UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

G 24
INTERGOVERNMENTAL
GROUP OF TWENTY-FOUR

G-24 Discussion Paper Series

Regional Arrangements to Support Growth and Macro-Policy Coordination in MERCOSUR

José María Fanelli

No. 46, September 2007

UNITED NATIONS

UNITED NATIONS CONFERENCE
ON TRADE AND DEVELOPMENT

INTERGOVERNMENTAL
GROUP OF TWENTY-FOUR

G-24 Discussion Paper Series

Research papers for the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development

UNITED NATIONS
New York and Geneva, September 2007

Note

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

*

*   *

The views expressed in this Series are those of the authors and do not necessarily reflect the views of the UNCTAD secretariat. The designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries.

*

*   *

Material in this publication may be freely quoted; acknowledgement, however, is requested (including reference to the document number). It would be appreciated if a copy of the publication containing the quotation were sent to the Publications Assistant, Division on Globalization and Development Strategies, UNCTAD, Palais des Nations, CH-1211 Geneva 10.

UNITED NATIONS PUBLICATION

UNCTAD/GDS/MDPB/G24/2007/4

PREFACE

The *G-24 Discussion Paper Series* is a collection of research papers prepared under the UNCTAD Project of Technical Support to the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development (G-24). The G-24 was established in 1971 with a view to increasing the analytical capacity and the negotiating strength of the developing countries in discussions and negotiations in the international financial institutions. The G-24 is the only formal developing-country grouping within the IMF and the World Bank. Its meetings are open to all developing countries.

The G-24 Project, which is administered by UNCTAD's Division on Globalization and Development Strategies, aims at enhancing the understanding of policy makers in developing countries of the complex issues in the international monetary and financial system, and at raising awareness outside developing countries of the need to introduce a development dimension into the discussion of international financial and institutional reform.

The research papers are discussed among experts and policy makers at the meetings of the G-24 Technical Group, and provide inputs to the meetings of the G-24 Ministers and Deputies in their preparations for negotiations and discussions in the framework of the IMF's International Monetary and Financial Committee (formerly Interim Committee) and the Joint IMF/IBRD Development Committee, as well as in other forums.

The Project of Technical Support to the G-24 receives generous financial support from the International Development Research Centre of Canada and contributions from the countries participating in the meetings of the G-24.

REGIONAL ARRANGEMENTS TO SUPPORT GROWTH AND MACRO-POLICY COORDINATION IN MERCOSUR

José María Fanelli

Senior Researcher, Department of Economics
Centro de Estudios de Estado y Sociedad (CEDES)

G-24 Discussion Paper No. 46

September 2007

Abstract

The main goal of the paper is to discuss the problem of macroeconomic policy coordination in MERCOSUR and how it could contribute to sustaining growth. In the first part, the paper reviews the macroeconomic situation of MERCOSUR, emphasizing the role of the developments that followed the regime change in Brazil in 1999 and in other member countries afterwards. The analysis suggests that the worst consequences of the crises have been overcome and MERCOSUR will probably enter a new stage in which intra-regional trade will resume the positive trend that it showed before the crises. However, for this new stage to consolidate, it is crucial that Brazil increases its growth rate significantly. The second part analyses the characteristics of macroeconomic fluctuations in the region. The paper focuses on three dimensions that are key to designing a framework for macroeconomic policy coordination. The first is cyclical movements within countries and the co-movements between MERCOSUR members. The study allows us to distinguish between the effects of common (i.e. regional) and idiosyncratic shocks. The second dimension is price and quantity dynamics and the interactions between the activity level and the real exchange rate. The third has to do with those financial market failures that contribute to creating and amplifying the shocks that impinge on the region. The last section addresses what member countries can do to support growth, macro-policy coordination, and financial integration. It is suggested that for macroeconomic coordination to progress, it is crucial to identify how the incentives to coordinate can be strengthened in order to avoid coordination failures that are similar to those that followed the post-1999 crises and that had a deleterious effect on intra-regional trade. From the study of cyclical movements, prices and financial failures, it follows that the strategy for the implementation of the coordination framework should be able to work under conditions of excess volatility; must take into account that the international financial architecture is far from developing-country friendly; and, must emphasize the role of institution-building at the regional level.

Table of contents

REGIONAL ARRANGEMENTS TO SUPPORT GROWTH AND MACRO-POLICY COORDINATION IN MERCOSUR

José María Fanelli*

Since MERCOSUR was created by the Asuncion Treaty in 1991, it has evolved in two very different periods. Until 1998, the regional agreement was perceived to be very successful. There was a substantial increase in the level of intra-regional trade and the region attracted important flows of foreign direct investment. This was accompanied by higher international visibility and the perception that the area was becoming more stable. These facts contrast with the results observed in the period that followed the Russian crisis in 1998, which triggered a host of negative effects and revealed that the MERCOSUR countries were, in fact, rather vulnerable. In the 1999–2002 period, Argentina and Brazil introduced radical changes in their exchange rate regimes and experienced financial and macroeconomic instability. The Argentine economy, in particular, severely deteriorated; there was a full blown financial crisis and the country went into partial default. These events had negative effects on the macroeconomic stability of the two smaller partners, Uruguay and Paraguay.

The consequences of the successive crises of the exchange rate regimes on growth and regional institutions were no less damaging. Between 1999 and 2002 the GDP growth rate was negative in Argentina and Uruguay, zero in Paraguay, and very low in Brazil. The process to establish the governance structures for regional transactions slowed substantially and there were partial policy and institutional reversals in specific cases. The building of the customs union was not completed, and neither macroeconomic policy coordination nor deep integration showed any progress. The quality of the policy responses of the different partners in this period, on the other hand, left much to be desired. The responses were basically reactive and defensive. Domestic goals took priority in the adjustment to the crisis and no coherent policies were implemented to preserve the integration process. The crisis revealed the weaknesses of the governance structures of MERCOSUR. It was only natural that, in a context of high aggregate volatility, falling domestic activity levels, and shaky regional rules of the game, intra-regional trade

* This work was carried out under the UNCTAD Project of Technical Assistance to the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development with the aid of a grant from the International Development Research Centre of Canada. The author gratefully acknowledges research assistance by Ramiro Albrieu and Eduardo Corso and comments by Alfredo Calcagno.

showed a persistently discouraging evolution from 1999 on.

The economic situation of the regional bloc, however, has been improving over the last three years. There has been a substantial acceleration in the growth rate; aggregate volatility is much lower, and the worst consequences of the financial turmoil are gradually fading away. Under these new circumstances, there has been a recovery in intra-regional trade flows.

As a consequence of these developments, public opinion has been showing renewed interest in analysing the pros and cons of integration. The main concerns consider the ability of the regional agreement to enhance the competitiveness of the members, the identification of the best-suited strategies to negotiate with other blocs, the improvement in the rules of the game governing intra-regional trade, the eventual deepening of the degree of integration, and the design of credible strategies to coordinate macro policies. The debates involve questions that are analytically complex and demand empirical evidence that is not necessarily available. What is clear, nonetheless, is that a thorough assessment of the integration strategy – including the analysis of the effects of the changes on the macroeconomic policy framework – will be necessary in order to revitalize the process and gain the political strength to introduce reforms. In fact, the authorities have repeatedly stated that a “redefinition” or “re-launching” of MERCOSUR is critically important to ensuring its political viability.

The regional members are middle-income countries characterized by marked social and geographic disparities. Therefore, it is reasonable to assume that the benefits of this Regional Integration Agreement (RIA) will ultimately be judged on the basis of its contribution to development and that, consequently, key development goals such as restoring strong and sustainable growth will play a central role in the strategies to redefine MERCOSUR. Achieving this latter goal will not be easy. The evolution of the region’s per capita income in the last quarter of a century has been disappointing and was associated with three persistent problems that are still constraining the growth potential: excess aggregate volatility, deficient integration with global trade and capital markets, and weak economic institutions. A central question therefore is: What kind of contribution – if any – can MERCOSUR make concerning these three problems?

Of course, this question has multiple aspects – from macro to micro and from trade and technology to finance and institutions – the analysis of which go well beyond the scope of this paper. Our intention is to address this question adopting a macroeconomic perspective in order to assess what contribution a higher degree of macroeconomic policy coordination can make. We will, consequently, privilege the study of aggregate phenomena, such as growth volatility, the fluctuations of quantities and the real exchange rate, and external financial constraints. We will also examine those institutional factors that have a bearing on macro equilibrium, such as the exchange rate regime and the rules governing financial transactions, capital flows, and fiscal policies. We hope to show that macro-policy coordination can contribute significantly to sustaining growth to the extent that it contributes to reducing volatility and strengthening financial stability. The recent growth literature has illuminated the central role of finance in fostering growth and of macro volatility in hindering it.[1] Note that the institutional perspective naturally enters the macroeconomic picture to the extent that macroeconomic policy coordination and deeper financial integration are, in the first place, exercises in institution building. Trade and technological issues, on the other hand, will only enter our analysis to the extent that they impinge on aggregate volatility and are factors that can either facilitate or constrain regional macro coordination.

Historically, MERCOSUR countries have not managed to establish a monetary and macroeconomic policy framework that can combine credibility in a stable performance of nominal variables with flexibility (particularly, in the exchange rate) as a way to deal with shocks and protect competitiveness, while ensuring external sustainability. A lengthy experience of instability has greatly damaged the credibility of “hands free” policies, while, at the same time, the economies of the region have experienced extremely large disturbances which demanded policy flexibility of some type. But policies and credibility are only part of the story. It is also crucial to understand the kinds of shocks that policies have to cope with and these shocks have to do not only with the structure of the economies of each member, but also with the characteristics of the integration in the global economy. This determines the size of shocks, as well as the presence or absence of ways for the economy to diversify its idiosyncratic risks. Furthermore, the MERCOSUR experience indicates that propagation mechanisms – including primarily the reactions of foreign investors' sentiment – frequently exacerbate rather than dampen shock impulses. It has been observed that the financial position of firms and the government can rapidly deteriorate under unfavourable macroeconomic circumstances and, when debtors are vulnerable, the solvency of banks and the ability of the country to meet external payments may become uncertain.

The problem of coping with aggregate shocks is essentially a problem of risk management, given certain rules of the game. Although the goals of the risk managers of financial institutions and national authorities differ, because the latter's objective is to stabilize the economy rather than to maximize profits, it is still true that both have to develop efficient strategies to cope with risk. In both cases the quality of risk management will crucially depend on two factors: the knowledge of the stochastic processes generating risks and the rules of the game, which pose constraints on what can or cannot be done to prevent, mitigate and cope with the adverse consequences of unknown events. Institutions matter because the quality of policies depends on the quality of the domestic institutional arrangements that support the macro and financial regimes. Of course, we should not overlook the fact that the problem has an international dimension embracing both the regional and global levels. Defects in the international "architecture" may well combine with domestic misperceptions and incentive problems to hinder the development of sound and stable macroeconomic policies. On the other hand, institutional arrangements at the regional level could substantially contribute to strengthening credibility, thereby simplifying the task of national risk managers, as in the case of the monetary arrangement of the European Union.

Thus, institutions and the credibility and ability of policies to help the economy to absorb shocks, the size and characteristics of shocks, and propagation effects are all key factors determining the countries' robustness or fragility. This implies that they cannot be overlooked when analysing the pros and cons and the incentives for macroeconomic policy coordination. The main question in this regard is how to design regional mechanisms that can promote steady and systematic policies and reduce and diversify risk.

Two key hypotheses of the study are:

(i) The framework regulating macroeconomic and financial policies in a given economy should not be conceived independently of the regional arrangements in which the economy participates and the developments in the international context. This applies to the design, reform, and management of macroeconomic policies and regulations.

(ii) The design of the institutional architecture for the co-ordination of macroeconomic policies at the regional level must take into account that the regional members in MERCOSUR are developing economies. This means that we have to consider the higher volatility of the macroeconomic and financial environment; the underdevelopment of the market structure (such as, imperfections, missing markets, and high transactions costs); weak institutions; and (as a consequence) the reduced number of countercyclical instruments at the disposal of authorities.

These two basic hypotheses give rise, in turn, to other questions which also motivated the paper: What does macroeconomic policy coordination "add up to" from the point of view of developing countries' main goals: growth and successful integration in the global economy? Can arrangements at the regional level make the domestic financial system more stable/efficient/transparent? Given that implementation capacities may be weak in many developing countries, why is institution building at the regional level a good idea? Why is macroeconomic instability an obstacle to deepening the process of integration?

The paper has three sections. The first section reviews the situation of MERCOSUR, emphasizing the analysis of the developments that followed the regime change in Brazil in 1999 and in other member countries afterwards. The main goal is to set the context for discussing the problem of macroeconomic policy coordination in the region. We stress the role of some structural economic characteristics that the countries in the region share. Among the questions to be addressed are: What is the current and recent evolution concerning regional trade? Why is growth a problem? How well are the new exchange rate regimes working? The second section analyses the characteristics of cyclical movements within countries and of co-movements between MERCOSUR members. This allows us to distinguish between the effects of common (i.e. regional) and idiosyncratic shocks. The section also studies price and quantity dynamics and examines the interactions between the activity level and the real exchange rate. On the financial side, we will show how external financial shocks impinge on the region. A detailed knowledge of these elements is key to developing counter-cyclical tools at the regional level. The last section addresses what member countries can do to support growth, macro-policy coordination, and financial integration.

I. Growth, trade, adjustment and life after crisis

The members of MERCOSUR share a number of structural characteristics that are key to understanding the challenges that the region is facing concerning growth and macroeconomic stability. The following stylized facts summarize the more salient characteristics:

- MERCOSUR is a RIA between middle-income countries.
- The growth rate has been uniformly low since the debt crisis in the early eighties.
- The degree of economic and trade integration is still low.
- The countries were hit by sizable aggregate shocks in the 1999–2001 period and this has been extremely detrimental to the integration process.
- Although the degree of industrialization differs, the share of primary and traditional industrial products in exports is still important.
- All MERCOSUR countries are instability-prone.
- The members show weak economic institutions and low financial deepening.

In what follows, we examine these stylized facts in more detail. The main purpose is to provide background information on the economic evolution of the region after the Russian crisis in order to set the stage for our discussion on macroeconomic factors in the ensuing sections.

