remarkable experiment in sub-regional economic integration.

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