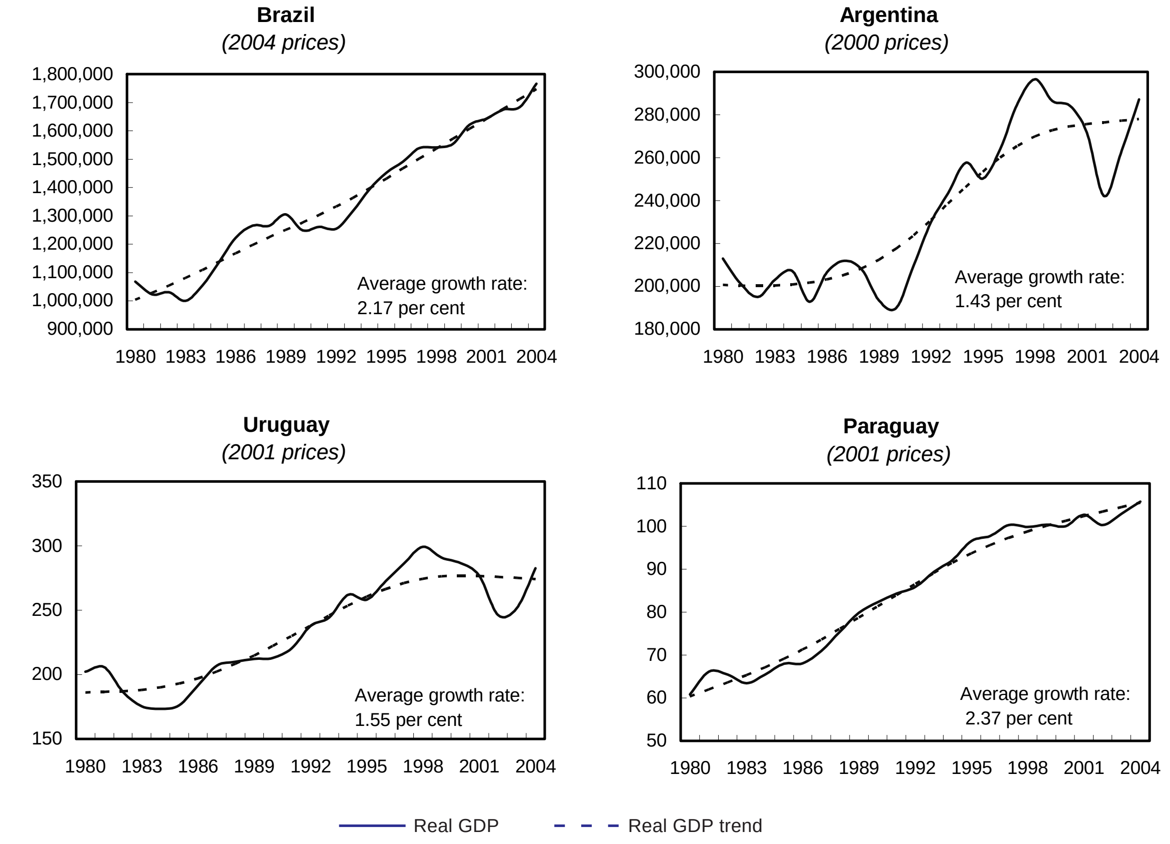
Growth, vulnerability and external adjustment

The figures in Panel A show the evolution of GDP and the growth trend corresponding to the four members of MERCOSUR. It is clear that the average rate of growth has been very low and aggregate fluctuations pronounced. In the last twenty-five years, the average growth rate has been less than 2 per cent in the cases of Uruguay and Argentina while it was only slightly higher in Paraguay and Brazil. Indeed, the case of Brazil is the most striking because this country was considered a "miracle" of high growth in the post-war period. Between 1947 and 1980, Brazilian growth averaged 7.5 per cent per year. It is easy to anticipate, then, that the popularity of MERCOSUR and the political will to deepen integration will be strongly influenced by the ability of the agreement to contribute to restoring and sustaining growth. Note that there are no substantial differences concerning growth and fluctuations between the pre- and post-MERCOSUR periods.

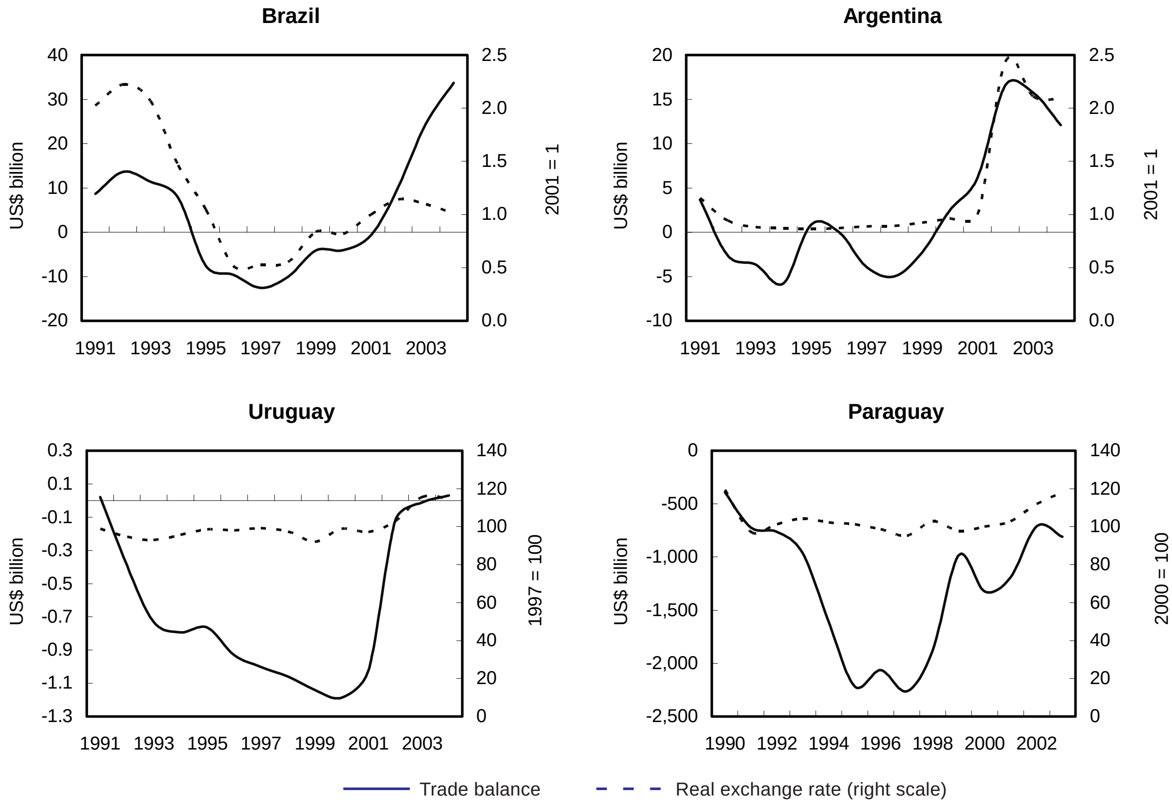
The Russian crisis of 1998 revealed that the economies of the region were highly vulnerable. To reduce external vulnerability, it was necessary to reduce the deficit in the current account. The privileged instrument was the depreciation of the currency. Panel B shows the evolution of the trade balance and the real exchange rate (a higher real exchange rate means a real depreciation of the currency). The depreciation of the currency induced a rapid fall in the members' trade deficits and the two largest economies recorded huge surpluses in 2004. This situation is just the opposite of the one observed in 1998 and has been instrumental in reducing MERCOSUR's external vulnerability.

The way in which real depreciation operated to generate a trade surplus, however, has changed over time. The most relevant effect of real depreciation in the short run was felt on imports, which fell abruptly in Argentina, Uruguay, and Paraguay hand-in-hand with plunging domestic absorption. Imports remained stable in Brazil because this country experienced the milder recessionary effects in the post-devaluation stage. As time elapsed, however, exports followed a sort of J-curve path and imports stabilized or began to increase. Panel C shows the evolution of exports and imports between 1990 and 2004. As can be seen, the evolution of Brazilian exports is remarkable, doubling between 1999 and 2004. Since imports were stagnant, the trade surplus is now at record levels. It is expected to be higher than $40 billion in 2005. These developments, nonetheless, also have a darker side: stagnant imports are the counterpart of low growth and the huge trade surplus is giving rise to increasing complications to manage monetary policy in the short run. To meet the inflation target the Central Bank has maintained extremely high real interest rates. In this context, it

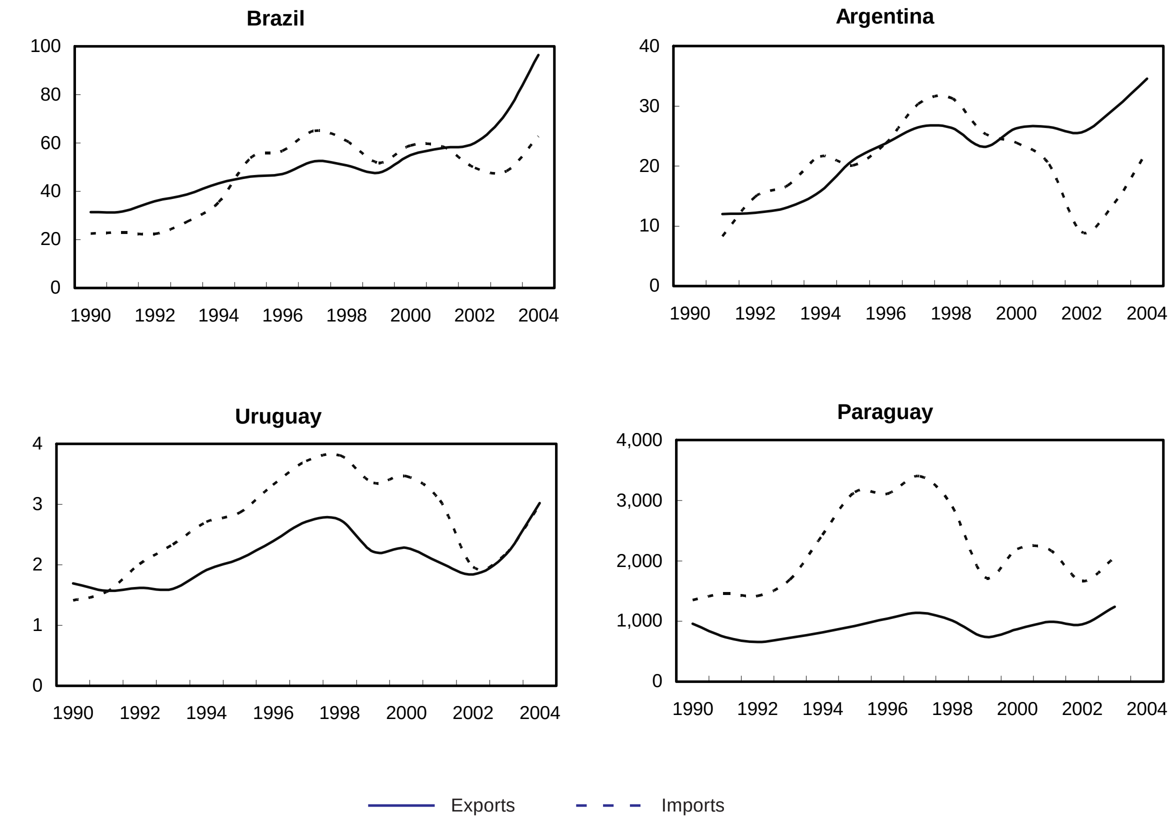
Panel A: REAL GDP (*LC million*)



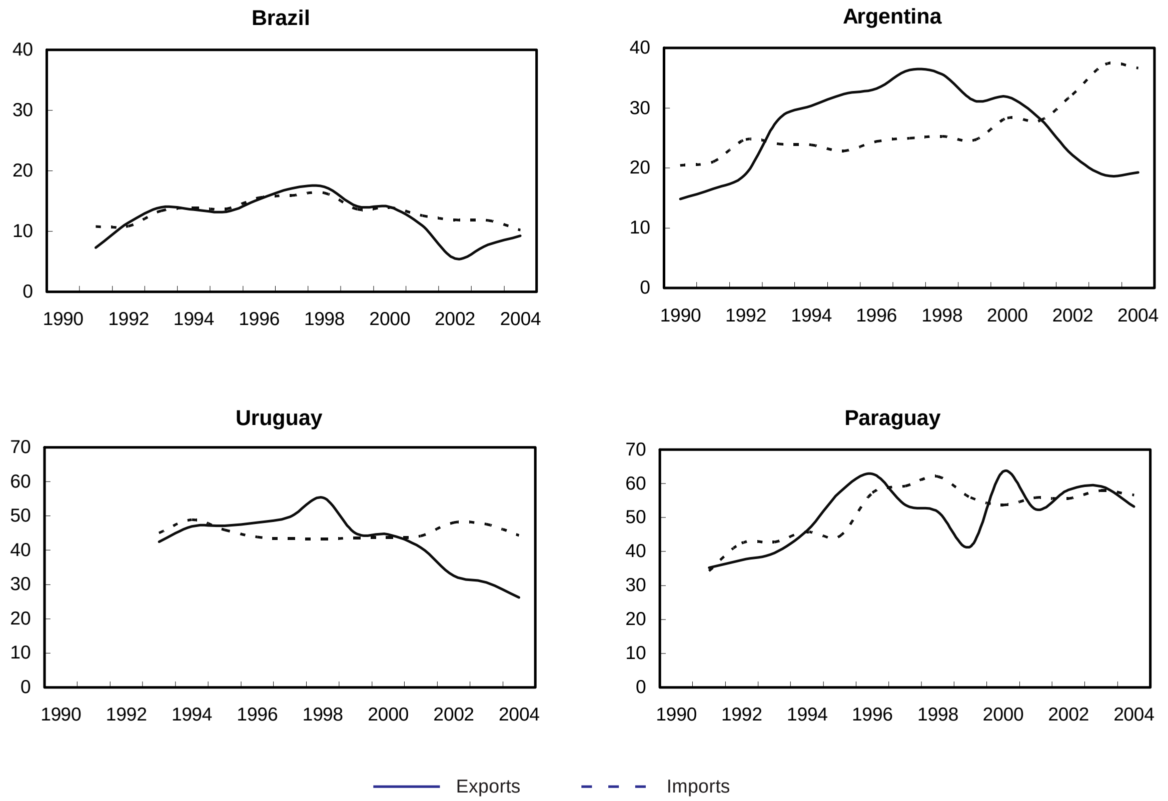
Panel B: TRADE BALANCE AND REAL EXCHANGE RATE



Panel C: TRADE (*US$ billion*)



Panel D: TRADE WITH MERCOSUR COUNTRIES (*per cent*)



is not surprising that Brazil repaid its outstanding obligations with the IMF in advance.

Argentine exports and trade surplus also show a positive evolution in the period following real depreciation (see Panel C). As a consequence, Argentina – like Brazil – is registering record trade surpluses. Argentina's evolution has two positive features:

(i) Imports are not stagnant; they are increasing substantially as a consequence of high growth and the increase in the investment ratio.

(ii) The increase in exports has occurred despite the weak Brazilian demand for Argentine products, which means that the country has been able to achieve a higher geographical diversification of its exports. The smaller economies show a similar pattern concerning imports, exports, and the trade balance.

Regional trade, size and competitiveness

The figures in Panel D present the evolution of the share of regional imports and exports in total imports and exports, respectively.

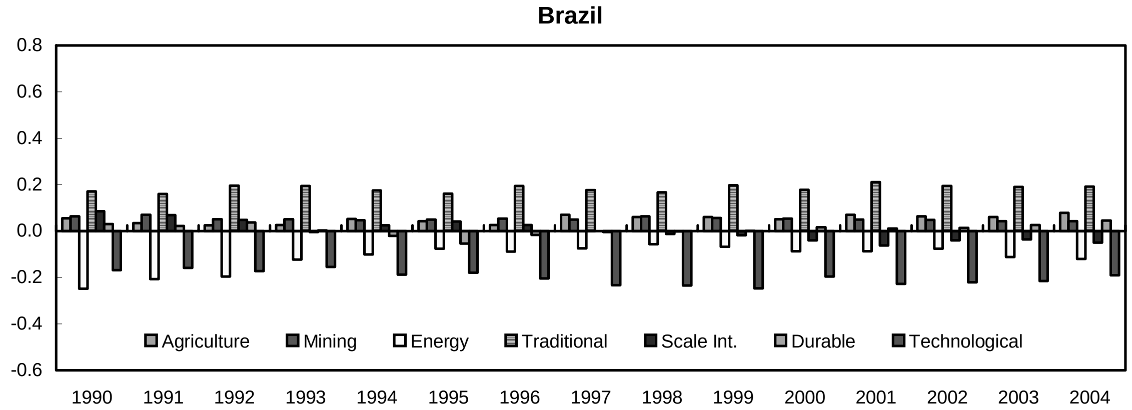
Note the strong negative impact of the post-1998 crisis on the significance of total trade: there is a strong tendency for the participation of intra-regional trade to fall after that year. This tendency, nonetheless, reversed after 2002 when the worst consequences of the recessions triggered by the successive domestic crises disappeared. This evolution confirms the importance of the domestic activity levels as a determinant of intra-regional trade, as has been detected in several studies (see, for example, Heymann and Navajas, 1998).

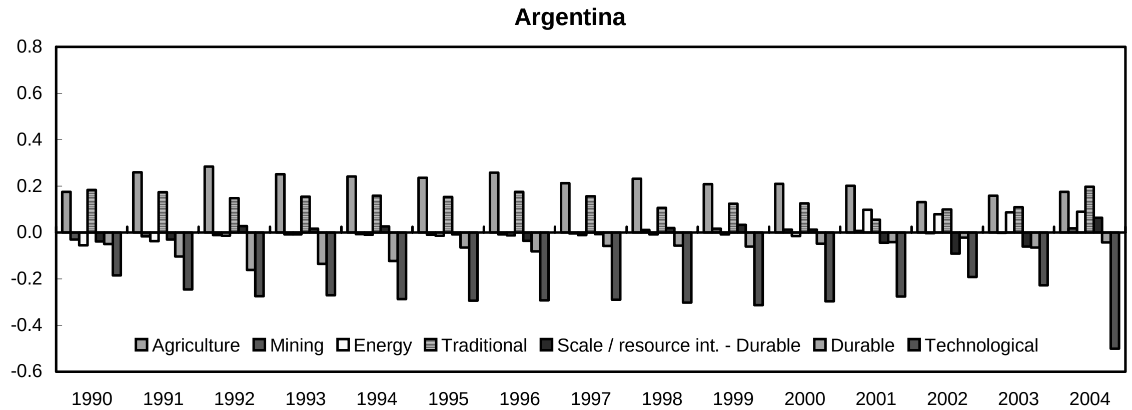
Some aspects of the recovery phase, however, are somewhat disappointing and might ultimately affect the incentives to deepen the integration process and to coordinate the macroeconomy. One discouraging aspect is that the evolution of the Brazilian regional trade pattern differs substantially from the rest. Brazilian trade has benefited much more from the recovery than the rest. For example, while the Argentine share of imports from MERCOSUR has been increasing significantly since 2002 – coinciding with the strong recovery of growth, the share of exports to MERCOSUR is falling and is substantially lower than during the pre-crisis period. Just the opposite has occurred in the case of Brazil; the share of regional exports in total exports increased while the weight of imports from MERCOSUR has been falling constantly. It is no wonder, then, that Brazil shows an increasing regional trade surplus in recent years. This situation does not seem to be sustainable in the long run and is currently a source of concern in the negotiations to revitalize the RIA.

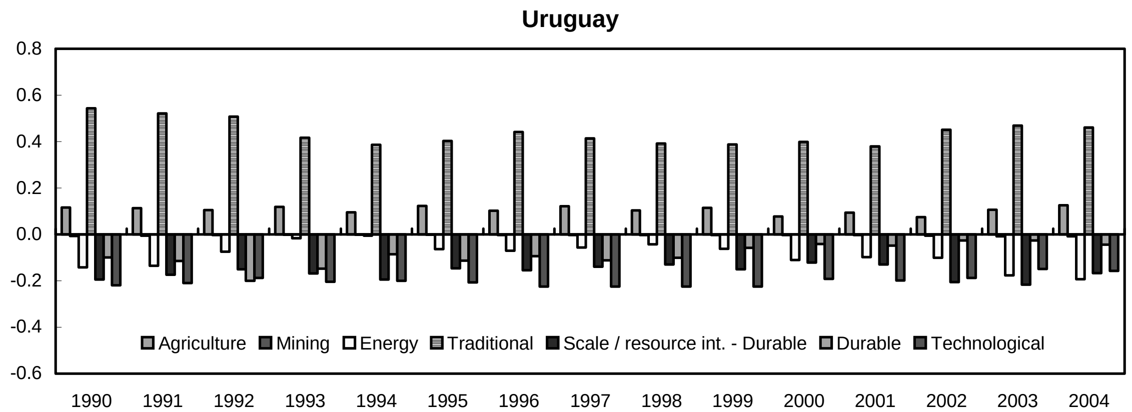
The fact that Brazil is doing better than the rest in the recovery phase may be an obstacle because it could deepen asymmetries. Panel D clearly shows the differences between the larger and smaller members. As can be seen, there is an inverse relationship between size and the regional trade/total trade ratio. While the weight of regional imports and exports is high in Uruguay's and Paraguay's total exports, the weight is much lower in the case of Argentina and Brazil. The second shows the lowest ratio. This means that the effects of the fluctuations in regional trade are stronger when the economy is smaller. Since the effects of macroeconomic shocks on trade have proven to be sizable, it is clear that the smaller the country, the more valuable become the counter-cyclical policies applied by its neighbours.

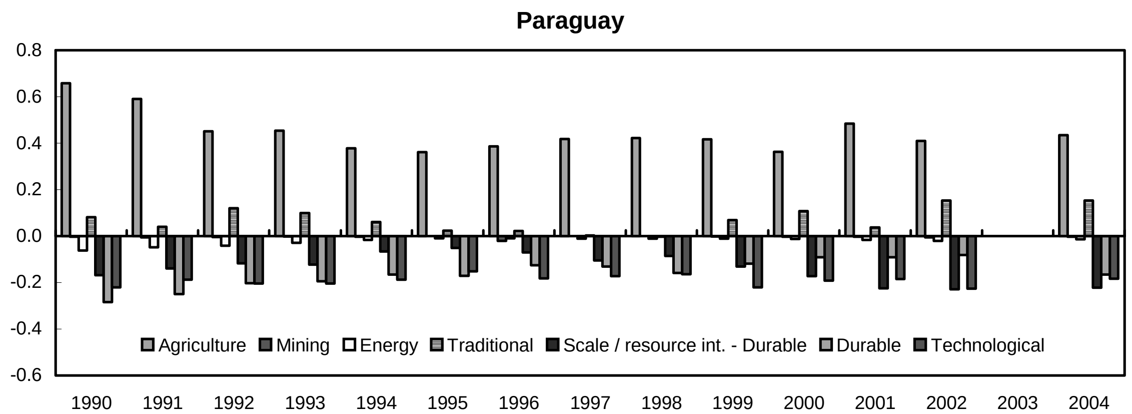
Panel E presents the contribution different trade items have made to the trade balance. Each item is classified by the degree of sophistication of the products. It is clear that the members depend on the primary and traditional industrial product surplus to finance a permanent deficit in scale and technology intensive goods. Although there have been changes, this structural feature has not changed much over the last twenty-five years. The picture, however, is indeed different concerning intra-regional trade. The share of exports of more sophisticated products (such as those that exploit scale economies or are technology intensive) is higher and, in the case of Brazil, some items show a relevant trade surplus (Fanelli, Gonzalez Rozada, and Keifman, 2001). It must be taken into account, therefore, that in the case of MERCOSUR it is not only quantity but also quality that counts. Since exports to MERCOSUR are more sophisticated than exports to the rest of the world, it is critical for the members to increase the volume of intra-regional trade.

Panel E: CONTRIBUTION TO TRADE BALANCE (*CTB index*)

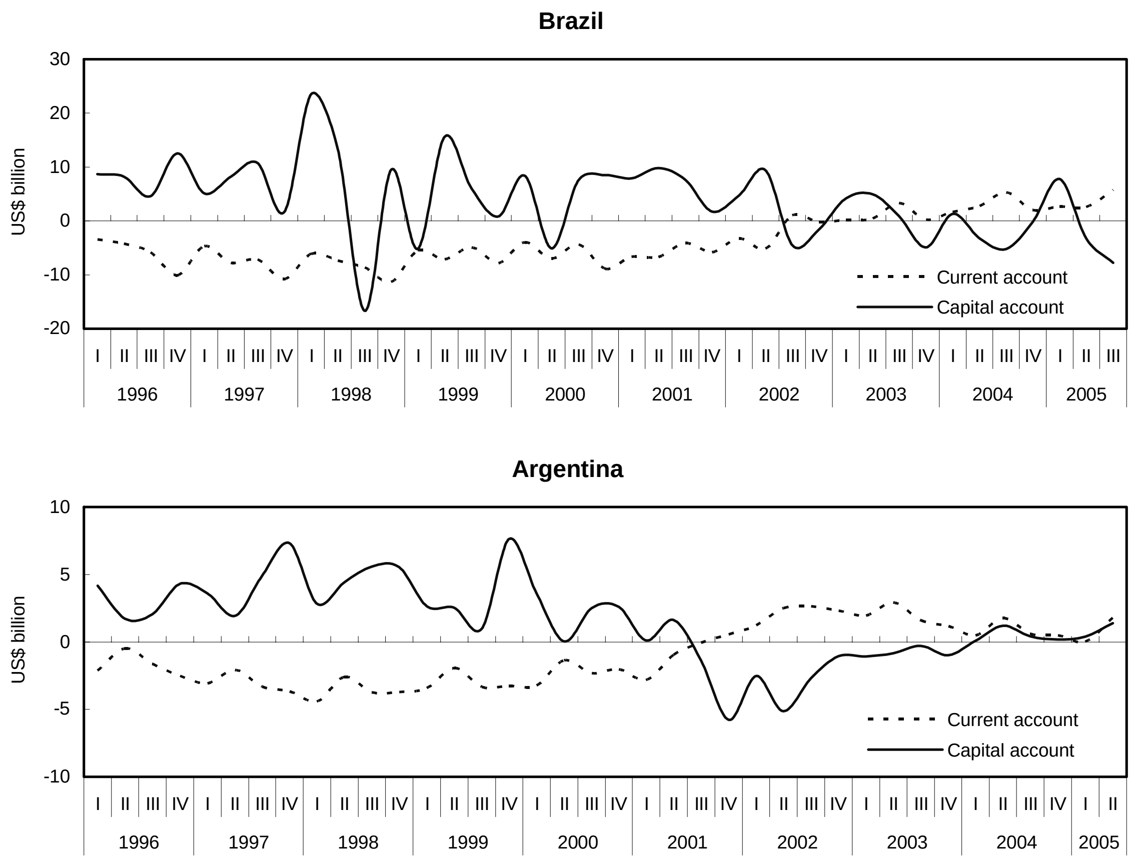








Panel F: BALANCE OF PAYMENTS *(quarterly)*

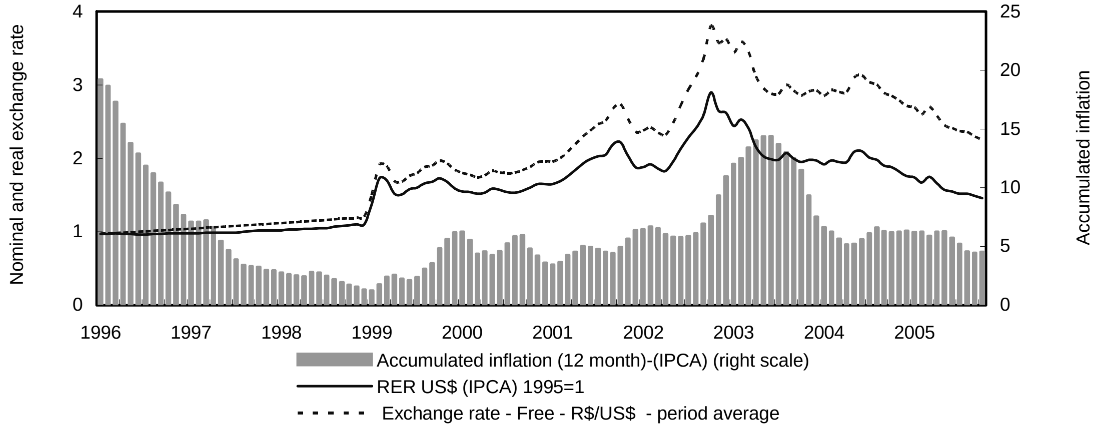


Capital movements, prices and quantities

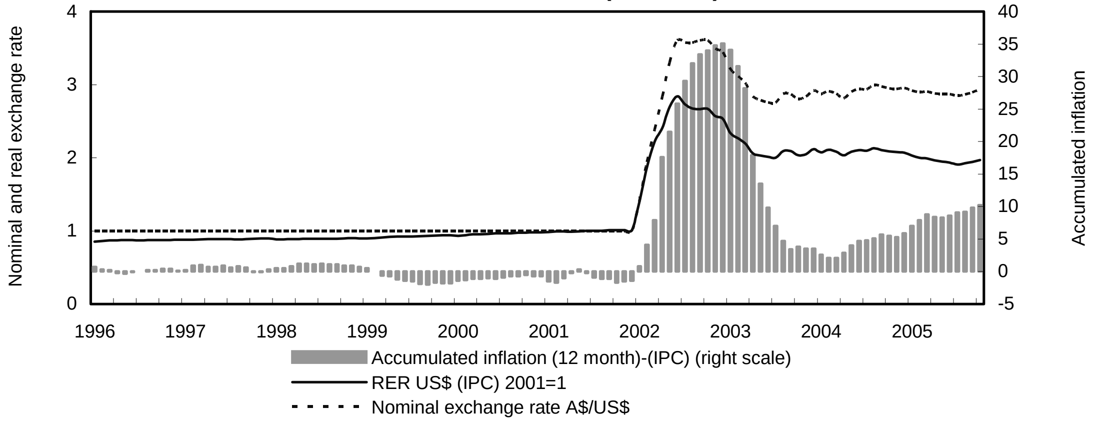
The most relevant consequence of the Russian crisis on the region was the sudden fall in capital inflows. Panel F shows the strong reduction in capital inflows that occurred in both Argentina and Brazil after 1998.[2] Under the new circumstances, it became extremely difficult for these countries to finance the ongoing current account deficit and, consequently, it was increasingly apparent that a sizable reduction in the deficit was necessary. This was not an easy task, however. The high level of the deficit called for severe adjustments and neither the international nor the political economy stance were propitious. Not only had the Russian events worsened financial conditions in emerging markets, but the dollar had also appreciated significantly. The "super dollar" was extremely harmful to the price competitiveness of the two largest MERCOSUR economies because both countries were maintaining a fixed parity. In the case of Argentina this occurred because the country had instituted a currency board in 1991. The Brazilian authorities, in turn, were *de facto* maintaining the fluctuation of the real/dollar parity within a very narrow band in order to keep inflation under control. Both countries showed a strong anti-inflation consensus after the hyper-inflationary events of the eighties and, thus, an acceleration of inflation would severely affect the governments' popularity. Under these circumstances, the authorities faced a dramatic dilemma originating in the fact that ensuring external sustainability and political economy equilibrium called for contradictory remedies. The natural way to achieve a rapid adjustment in the current account was to depreciate the currency. However, this implied changing the exchange rate regime and allowing the inflation rate to accelerate, which would have extremely stressful effects on credibility and,

Panel G: NOMINAL EXCHANGE RATE, REAL EXCHANGE RATE AND ACCUMULATED INFLATION

Brazil: nominal exchange rate (R$ / US$), real exchange rate (BR/US) and accumulated inflation (12m, IPCA)

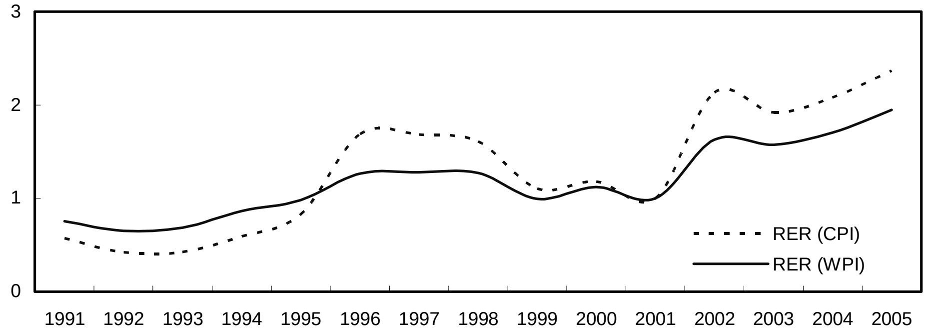


Argentina: nominal exchange rate (A$ / US$), real exchange rate (ARG/US) and accumulated inflation (12m, IPC)



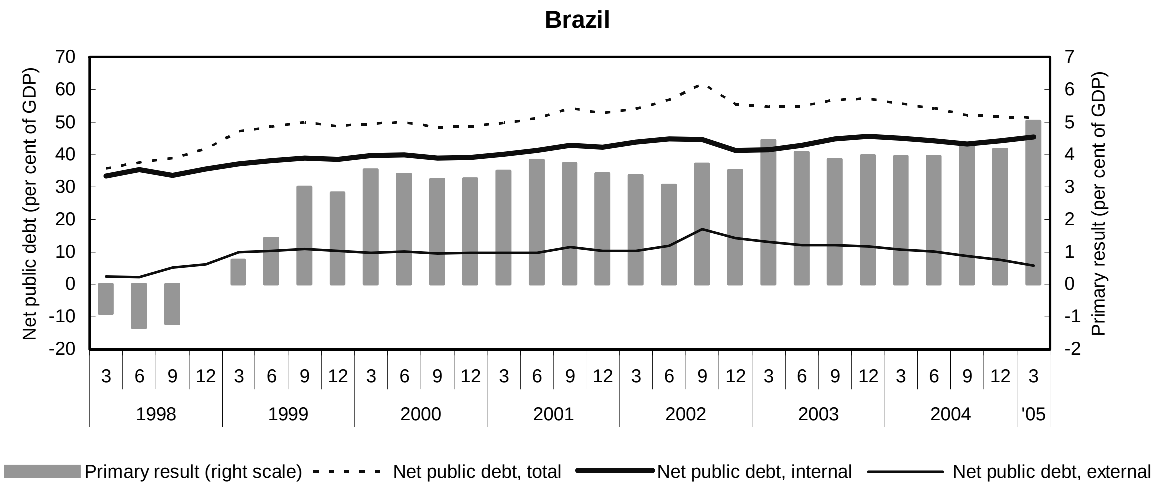
Argentina/Brazil: real exchange rate

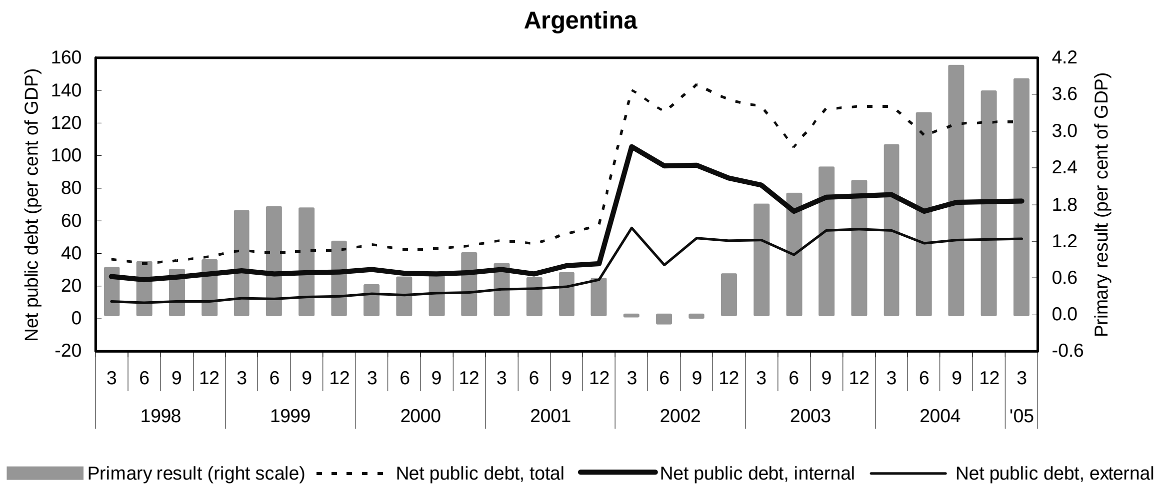
(2000 = 1)



hence, on institutions. The political economy stance, nonetheless, determined that this dilemma was more dramatic in Argentina than in Brazil. So, it is not surprising that there was less procrastination in Brazil. Brazil induced the regime change in January 1999 while Argentina did not do so until three years later. Both countries opted for more flexibility. Brazil instituted a floating regime and inflation targeting, while Argentina opted for dirty floating with a monetary base target.

Panel H: NET PUBLIC DEBT AND PRIMARY RESULT





The most salient result of the regime change in Argentina and Brazil was the strong depreciation in the currency in real terms. Panel G shows the path of the nominal and real exchange rates. We have also depicted the evolution of the inflation rate. As expected, the increase in the nominal exchange rate pushed the inflation rate upward. These facts confirm that exchange rate regimes are not neutral and that nominal magnitudes play a substantial role in determining the evolution of real variables. We will elaborate further on this crucial issue in the next section. One additional interesting fact is that Brazil's trade surplus vis-à-vis Argentina is increasing even though the Brazilian currency has appreciated against the peso. This suggests that the Brazilian tradable sector has been doing better than the Argentine one after the crisis.

The results concerning the adjustment on the external side and the political economy also coincided with expectations. As can be seen in Panel F after a period, the current account result turned out to be highly positive. On the political side the results were no less impressive: In Argentina, the President resigned in 2001 and the opposition won the election in 2002.

The functioning of the new regimes in recent years has shown some important benefits. First, the inflation rate was kept reasonably under control after the devaluation. Second, external sustainability improved and reserves were replenished. As Panel H shows, fiscal discipline has improved substantially. Both Argentina and Brazil are running substantial primary fiscal surpluses. Third, the region has been growing. Nonetheless, some weaknesses exist. In the case of Brazil, the flip side of the low-inflation coin has been extremely high real interest rates and low growth. Likewise, the level of the public debt has been exerting pressure on the availability of credit for the private sector. In the case of Argentina, the maintenance of the real exchange rate has led to an accumulation of reserves and inflationary pressures. In addition, the level of financial deepening is still extremely law. Credit to the private sector is only around ten percent of GDP.

In sum, since the worst consequences of the crises have been overcome, MERCOSUR will probably enter a new stage in which intra-regional trade will resume the positive trend that it showed before the crises. For this new stage to consolidate, however, it is crucial that Brazil increase its growth rate significantly.

II. Cyclical fluctuations and the need for adequate counter-cyclical policies and financing

We have previously argued that the problem of designing and implementing counter-cyclical policies can largely be conceived of as a problem of risk management and that, therefore, two factors take central stage: first, the degree of knowledge about the stochastic processes that generate aggregate shocks and the propagation mechanisms that transmit the shocks throughout the economy; and, second, the quality of the macroeconomic regime, understood as the institutions and practices that define the set of macroeconomic policies which are feasible under specific circumstances.

These two elements are especially important in the current situation of MERCOSUR because both the impulse-response mechanisms and the macroeconomic regime have changed as a consequence of the crisis. These changes must be taken into account not only to design the domestic macroeconomic regime but also to advance in the coordination of macroeconomic policies. In the previous section we tried to shed some light on the changes in the macroeconomic regime that the crisis induced and the way the new regime is functioning. In this section we discuss the characteristics of macroeconomic fluctuations and of cyclical co-movements in the region based on the analytical literature on MERCOSUR. The main purpose is to pursue the implications for the design of adequate counter-cyclical policies and macroeconomic policy coordination.

The issues discussed here are closely related to those highlighted in the literature on optimum currency areas (OCA) and exchange-rate-regime choice: the degree of symmetry of the business cycles, the identification of the sources of shocks, volatility, and the interactions of output and price disturbances. Our analysis, however, incorporates some elements that are overlooked in this literature that are critical to explaining some particularities of the MERCOSUR economies. We would like to highlight the following aspects in this regard.

(i) There is excess aggregate volatility. It is a well-documented fact that stochastic processes tend to be more unstable in developing countries. In particular, the size and variance of shocks are large and the parameters of the stochastic processes frequently show unexpected changes ("structural breaks").

(ii) There is little synchrony between regional fluctuations in MERCOSUR.

(iii) Market failures are pervasive and, therefore, it is necessary to consider the features of the economic structure that impinge on aggregate fluctuations. In the case of MERCOSUR, the characteristics of the tradable sector, capital flows, and domestic financial intermediation contribute to shaping the price-quantity dynamics and regional co-movements (i.e., the idiosyncratic and regional components of aggregate fluctuations).

(iv) Financial constraints and price rigidities play a significant role concerning both shocks and propagation mechanisms.

(v) MERCOSUR macroeconomic regimes have been historically weak.

In what follows we analyse these factors in more detail.

Excess volatility

Although there is a consensus that MERCOSUR countries are volatile, measuring the degree of excess volatility is not that simple (see Fanelli, 2005). In view of this, we will adopt a pragmatic strategy and use two standards to identify excess volatility: international and analytical.

Concerning the international standard, we can take developed economies as the benchmark. Given that developing countries' risk management is flawed because market options to allocate risks are reduced and the policy sophistication is limited, it is reasonable to assume that the amount of excess aggregate volatility should be the lowest in those countries where the level of financial deepening and the quality of policies is highest. Although the comparison with the developed-country benchmark does not tell us how far one developing economy is from a first-best situation, it does tell us how much excess volatility could, in principle, be eliminated if a developing country's markets and institutions were to become as strong as in developed countries. Figure 1 presents the volatility of GDP growth for OECD countries and MERCOSUR. The figure indicates that growth volatility is much higher in MERCOSUR.

Our analytical standard will be the main predictions of the perfect-market theoretical paradigm. The complete-market approach has a set of straightforward predictions regarding the relationship between consumption and income volatility. First, private consumption volatility should be lower than income volatility to the extent that private agents use financial markets to smooth consumption. Second, the evolution of domestic consumption should be more correlated with the evolution of world consumption than with national income.

These predictions indicate that they would engage in consumption-smoothing and consumption volatility would be lower than income volatility if the financial constraints that agents face in MERCOSUR were not strict. Figure 2 shows that consumption growth volatility is higher than income growth volatility in the case of MERCOSUR countries while the opposite tends to occur in the OECD area, where consumption volatility is lower than income volatility in most countries. *A priori*, this evidence suggests that financial constraints are softer and that the quality of financial markets are better in high-income regions, which is consistent with the close association between GDP per capita and financial deepening that was detected in the literature (see Levine, 2004).

If MERCOSUR countries had relatively fluent access to international capital markets, they would use them to diversify idiosyncratic risk away. Under

Figure 1

GDP VOLATILITY, 1960–1989 VS. 1990–2002

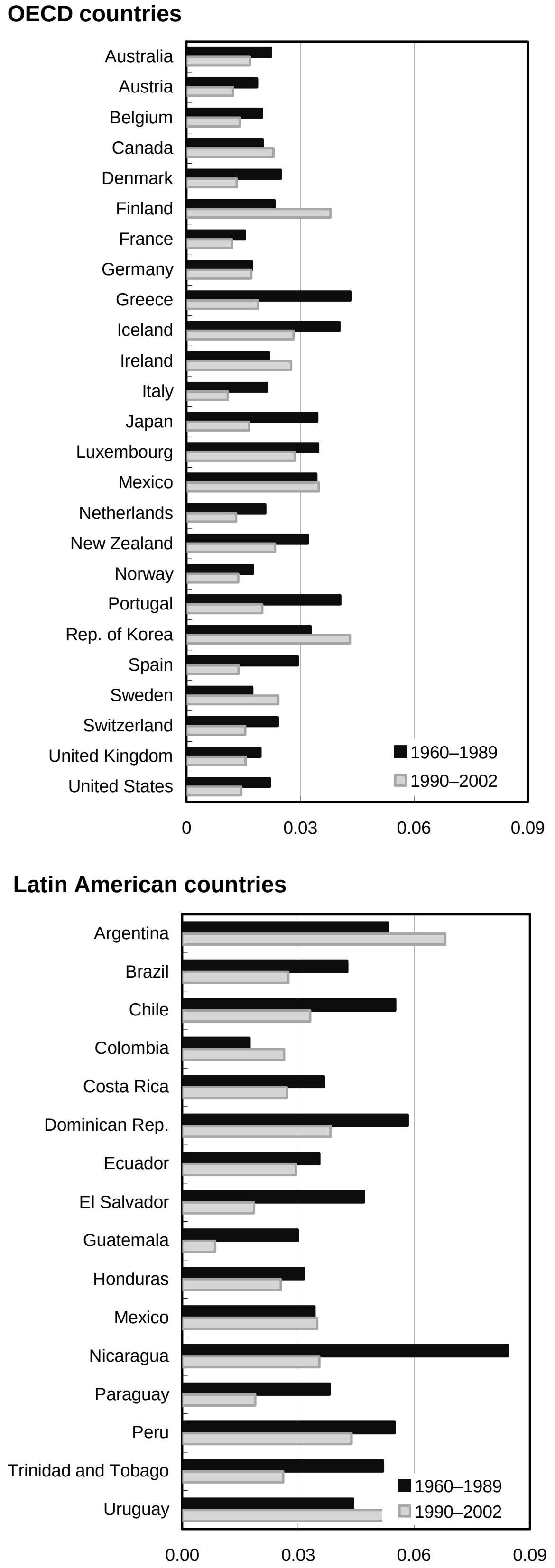
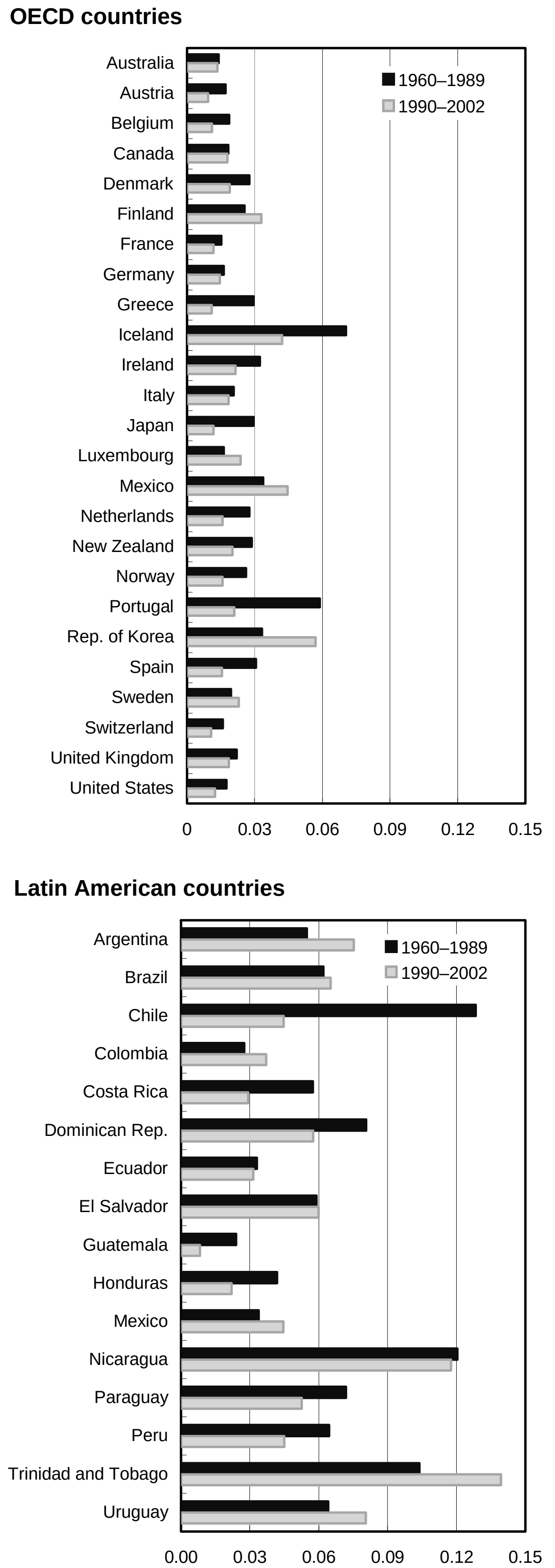


Figure 2

CONSUMPTION VOLATILITY, 1960–1989 VS. 1990–2002



these conditions, the evolution of domestic and world consumption should be correlated while there should not be a significant relationship between the growth rate of domestic consumption and GDP growth. The empirical results are just the opposite (see Fanelli, 2005). In sum, the evidence suggests that excess volatility in MERCOSUR is sizable.

Regional co-movement and synchrony[3]

A natural first step to assess the degree of co-movement of business cycles at the regional level is to calculate the correlation between domestic business cycles, where "business cycle" is defined as the residual left once the H-P trend has been removed. In this context, a high correlation suggests the existence of common sources of and similar responses to disturbances. If the correlation is low, however, it may be due either to differing disturbances and/or different responses to shocks.

Table 1 shows that contemporaneous correlations between Argentina and Brazil are low, while Uruguay experiences a larger degree of co-movement with the other members. The value of the coefficients indicates that the strongest co-movement occurs between Argentina and Uruguay.[4] If we consider that the United States is a well-developed monetary union, we can use the value of the correlation coefficients between the United States regions as a standard for comparison. According to the evidence

Table 1

BUSINESS CYCLE CO-MOVEMENT IN MERCOSUR

	*GDP at time **t***		
*GDP at time **t***	*Argentina*	*Brazil*	*Uruguay*
Argentina	1.00	0.13	0.43
Brazil	0.13	1.00	0.34
Uruguay	0.43	0.34	1.00

Source: Fanelli and Gonzalez Rozada (2004).

Table 2

LEAD/LAG CORRELATIONS IN MERCOSUR

	Panel A. GDP at time ***t + 1***			*Panel B. GDP at time* ***t + 4***		
GDP at time t	*Argentina*	*Brazil*	*Uruguay*	*Argentina*	*Brazil*	*Uruguay*
Argentina	0.79	0.12	0.55	0.10	0.12	0.37
Brazil	0.08	0.68	0.37	-0.08	0.19	0.40
Uruguay	0.26	0.23	0.72	-0.15	0.05	0.18

Source: Fanelli and Gonzalez Rozada (2004).

in Kouparitsas (2002) the minimum value of the correlation coefficient is 0.51 and the mean is 0.78. It is apparent that the degree of co-movement in MERCOSUR is much weaker. This suggests that common sources of disturbances are weak and/or that the responses to common shocks are dissimilar.

A contemporaneous correlation, however, does not permit the evaluation of persistence and lead relationships. We can obtain a better knowledge of regional dynamics by computing lead/lag coefficients between these variables, that is, the correlation between output disturbances at time t and at time $t+k$ and $t-k$, where k is a positive integer. Table 2 shows the value of the coefficients for $k=1$and $k=4$. Coefficients close to one indicate highly persistent cyclical fluctuations while coefficients close to zero indicate very little persistence. Own-lag correlation coefficients reveal a moderate degree of persistence with Brazil showing the lowest value.

This evidence suggests that there is little inertia in the adjustment process, which is consistent with the hypothesis that contracts are shorter under volatile conditions (Fanelli, Gonzalez Rozada, and Keifman, 2001). In the case of the United States regions, for example, there are no own-lag coefficients below 0.9.

The effects of disturbances may be transmitted across countries via trade, productive, and financial channels. High lead/lag correlations relative to contemporaneous correlations indicate that there may be relevant propagation mechanisms at work in the region. The linkages of Uruguay with the largest two members are the most striking in this regard. The correlations between Brazil and Argentina do not reveal any strong lead relations.

A drawback of assessing co-movement based on cross-correlograms is that it only allows for a rudimentary identification of the sources of shocks. To improve identification it is necessary to apply more complex methods and make more audacious assumptions. Fanelli and Rozada (2004) build on the unobserved component approach (Watson, 1986; Kouparitsas, 2002) to decompose the MERCOSUR countries' real GDP fluctuations[5] into idiosyncratic and common cycles. The analysis reveals that Argentina's idiosyncratic cycle explains 87.6 per cent of the total cycle variability, while the common component represents 12.4 per cent of that variability. For Brazil, the idiosyncratic cycle variability explains 84.5 per cent of the total cycle variability and the common cycle variability explains 15.5 per cent. In Uruguay, 87 per cent of the total cycle variability is explained by the variation in the regional cycle and 13 per cent is explained by the variability of the common cycle.

This indicates that there is little synchrony between fluctuations. Nonetheless, a low correlation of cyclical movements does not mean that there are no coordination opportunities to exploit. The countries could still reduce macroeconomic volatility by implementing mechanisms to exchange idiosyncratic risks. The implementation of these mechanisms should improve both macroeconomic stability and welfare because it would expand trading opportunities and allow the economies to exchange risks that could not otherwise be exchanged insofar as the international markets for transacting those risks are missing. For these mechanisms to be designed and implemented, it is critical to fully comprehend not only the relationship between common and idiosyncratic cycles but also to identify regional propagation mechanisms within a unified methodological framework (see Fanelli and Gonzalez Rozada (2004) for details).

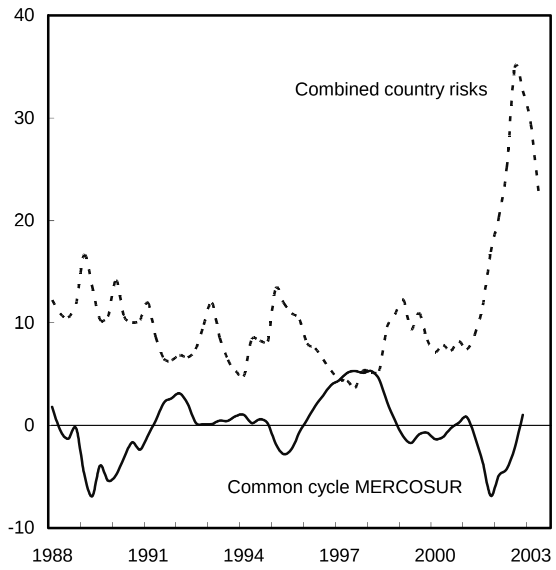
Structural factors: trade diversification and capital movements

There is strong evidence that trade specialization matters to aggregate fluctuations. In his work on the United States regional cycle, Kouparitsas (2002) found that, in those United States regions that devote a disproportionate share of their industrial activity to the production of commodities, region-specific cycles are dominated by fluctuations in commodity prices that are largely exogenous to the region: region-specific shocks explain almost 30 per cent of the business cycle variation. In those states in which industrial composition is virtually identical to that of the aggregate the United States economy, on the other hand, region-specific shocks account for an insignificant share of the business cycle variation in income. According to Kenen (1969), if countries specialize in distinct goods, they will be affected very differently by a given disturbance. Elaborating on this idea, Eichengreen and Taylor (2003) show that real exchange rate variability is associated with trade dissimilarity between partners.

If trade specialization and external shocks matter, one would expect supply shocks originating on the trade side (variations in the terms of trade, oil shocks, or changes in the parity between the main reserve currencies) to be important. Following Bayoumi and Eichengreen's (1992) methodology, Fanelli and Rozada (2004) find that the size of "supply" shocks is consistently larger than the size of demand shocks in the case of MERCOSUR. The comparison with the results obtained by Bayoumi and Eichengreen (1992) for the case of Europe and the United States reveals that supply shocks are much larger in MERCOSUR, while demand shocks are similar. In the United States regions and "core" European countries, the size of shocks is consistently between 1 per cent and 2 per cent. "Peripheral".[6] European countries, however, are much more volatile. Their supply shocks are twice as large as the core countries, which is a similar level of volatility to the one that has been estimated for Brazil.

Figure 3

MERCOSUR: COMMON CYCLE AND FINANCIAL CONDITIONS, 1988–2003



In addition to trade, in the last two decades changes in financial conditions became a primary source of shocks, hand-in-hand with the increase in capital flows. Under these new circumstances, swings in market sentiment usually induce changes in the supply of external funds and the country risk premium. In order to assess the influence of the external financial shocks and swings in market sentiment on the co-movement of MERCOSUR economies, Fanelli and Rozada (2004) run a regression with the common cycle that they identified using Stock and Watson techniques as the dependent variable and a weighted average of the country risk premium as the independent variable.[7] They found that the swings in financial market conditions that affect the region as a whole have a bearing on cyclical co-movement; the risk premium variable is strongly significant. Figure 3 illustrates this point. There is a clearly negative association between the common cycle and variations in the country risk premium.

Financial constraints

Our previous findings concerning consumption volatility indicate that financial constraints are particularly strong in MERCOSUR. The research results (Bebczuk, 2000; Schmuckler and Vesperoni, 2000; Bebczuk, Fanelli and Pradelli, 2002; Pires de Souza, et al., 2005) indicate that: (i) credit markets have been markedly segmented, (ii) the volume of cash flows influences investment decisions, (iii) the capital structure of firms varies greatly with the macroeconomic environment, (iv) changes in the volume of credit anticipate movements in real activity, and (v) movements in "country risk" indicators are strongly related to domestic financial variables.

Typically, when the supply of funds is scarce, firms tend to issue short-term debt or liquidate assets to cushion the effects of credit crunches and try to reduce their financial obligations. In "tranquil" periods, leverage levels tend to increase and more long-term financing is utilized. Investors, in turn, tend to increase the demand for dollar-denominated assets when the macroeconomic environment worsens. In the case of Brazil, the public sector frequently increases the proportion of its dollar-denominated debt to satisfy the investors' appetite at the cost of assuming a higher currency risk (see Pires de Souza, 2005). This characteristic, which of course is derived from the uncertainties of agents about the future of the economy, particularly with respect to monetary management, implies that an expansion of longer-run credit (either of external or internal origin) carried with it the risk of currency mismatches if the exchange rate varied significantly.

The tendency to demand dollarized, short-term instruments when macroeconomic conditions worsen is an autonomous source of difficulties. A macroeconomic consequence is that economic downturns are associated with pressures on both financial and exchange markets. When the disturbance is strong enough, it may end in "twin crises".

Problems of liquidity and duration mismatch can be linked to the behaviour of risk management by banks, and to certain features of prudential regulations (see Calomiris and Powell, 2000; Fanelli and Medhora, 2001). In Argentina, the experience has been that, when the level of perceived systemic risk increases, banks hedge against currency risk and seek a better matching of the duration of assets and liabilities. This behaviour puts financial pressure on business firms and can lead to higher counter-party risk. The Argentine crisis indicates that when the economy is very weak, transferring risks to their business borrowers may not solve the fragility of banks.

Prices and quantities

Movements in the real exchange rate have been highly correlated with shifts in the nominal exchange rate (Fanelli, 2001). Thus, domestic price adjustments have contributed comparatively little (relative to the nominal exchange rate) to the variations in the real exchange rate (Rogoff, 1996; Froot and Rogoff, 1995; Basu and Taylor, 1999).

During the nineties, the transmission of macroeconomic impulses between the MERCOSUR countries grew significantly from quite low levels as the volume of trade expanded. In consequence, the bilateral real exchange with Brazil became an increasingly significant variable for Argentina. Fanelli (2001) examined the properties of the series using GARCH models. This study found strong volatility in the variable, with considerable effects of regime changes, such as the launching of the Argentine convertibility in 1991 and the floating (cum devaluation) of the Brazilian currency in 1999. In the case of Argentina and Brazil (perhaps because of the comparatively weaker price inertia in economies with inflationary experience), the variance around the mean is larger than for other economies, but deviations have smaller mean durations. In fact, the presence of a unit root is rejected more easily for the Argentina-Brazil bilateral real exchange rate than it is for the exchange rates of developed countries (Froot and Rogoff, 1995; Edwards and Savastano, 1999; Fanelli, 2001). That is, the bilateral real exchange rate has varied a great deal, but does not seem to have a "permanent" drift. These results may be relevant when examining the possibilities of monetary cooperation within MERCOSUR after the current crisis has passed one way or the other, but more research is needed concerning the post-crisis period.

The research on the dynamics of prices and quantities in MERCOSUR indicates that there is an inverse relationship in the short run in the three countries under analysis (Fanelli and Rozada, 2004). Whenever there is a movement above trend in prices, there is a movement below trend in output. The correlation turns positive, nonetheless, as time elapses. Brazil shows the most rapid reversion in the sign of the correlation coefficient. This seems to be counter-intuitive. According to the literature, this relationship should be positive in the short run and negative in the long run as demand impulses are stronger than supply forces in the short run, with the sign of the correlation reversed as time elapses because of the dominance of supply effects in the long run.

In the MERCOSUR context, however, this fact is not as striking as it may seem at first glance. In the region, prices tend to be above their trend under two basic circumstances. First, a demand shock (because of monetary or fiscal impulses) creates extra inflationary pressures and output expansion. As a consequence, when the impulse originates in a demand shock, we would expect the response to take the form of a positive correlation between output and price disturbances. Second, upward deviations in prices also occur when the domestic currency depreciates, usually to compensate for an external shock. The upward pressure on prices originates in the fact that pass-through coefficients tend to be high in the region. But unlike the case of demand shocks, real depreciation usually has contractionary effects on output; this is a well-documented fact in the region, particularly in the case of Uruguay and Argentina. Hence, when an external shock occurs (a "supply" shock) one would expect a negative correlation between prices and output disturbances.

The contemporaneous correlation between the real exchange rate and cyclical movements in output is negative, confirming the importance of supply shocks. Whenever the real exchange rate increases, that is, the country becomes more competitive, real output tends to fall below its trend in the ensuing periods. In the case of Uruguay and Argentina the correlation remains negative for several quarters after the change in the real exchange rate takes place. In the case of Brazil, to the contrary, the correlation coefficient soon becomes positive, indicating that real depreciation is less contractionary. It appears that Brazilian producers respond more quickly to relative prices. It could also be the case that more Brazilian firms on the verge of international competitiveness become internationally competitive immediately following a real depreciation.

In sum, the evidence presented in this section suggests that the MERCOSUR members experience more volatility than developed countries; idiosyncratic shocks are more sizable than common shocks; the supply/external financial shocks dominate demand shocks as a source of short-run disturbances; and real depreciation can trigger recessionary impulses.

Weak institutions

MERCOSUR countries have always faced strong difficulties to develop "stability-friendly" institutions. The need for a monetary framework with a well-defined institutional status and objectives that prioritize slow-moving and predictable prices are generally well understood. But the monetary regime is only one component of the institutional infrastructure: sooner or later it will be threatened if fiscal and financial policies do not cooperate to make it viable. In this regard, budgetary control represents a necessary condition for any reasonably stable monetary system to work and be sustainable. Also, it has been amply verified that financial instability can result in large fiscal costs and strong (possibly unbearable) pressures on monetary management.

But it is also true that the behaviour of the financial system is influenced by the monetary setup. A well-managed and well-capitalized banking system is a requisite to avert financial crises that may jeopardize monetary stability. However, it is not a sufficient condition since the health of the banking system depends on the macroeconomic environment. In the Argentine experience, it has been observed that the financial position of business firms can rapidly deteriorate under unfavourable macroeconomic circumstances. Clearly, when debtors are vulnerable, the solvency of banks may be at risk. Thus, the macroeconomic properties of a monetary system (including both its institutional credibility and its ability to help the economy absorb shocks) are ultimately among the main factors in its robustness or fragility. However, these depend on the presence or absence of ways for the economy to diversify its idiosyncratic risks. The matter has international aspects, both at regional and global levels. Defects in the international "architecture" may well combine with domestic misperceptions and incentive problems to hinder the development of sound and stable macroeconomic policies.

If regional agreements are going to contribute to the improvement of macroeconomic regimes, they should create tighter constraints on bad practices and facilitate institution building. The two larger MERCOSUR countries can make important mutual gains if a deeper coordination between their macroeconomic policies results in better macroeconomic practices. At present, the countries have different exchange rate policies and this may be harmful for the integration process if large shocks occur that affect one member more than others. An important step in the right direction could be to announce that the macroeconomic policies in the region will try to achieve the convergence of fundamental macroeconomic variables and the harmonization of fiscal institutions and prudential regulations.

III. Regional arrangements to support growth and integration

The design of the rules for the regional coordination of macroeconomic policies has proven to be a complex task in general and it is perhaps more difficult in the case of MERCOSUR. Two reasons are central. The first is that, under the existing rules of the regional game, the incentives to coordinate do not appear to be strong enough to prevent the prisoner's dilemma situations. The characteristics of the real depreciation of the national currencies and the regime changes that followed the Russian crises suggest that there was little concern, in practice, to internalize the costs that national policy initiatives had for the region as a whole and the resulting equilibrium was one of low intra-regional trade. This was especially harmful for the smaller members. The passive acceptance of the "bad" equilibrium implies denying the simple fact that when it comes down to constraints and opportunities, geography matters. Geography is a constraint because countries cannot choose either their neighbours or natural resources. Geography is an opportunity because neighbouring countries are in a better position to exploit the mutual advantages of trade and the opportunities for productive complementation and macroeconomic coordination. It is, of course, a task for the national policies to change the rules of the game so as to create the right incentives to exploit the windows of opportunity that exist at the regional level.

The second reason is that the features of the macroeconomic dynamics that we analysed in the two previous sections pose severe constraints on the ability to build the necessary institutions for the design, implementation, and enforcement of a macroeconomic regime defined at the regional level. This means that the "technical" difficulties to design an effective coordination framework would remain even though the polities could face the political economy challenge successfully. The characteristics of macro fluctuations, regional co-movements, trade specialization patterns, and volatile capital flows suggest that these difficulties can be important. In addition, the succession of events with respect to financial stress following the Asian crisis indicate that the institutions of the international financial architecture (IFA) have not been able to help emerging countries diversify national risk and thus, avoid marked downturns and financial collapse.

These two reasons suggest that for macroeconomic coordination to progress, it is crucial to identify how the incentives to coordinate can be strengthened and to design a strategy for the implementation of the coordination framework that can work under conditions of excess volatility This strategy should also take into account that the international financial architecture is far from developing-country friendly. In what follows, we will elaborate on the implications of our analysis for these problems. We emphasize the role of growth, institution building at the regional level, aggregate volatility, deep financial integration, and the relationship between initiatives at the regional and multilateral levels.

The challenge of growth and the building of regional institutions

We have seen that MERCOSUR countries share three characteristics: low growth, high volatility and some weak economic institutions. Can a regional arrangement be instrumental to restoring growth, strengthening institutions and securing stability?

From our discussion it follows that a pressing political goal of the four members is to restore sustainable growth. MERCOSUR can be instrumental to this objective to the extent that it contributes to improving the specialization pattern. We have seen that the technological sophistication of intra-regional trade is higher. Hence, by promoting trade, the regional agreement could greatly help to increase productivity and improve the trade specialization pattern. Although the specific analysis of trade issues goes beyond the scope of this paper, we must take into account that the diversification of trade could greatly facilitate aggregate risk management. Trade diversification mitigates aggregate fluctuations to the extent that it reduces the incidence of terms of trade shocks.

If regional integration does not change the pattern of external trade, the regional members will continue to depend heavily on the net exports of primary goods to finance the net imports of industrial products and, particularly, the import of capital goods that are essential to ensuring the accumulation of capital and knowledge in the region. These characteristics of the trade specialization pattern have important consequences for the macroeconomic dynamics and suggest that macro, "industrial" and "structural" policies are far from independent. If we assume that any policy measure to smooth macroeconomic fluctuations is, by definition, counter-cyclical, it may be useful to distinguish between *short-run* and *structural* counter-cyclical policies. Short-run policies smooth fluctuations, taking the economic structure and the macroeconomic regime as given. Structural policies transform the structure and/or the macroeconomic regime to reduce the size and frequency of cyclical movements. The distinction is a natural consequence of our previous arguments that stressed the role of market failures, institutional flaws and some features, such as the trade specialization pattern, as sources of macroeconomic instability. This distinction implies that a program of structural reforms may include counter-cyclical policies, such as measures to complete the market structure and increase its efficiency (to remedy instability-generating market failures); initiatives to restructure institutions and to ensure enforcement of law and regulations, and so on. Note that this view is akin to the optimum currency area approach (Mundell, 1961). It considers structural features to assess the convenience of a specific exchange rate regime and the scope and effectiveness of macroeconomic policies.

Institutional weaknesses severely constrained the ability of the authorities to respond to the challenges faced by integration in the turbulent years of the period 1999–2002. Since it is the polity that builds institutions and growth is essential to strengthen and legitimate the government politically, it is clear that MERCOSUR's contribution to trade diversification and growth and the process of building regional institutions are not independent developments. This suggests that regional institutions and regional determinants of growth should not be analysed independently.

The preoccupation with growth and institutions, nonetheless, does not appear only within the context of MERCOSUR. One distinctive characteristic of the nineties was the enthusiasm with Regional Integration Agreements (RIAs) (World Bank, 1999). The RIAs were perceived, in the first place, as an instrument for integration with the global economy, suitable for increasing trade flows and fostering foreign direct investment. Growth – and the closing of the "great divergence"[8] – was implicitly assumed to be a developing country's ultimate goal to join a RIA. However, the "details" of how integration with the world economy would result in an overall and sustained acceleration of productivity growth were not fully spelt out. Neither did the literature discuss in "detail" the problems posed by institution building. The supply of blueprints was varied but the implicit assumption in this case was that – independently of the blueprint guiding engineering works – the European Union's impressive ability to build regional institutions was the benchmark.

After more than a decade of high activity regarding the formation of RIAs, the enthusiasm of the 1990s has gradually given way to a period of reflection on the quality of the results obtained. Two facts stand out: first, the results in terms of growth in general and catching up, in particular, are far from satisfactory; second, the problems posed by institution building proved to be more complicated than expected. The kinds of problems that are now being discussed are well represented by two recent and highly influential works: the World Bank's report on the lessons of NAFTA and the Sapir Report on the European Union.

These two works share the concerns regarding the results in terms of growth. In both cases, the conclusions are not optimistic. According to the Sapir Report (Sapir et al., 2003) the EU economic performance has been varied. "While macroeconomic stability has considerably improved and a strong emphasis on cohesion has been preserved, the EU economic system has failed to deliver a satisfactory growth performance." The authors of the Report propose changes to establish a "blueprint for an EU economic system capable of delivering faster growth together with stability and cohesion in the enlarged Union" (page 1). The diagnosis about institutions and policies also pinpoints a number of weaknesses.

The Report finds that the EU system of economic policies is very complex and lacks coherence. "Coherence – across instruments and objectives, across decision-makers and jurisdictions and over time – is therefore difficult to achieve inside the EU system" (page 1).[9]

In the case of the World Bank's Report (Lederman et al., 2003), the main conclusion regarding NAFTA is that "NAFTA is not enough to ensure economic convergence among North American countries and regions. This reflects both limitations of NAFTA's design and, more importantly, pending domestic reforms." The policy lessons for the FTAA are not very optimistic. "An FTAA designed along the lines of NAFTA will offer new opportunities for growth and development in LAC, particularly if improvement is achieved on some aspects of NAFTA –such as the distorting rules of origin and the anti-dumping and countervailing duties. However, significant policy and institutional reforms will be necessary in most countries to seize those opportunities" (page vi).[10] The report does not analyse how regional integration interacts with the ability to build the necessary institutions.

The recent literature on growth has emphasized the role of institutions (Acemoglu et al., 2004). Hence, it is not surprising that the concern about growth is associated with the concern about institutions. However, we must take into account that the literature on institutions shows important flaws when analysed from the perspective of the questions posed by growth and institution building in the context of a RIA. For one thing, this literature focuses on the domestic determinants of governance structures while international actors and relationships play an essential role in the formation of a RIA. In fact, to tackle this problem, it is necessary to complement the growth/institutions literature with the contributions of the literature on the role of international regimes. There are a number of contributions that forcefully argue that the characteristics of the international scenario affect the evolution of the domestic economy and put severe constraints on the governance structures and policy regimes that are suitable to sustaining the growth process and a successful integration with the international flows of trade and capital (Basu and Taylor, 1999). This raises two points – highly relevant to RIAs in general and MERCOSUR in particular–that the regional authorities must face. First, what is the relationship between domestic governance rules and regional or international rules? For example, is it sensible to import institutions (as is the case of European accession countries)? Is the institution building process easier or more complicated? Second, the literature has basically emphasized that bad institutions generate bad policies and, therefore, we need to improve institutions to improve policies. However, the role of supranational institutions is largely unknown and, more importantly, the Sapir report clearly states that, in the case of the European Union, the outstanding ability to build institutions may not generate high-quality policies. In addition, the idea that good policies naturally follow from good institutions has also been questioned (Glaeser et al., 2004).

In the 1990s, the main points in the agenda were those associated with the creation of a RIA and the comparison with alternative strategies such as unilateral opening. Hence, the centre stage corresponded to trade diversion vs. trade creation, the problems posed by the establishment of rules of origin, the implications of a common external tariff, and the implications of deeper integration. The current preoccupation with growth, institutions, and policies gave rise to a policy agenda on RIAs that substantially differs from this one. Important roles now correspond to the identification of the new opportunities that the formation of a RIA can open to growth, and the non-traditional advantages that a regional governance structure can imply in terms of credibility and the facilitation of institution building concerning the macroeconomic regime.

Volatility matters

It is crucial to solve the problem of the incentives to coordinate trade. It is clear that the larger intra-regional trade is, the stronger the incentives are to coordinate the macroeconomy. But it is also true that trade is low to a certain extent precisely because of the lack of macroeconomic coordination. To break this vicious circle, political will is key. The agreement is under strong political pressure because the four members have been dealing with sizable shocks since 1999 and the consequences were highly detrimental to the integration process. Under these circumstances, the most important challenge that the bloc is facing is the recovery of the dynamic that the integration process showed in the pre-shock period, before 1998. Macroeconomic instability has been and is still perceived by the authorities as one of the main – perhaps *the* main obstacle – to deepening the process of integration and a variety of proposals have addressed this problem. They go from soft macroeconomic coordination initiatives (i.e. periodic meetings of economic authorities) to appeals to advance firmly toward a monetary union. But, beyond the specifics of each proposal, we think that one important conclusion that follows from this paper is that the problems that policymakers must solve to harmonize the MERCOSUR's macroeconomies are different from those that, say, the European Union was facing when the architecture of the future monetary union was being designed and built. In this sense, we would like to highlight the following points that were raised in our work.

First, volatility matters, and matters especially in the case of recent regional agreements. We have seen that shocks (for example, supply shocks) in MERCOSUR countries tend to be larger and that departures from trends tend to die out more quickly. These characteristics appear to be shared with those countries that were peripheral when the European monetary union was being formed and with the United States regions specializing in the production of commodities. In this sense, the basic insight of the OCA approach that calls for establishing a strong analytical link between the characteristics of the economic and the trade structure on the one hand, and the macroeconomy on the other, seems to be particularly suitable for understanding the cycle in recent regional agreements.

Second, the decomposition of cyclical fluctuations into a common and an idiosyncratic component uncovered a rich set of interactions that lie behind series co-movements. In particular, it seems that common factors originating in impulses stemming from changes in investor's sentiment are relevant to explaining regional output co-movements and that spillover effects between neighbours are significant. Likewise, we have detected that the country-specific cycle accounts for a large part of total output variance. These two points have important implications for macroeconomic policy coordination, which are largely unexplored. For example, while it seems sensible that the IMF helps these countries to manage the effects of common global shocks that cannot be diversified away within the region, the members of the region could take some steps to diversify the idiosyncratic risks associated with the country-specific cycle. More simply, there could be a division of labour in risk management. The IMF would help countries to hedge "systematic" global risk and the countries would develop an institutional framework to manage those risks that could be diversified away within the regional agreement, for example, via reserve funds or new fiscal instruments developed at the regional level.

Third, finance matters for both volatility and output/price dynamics. We have detected a relationship between the common regional cycle and changes in financial conditions – as represented by the country risk premium. We have also called attention to the fact that financial accelerator effects may be important in explaining some features of the output/price dynamics. This indicates that a more stable access to international capital markets could greatly help to stabilize regional fluctuations.

Financial integration

The importance of financial intermediation, however, goes beyond its influence on macrodynamics. Financial integration is a key component of the deep integration process in a single market. There are two main reasons. First, financial markets are an important segment of the services sector. Second, financial intermediation is essential to the functioning of the market economy as a whole because of the role that it plays in the inter-temporal allocation of resources, the management of risk, and the generation of liquidity. Higher financial deepening positively influences static efficiency, growth dynamics, and the management of aggregate risks.

The most ambitious attempt at integrating regional financial markets was put into practice by the European Union. The authorities of the European Union perceived the integration of financial markets to be of central relevance to the consolidation of the monetary union and a more dynamic single market. According to the EU authorities, deep financial integration can only be achieved if the barriers to cross-border financial activities are effectively abolished. Based on this view, the European Commission launched the Financial Services Action Plan (FSAP) in the spring of 1999. Although this is a major undertaking, it has been recognized that the legislative framework in itself cannot achieve an effective integration of the market. The elimination of obstacles that have to do with differences in the practices and organizations of the private sector in each member state plays a central role. Of course, a critical element that cements the financial integration efforts is the Eurosystem. The Eurosystem is the arrangement between the European Central Bank and the National Central Banks of the member states. It governs the monetary side of the economy and is responsible for defining and implementing the single monetary policy in the euro area.

In the case of MERCOSUR, financial integration can also play a key role. In fact, it could be argued that the development of financial markets could make a marginally more important contribution to growth, efficiency, and stability, than in the case of the EU, given the underdevelopment of regional financial markets and the much higher degree of segmentation between national financial markets (Fanelli and Heymann, 2002).[11] Regrettably, the benefits are higher, but the obstacles to financial integration are also stronger. First, the cross-border financial transactions and the participation of financial institutions of one member state in the market of the others are minimal; second, there is no monetary policy coordination; third, the institutional infrastructure is weak and dissimilar and the member countries have not been able to build regional institutions.

In sum, potential benefits are high but financial integration has to begin practically from scratch. In order to meet the objective of deep financial integration the following specific points should be taken into account: (i) it is reasonable to expect that the greater coordination of the macroeconomy would be of significant help, especially if it results in the consolidation of a regional nominal anchor for regional financial contracts; (ii) the consistency between the regulatory framework for regional financial integration and the regional coordination of monetary regimes must be ensured; (iii) the authorities should select what type of intermediaries and institutions should be prioritized at the regional level. Our view is that the first financial activities to be developed should be those that present the most profitable combination in terms of the trade off between institutional building requirements on the one hand, and potential contributions to fostering growth and improving the management of risks and liquidity on the other; (iv) there must be an effort to identify obstacles and opportunities. The following are examples of little-known issues:

- *Identification of obstacles to integration*: Differences in: legal and tax systems; regulations; private sector practices (informal rules, language, cultural barriers), industrial standards; the technological level of intermediaries; monetary frameworks; the degrees of banks' resilience and the volatility of returns; market structures and the degrees of competition; policies regarding the opening of the capital account; the degree of access to international markets; the linkages with the International Financial Institutions.

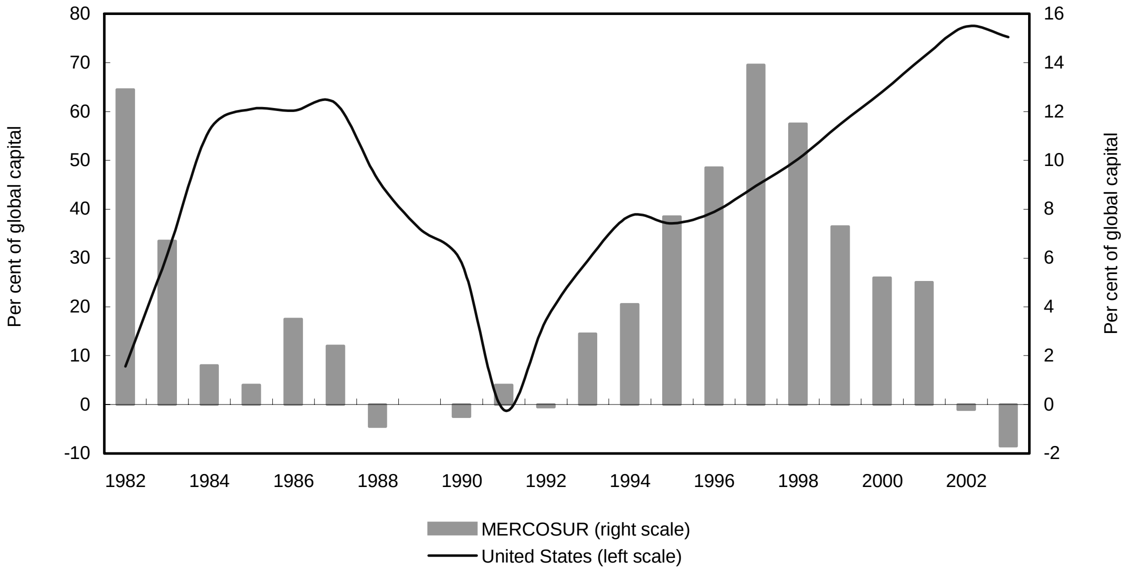
- *Identification of opportunities for*: better diversification of idiosyncratic risks; better management of aggregate risks and the development of regional stabilization funds; cross listing of stocks in the regional markets; increases in intraregional foreign investment; the development of regional bonds markets and the financing of large regional infrastructure projects.

MERCOSUR, the IFA and national risk management

In the present international scenario there is not too much room for autonomy. The regional authorities must learn to pursue their best interests in an increasingly interdependent world. This means that policies must be designed with an eye both on the region and on the global setting. To be sure, this does not deny that the quality of domestic policies and institutions matters a lot in the current situation. International initiatives should complement rather than replace consistent national policies. But, this said, note that national efforts may not be sufficient to ensure sustainable growth in the post-Bretton Woods world, characterized by broad swings in real exchange rates and in the United States demand for international capital; significant deregulation of trade and financial transactions; and, the greater importance of capital flows, which can be highly volatile. Increased volatility and interdependence have given rise to difficult policy challenges because they simultaneously increased the demand for volatility-reducing policies and severely restrained the domestic authorities' autonomy. One expression of this was the appearance of the "trilemma" (Frankel, 1999), that is, the necessity to choose between autonomous monetary policy, exchange rate stability, and free capital mobility. To be sure, the diversity of the existing exchange rate arrangements in developing

Figure 4

MERCOSUR AND THE UNITED STATES: USES OF GLOBAL CAPITAL, 1982–2003



countries suggests that there is scope for intermediate solutions between fixing and pure floating. But, the depth of the recent crises in the region suggests that emerging economies are facing particularly severe constraints on their ability to implement effective counter-cyclical policies.

These challenges call for creative policy responses to complement domestic counter-cyclical efforts with the development of new policy instruments in the regional and multilateral ambits. In this regard, the MERCOSUR countries can reap important benefits from establishing mechanisms designed to operate at the regional levels. Obviously, this demands efficient coordination of the different decision-making levels. But the potential benefits of facing the challenge in terms of institution building are worth the effort.

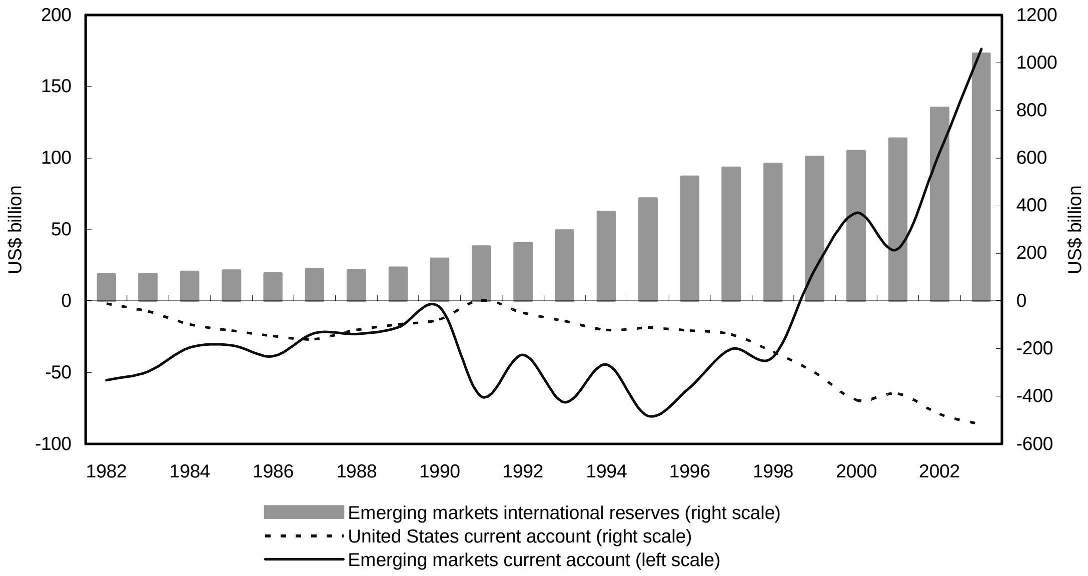
What goals should the MERCOSUR countries pursue in negotiating the regional and multilateral "counter-cyclical" agenda? From our analysis it follows that they need arrangements that can help to:

- minimize the volatility of national income;
- ameliorate international capital market imperfections;
- minimize the variance of foreign exchange proceeds;
- develop international institutions to support.

Of course, establishing these goals at the regional level does not mean that multilateral institutions and organizations dominated by developed countries like the G7 should not contribute to the stabilization effort. In particular, these institutions could develop

Figure 5

EMERGING MARKETS AND THE UNITED STATES CURRENT ACCOUNT, AND EMERGING MARKETS INTERNATIONAL RESERVES, 1982–2003



mechanisms to manage the consequences of “systematic” or “global” risks, that is, risks that originate from global coordination failures and spillover effects inherent to the operation of the world economy. These organizations have comparative advantages in helping developing countries to:

- smooth volatility of financial flows and eventually alleviate credit rationing;
- manage disequilibria induced by misalignments in key macroeconomic variables in developed countries (e.g. real exchange rate variations, sudden changes in fiscal or monetary policies that change financial conditions, the United States demand for external funds).

The current international situation, however, is not encouraging in this regard. Two facts are extremely disappointing. The first is that the huge increase in the use of international capital by the United States has *de facto* crowded out the MERCOSUR countries in international capital markets. Figure 4 shows that there has been an inverse relationship between the uses of international capital by MERCOSUR and the United States in recent years. The second fact is that the macroeconomic response of emerging countries to the uncertain financial environment that followed the Asian crisis was to increase substantially the stock of reserves (see figure 5). This liquidity-strengthening strategy has an important opportunity cost in terms of growth forgone. It seems sensible to assume that a better exploitation of the possibilities for smoothing fluctuations operating at the regional level could help save a good part of the costs of excessive reserve accumulation.

Notes

1 See Levine (2004). It must be taken into account, nonetheless, that the goal of achieving higher financial deepening and deeper integration with international capital markets has proved to be far more difficult than expected. The countries in the region have implemented important financial reforms and liberalization measures that did not preclude financial distress episodes.

2 For the sake of brevity, this subsection concentrates on the analysis of the two largest members.

3 This section draws on Fanelli and Gonzalez Rozada (2004).

4 We did not include Paraguay because of a lack of data.

5 The unobserved components approach is usually applied to decompose an observed time series into their seasonal, trend and irregular components.

6 Bayoumi and Eichengreen (1992) divide the EC and the United States into a "core" of regions characterized by relatively symmetric behaviour and a "periphery" whose disturbances are more loosely correlated.

7 To control for endogeneity, they instrumented the country risk with its own lag and corrected for autocorrelation in the residuals with an AR(2).

8 According to Alan M. Taylor: "The Industrial Revolution implied wherever it spread – and equally, where it didn't – as countries traded among themselves, exchanging manufactures for primary products and vice versa. This was a fundamental international division of labor that had not been seen before on such a scale, and it also heralded the Great Divergence of incomes and productivity in the last two centuries" (Taylor, 2002: 6).

9 This opinion, nonetheless, has not gone uncontested. Blanchard (2004) argues that part of the increase in productivity was used for increasing leisure rather than increasing monetary income.

10 "In particular, the reforms will need to focus on reducing macroeconomic instability, improving the investment climate and the institutional framework, and putting in place an education and innovation system capable of fostering technological advancement and productivity growth. In addition, regional trade integration will have to be accompanied by unilateral, bilateral and multilateral actions on other trade fronts to maximize the gains from trade liberalization and reduce the possible costs from trade diversion caused by the FTAA " (page vi). Of course, one may wonder why a country should prioritize joining FTAA in the first place if the country can meet all these conditions. It is as if the growth capability of the country were to help FTAA to be successful rather than the other way around.

11 The literature on financial intermediation in developing countries has produced sound analytical arguments and abundant empirical evidence on the links between finance and growth (See, for example, Levine, 1997).

References

Acemoglu D, Johnson S and Robinson J (2004). Institutions as the Fundamental Cause of Long-Run Growth. *NBER Working Paper* 10481. Cambridge, MA, National Bureau of Economic Research.

Bayoumi T and Eichengreen B (1992). Shocking Aspects of European Monetary Unification. *NBER Working Paper* 3949. Cambridge, MA.

Basu S and Taylor A (1999). Business Cycles in International Historical Perspective. *Journal of Economic Perspectives*, 13 (2).

Bebczuk RN (2000). Corporate Saving and Financing Decisions in Argentina. *Economica*. La Plata.

Bebczuk RN, Fanelli J M and Pradelli JJ (2002). Determinants and Consequences of Financial Constraints Facing Firms in Argentina. *Research Network Working Papers*, R-453. Research Department, IADB-CEDES, Buenos Aires.

Blanchard O (2004). The Economic Future of Europe. *NBER Working Paper* 10310. Cambridge, MA.

Calomiris CW and Powell A (2000). Can Emerging Market Bank Regulators Establish Credible Discipline? The Case of Argentina, 1992–1999. *NBER Working Paper* 7715. Cambridge, MA.

Edwards S and Savastano MA (1999). Exchange Rates in Emerging Economies: What Do We Need to Know? *NBER Working Paper* 7228. Cambridge, MA.

Eichengreen B and Taylor AM (2003). The Monetary Consequences of a Free Trade Area of the Americas. *NBER Working Paper* 9666. Cambridge, MA.

Fanelli JM (2001). Coordinación Macroeconómica en el MERCOSUR. Marco analítico y hechos estilizados. In: Fanelli JM, ed., *La coordinación macroeconómica en el MERCOSUR*. Siglo XXI de Argentina Editores.

Fanelli JM (2005). Notes on International Volatility for the Country Studies. Mimeo.

Fanelli JM and Gonzalez Rozada M (2004). Business Cycle and Macroeconomic Policy Coordination in Mercosur. Mimeo. CEDES, Buenos Aires.

Fanelli JM and Heymann D (2002). Monetary Dilemmas in Argentina, *Revista de Desarrollo Económico*, 42 (165): 3–24.

Fanelli JM and Medhora R (2001). The Emerging International Financial Architecture and Its Implications for Domestic Financial Architecture. Latin America Research Group, Federal Reserve Bank of Atlanta. Proceedings of the Conference *Domestic Capital and Global Finance in Latin America*. Miami, Florida, 1–2 November. www.frbatlanta.org/index.cfm.

Fanelli JM, Gonzalez Rozada M and Keifman S (2001). Comercio, Régimen Cambiario y Volatilidad. Una visión desde la Argentina de la coordinación macroeconómica en el MERCOSUR, en Coordinación de políticas macroeconómicas en el MERCOSUR. Red de Investigaciones Económicas del MERCOSUR, Siglo XXI de Argentina Editores, chap. 2: 25–70, April.

Froot KA and Rogoff K (1995). Perspectives on PPP and Long-run Real Exchange Rate. In: Grossman G and Rogoff K, eds., *Handbook of International Economics*, Vol. III, chap. 32: 1647–1688.

Graeser E, La-Porta R, Lopez-de-Silanes F and Shleifer A (2004). Do Institutions Cause Growth? *NBER Working Paper* 10568. Cambridge, MA.

Heymann D and Navajas F (1998). Coordinación de Políticas Macroeconómicas en el Mercosur: Algunas Reflexiones. In: *Ensayos Sobre la Inserción Internacional de la Economía Argentina, Documento de Trabajo,* 81. CEPAL.

Kenen P (1969). The Theory of Optimum Currency Areas: An Eclectic View. In: Mundell RA and Swoboda AK, eds., *Monetary Problems of the International Economy*. University of Chicago Press.

Kouparitsas M (2002). Understanding U.S. regional cyclical comovement: How important are spillovers and common shocks? *Economic Perspectives*, 4th quarter, 26: 30–41. Federal Reserve Bank of Chicago, Chicago.

Lederman D, Maloney W and Serven L (2003*).* Lessons From NAFTA for Latin America and the Caribbean Countries: *A Summary of Research Findings*, World Bank, Washington, DC.

Levine R (1997). Financial Development and Economic Growth: Views and Agenda. *Journal of Economic Literature*, 35 (2): 688–726.

Levine R (2004). Finance and Growth: Theory and Evidence. *NBER Working Paper* 10766. Cambridge, MA.

Mundell R (1961). The Theory of Optimum Currency Areas. *American Economic Review,* 51.

Obstfeld M and Rogoff K (1996). Foundations of International Macroeconomics. MIT Press, Cambridge, MA.

Pires de Souza F, Borges da Silva G and Cardim de Carballo F (2005). International Financial Architecture, Macro Volatility and Institutions: *The Developing World Experience. Country Study: Brazil*. Presented at the ECLAC/CEDES Workshop on "International Financial Architecture, Macro Volatility, and Institutions: The Developing World Experience". Santiago de Chile, November.

Rogoff K (1996). The Purchasing Power Parity Puzzle. *Journal of Economic Literature*, 34 (2): 647–668. The American Economic Association, United States, June.

Sapir A et al. (2003). An Agenda for a Growing Europe. Making the EU Economic System Deliver. Mimeo. World Bank, Washington, DC.

Schmuckler S and Vesperoni E (2000). Does Integration with Global Markets Affect Firm's Financing Choices? Evidence from Emerging Economies. Mimeo. World Bank, Washington, DC.

Taylor AM (2002). Globalization, Trade and Development: Some Lessons from History. *NBER Working Paper* 9326. Cambridge, MA.

Watson MW (1986). Univariate detrending methods with stochastic trends. *Journal of Monetary Economics*, 18: 49–75.

World Bank (1999). Trade Blocs and Beyond: Political Dreams and Practical Decisions, *Draft Policy Research Report*. World Bank, Washington, DC, October.

G-24 Discussion Paper Series*

Research papers for the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development

No. 45	April 2007	Sheila PAGE	The Potential Impact of the Aid for Trade Initiative
No. 44	March 2007	Injoo SOHN	East Asia's Counterweight Strategy: Asian Financial Cooperation and Evolving International Monetary Order
No. 43	February 2007	Devesh KAPUR and Richard WEBB	Beyond the IMF
No. 42	November 2006	Mushtaq H. KHAN	Governance and Anti-Corruption Reforms in Developing Countries: Policies, Evidence and Ways Forward
No. 41	October 2006	Fernando LORENZO and Nelson NOYA	IMF Policies for Financial Crises Prevention in Emerging Markets
No. 40	May 2006	Lucio SIMPSON	The Role of the IMF in Debt Restructurings: Lending Into Arrears, Moral Hazard and Sustainability Concerns
No. 39	February 2006	Ricardo GOTTSCHALK and Daniela PRATES	East Asia's Growing Demand for Primary Commodities – Macroeconomic Challenges for Latin America
No. 38	November 2005	Yilmaz AKYÜZ	Reforming the IMF: Back to the Drawing Board
No. 37	April 2005	Colin I. BRADFORD, Jr.	Prioritizing Economic Growth: Enhancing Macroeconomic Policy Choice
No. 36	March 2005	JOMO K.S.	Malaysia's September 1998 Controls: Background, Context, Impacts, Comparisons, Implications, Lessons
No. 35	January 2005	Omotunde E.G. JOHNSON	Country Ownership of Reform Programmes and the Implications for Conditionality
No. 34	January 2005	Randall DODD and Shari SPIEGEL	Up From Sin: A Portfolio Approach to Financial Salvation
No. 33	November 2004	Ilene GRABEL	Trip Wires and Speed Bumps: Managing Financial Risks and Reducing the Potential for Financial Crises in Developing Economies
No. 32	October 2004	Jan KREGEL	External Financing for Development and International Financial Instability
No. 31	October 2004	Tim KESSLER and Nancy ALEXANDER	Assessing the Risks in the Private Provision of Essential Services
No. 30	June 2004	Andrew CORNFORD	Enron and Internationally Agreed Principles for Corporate Governance and the Financial Sector
No. 29	April 2004	Devesh KAPUR	Remittances: The New Development Mantra?
No. 28	April 2004	Sanjaya LALL	Reinventing Industrial Strategy: The Role of Government Policy in Building Industrial Competitiveness
No. 27	March 2004	Gerald EPSTEIN, Ilene GRABEL and JOMO, K.S.	Capital Management Techniques in Developing Countries: An Assessment of Experiences from the 1990s and Lessons for the Future
No. 26	March 2004	Claudio M. LOSER	External Debt Sustainability: Guidelines for Low- and Middle-income Countries
No. 25	January 2004	Irfan ul HAQUE	Commodities under Neoliberalism: The Case of Cocoa
No. 24	December 2003	Aziz Ali MOHAMMED	Burden Sharing at the IMF
No. 23	November 2003	Mari PANGESTU	The Indonesian Bank Crisis and Restructuring: Lessons and Implications for other Developing Countries
No. 22	August 2003	Ariel BUIRA	An Analysis of IMF Conditionality

G-24 Discussion Paper Series*

Research papers for the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development

No. 21	April 2003	Jim LEVINSOHN	The World Bank's Poverty Reduction Strategy Paper Approach: Good Marketing or Good Policy?
No. 20	February 2003	Devesh KAPUR	Do As I Say Not As I Do: A Critique of G-7 Proposals on Reforming the Multilateral Development Banks
No. 19	December 2002	Ravi KANBUR	International Financial Institutions and International Public Goods: Operational Implications for the World Bank
No. 18	September 2002	Ajit SINGH	Competition and Competition Policy in Emerging Markets: International and Developmental Dimensions
No. 17	April 2002	F. LÓPEZ-DE-SILANES	The Politics of Legal Reform
No. 16	January 2002	Gerardo ESQUIVEL and Felipe LARRAÍN B.	The Impact of G-3 Exchange Rate Volatility on Developing Countries
No. 15	December 2001	Peter EVANS and Martha FINNEMORE	Organizational Reform and the Expansion of the South's Voice at the Fund
No. 14	September 2001	Charles WYPLOSZ	How Risky is Financial Liberalization in the Developing Countries?
No. 13	July 2001	José Antonio OCAMPO	Recasting the International Financial Agenda
No. 12	July 2001	Yung Chul PARK and Yunjong WANG	Reform of the International Financial System and Institutions in Light of the Asian Financial Crisis
No. 11	April 2001	Aziz Ali MOHAMMED	The Future Role of the International Monetary Fund
No. 10	March 2001	JOMO K.S.	Growth After the Asian Crisis: What Remains of the East Asian Model?
No. 9	February 2001	Gordon H. HANSON	Should Countries Promote Foreign Direct Investment?
No. 8	January 2001	Ilan GOLDFAJN and Gino OLIVARES	Can Flexible Exchange Rates Still "Work" in Financially Open Economies?
No. 7	December 2000	Andrew CORNFORD	Commentary on the Financial Stability Forum's Report of the Working Group on Capital Flows
No. 6	August 2000	Devesh KAPUR and Richard WEBB	Governance-related Conditionalities of the International Financial Institutions
No. 5	June 2000	Andrés VELASCO	Exchange-rate Policies for Developing Countries: What Have We Learned? What Do We Still Not Know?
No. 4	June 2000	Katharina PISTOR	The Standardization of Law and Its Effect on Developing Economies
No. 3	May 2000	Andrew CORNFORD	The Basle Committee's Proposals for Revised Capital Standards: Rationale, Design and Possible Incidence
No. 2	May 2000	T. Ademola OYEJIDE	Interests and Options of Developing and Least-developed Countries in a New Round of Multilateral Trade Negotiations
No. 1	March 2000	Arvind PANAGARIYA	The Millennium Round and Developing Countries: Negotiating Strategies and Areas of Benefits

* ***G-24 Discussion Paper Series*** are available on the website at: **www.unctad.org**. Copies of ***G-24 Discussion Paper Series*** may be obtained from the Publications Assistant, Macroeconomic and Development Policies Branch, Division on Globalization and Development Strategies, United Nations Conference on Trade and Development (UNCTAD), Palais des Nations, CH-1211 Geneva 10, Switzerland; Fax (+41-22) 917.0274.