

# CEPAL

## Review

*Executive Secretary of ECLAC*  
Gert Rosenthal

*Deputy Executive Secretary*  
Carlos Massad

*Director of the Review*  
Anibal Pinto

*Technical Secretary*  
Eugenio Lahera



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A blank space in a table means that the item in question is not applicable.

A minus sign (-) indicates a deficit or decrease, unless otherwise specified.

A point (.) is used to indicate decimals.

A slash (/) indicates a crop year or fiscal year, e.g., 1970/1971.

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# CEPAL

## Review

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## Latin American integration and external openness

*Germánico Salgado\**

The economic integration of the region reached a turning point in early 1984. From that moment on, there has been a growing number of initiatives that have given dynamism to what was a languishing process. According to the author, this new surge towards integration is the region's response to a world that seems to be restructuring itself into large economic groupings.

Two stages can be distinguished in this process of reactivation: a first stage, which could be described as cautious and rather timid, and a second one which began with the agreement between Argentina and Brazil in mid-1986. This latter stage reflects an intention to speed up and deepen economic integration by resorting to new forms or to much greater openness at a more rapid pace.

The signs of openness in the region's economies are more and more frequent, to the point where economic integration should be seen rather as a derivative of a wider attitude that seeks to shift the centre of gravity of development policy towards the world market. Indeed, in some cases trade was first liberalized with third countries, so that what took place with regional integration was only an extension of what was taking place with foreign trade systems in general. On the other hand, there has been no significant progress in fields that are critically important for reintegration, such as payments clearing arrangements and balance-of-payments support systems.

Can indiscriminate opening-up to the international economy be reconciled with regional integration? It may be assumed that as both processes advance, it will be necessary to decide to give priority to one or the other, unless it is possible to find levels of openness and selections of activities which make them compatible. The author concludes that without a significant margin of preference it would be useless to propose the integration of markets, and still less the integration of production.

Selective integration would be easier to reconcile with the general trend towards openness. The aspects of the integration processes that merit the most attention are the most dynamic currents of intraregional trade and the development of activities with a high knowledge content and those that are critical for progress in the transformation of production.

\*Ecuadorian consultant specializing in regional integration policies.

## I

### Recollection and homage

Interest in economic integration has sprung back to life in recent years in Latin America. The short-term economic situation has continued to be unfavourable, but apparently uncertainty about the future and awareness of Latin America's diminishing part in the world concert were even stronger motives. At first sight there is something in common between this moment and that time long ago when the first steps towards integration in the region took shape: the Central American Common Market in 1960 and the Latin American Free Trade Association (ALALC) in 1961, both of which were decisively influenced by the signing of the Treaty of Rome (1957) and the early dynamism of the European Economic Community (EEC). Now the impetus is coming from a multitude of initiatives, among them once again the EEC, with its Single European Act as perhaps the most relevant example.

But there are differences. Towards the end of the 1950s, the personality of Dr. Raúl Prebisch and the ideas of ECLAC inspired a coherent line of promotional action with clear objectives. Ultimately, however, neither ALALC nor the Central American Common Market faithfully followed Prebisch's postulates in their articles of association, and this was later to prove unfortunate.<sup>1</sup>

But neither these discrepancies nor the uneven and frustrating experience of these efforts should make us forget that the birth of Latin American integration was the result of mature reflection about the requirements for the sound development of the region. A strongly vertebrate Latin America, with all its parts closely articulated thanks to integration, was the image that Raúl Prebisch insisted on. That is what he meant when he spoke of the "globality" of regional integration: a term he used to emphasize the need for the formula chosen to include all Latin American countries, with different treatment

<sup>1</sup> See Germánico Salgado, "The Latin American regional market: the project and the reality", *CEPAL Review*, No. 7 (E/CEPAL/1084), Santiago, Chile, April 1979, pp. 85-132. United Nations publication, Sales No. E.79.II.G.2.

according to the situation of each one, but with no exclusions nor segmentations,<sup>2</sup> except for Central America, where he admitted that for the time being a subregional form of integration was called for. Never again was the integration of Latin America to be posed in such global terms, even though ever since clip-service has been paid to that old model when people speak of the remote objective of a "Latin American common market" or a "regional market".

Today, in a context of enormous instability and extreme pressure, Latin America has returned to the search for unity. As we have already noted, there is no longer a vision of the whole. There have been a number of attempts, some bold and imaginative, others virtual improvisations, but they all clearly contain an element of a makeshift response to a difficult and uncertain situation. It is also clear that now, more than ever, we need to base our efforts on a regional project elaborated by all concerned.

## II

### Once again, integration...

When the Latin American Economic Conference was held in Quito in January 1984, its call for integration appeared to be just another tip of the hat to the myth of Latin American unity. Normally the admonition would very soon have disappeared, leaving no visible trace. But this time, apparently, something else happened: the Latin American Integration Association soon thereafter initiated the regional round of negotiations, the Andean Group accelerated the preparations for its reform of the Cartagena Agreement, and Brazil and Argentina launched in record time an Economic Integration and Co-operation Programme which was unlike any of the usual agreements of this kind. Even in Central America, despite the divisions and tensions, a new spirit was born with the Esquipulas II Agreement and the signing in Guatemala of the treaty establishing the Central American Parliament and connected agencies, while in the Caribbean Community (CARICOM), the Nassau Consensus of 1984 was a genuine attempt to overcome the obstacles to intraregional trade. There were many examples of joint actions in the political and economic spheres in Latin America: the Cartagena Consensus, the Contadora Group, the Support Group and later, the Permanent Mechanism for Consultation and Policy Co-ordination, also known as the Group of Eight. Nor has there been

any lack of decisions designed to make regional co-operation a major factor in foreign policy, such as Mexico's programme with Central America, the Oil Facility of the San José Agreement on Energy Co-operation, and the Group of Eight's Acapulco Commitment to Peace, Development and Democracy in Central America.

This renewed interest in integration and co-operation has continued even more intensely since that time, giving rise to still bolder proposals, as we will see shortly.

The Latin American Economic Conference in Quito was not, of course, the only cause of this wave of initiatives: the region was deeply concerned about the future, and this led to a new reappraisal of the efforts and initiatives to promote integration and solidarity.

There are many good reasons for this concern. It would be hard to imagine a more difficult situation for Latin America than the present one. The problem of the debt is everywhere, at all levels and all times, and other issues in the region which could have much more serious consequences in the medium term are only just beginning to receive attention. Such issues could, for example, make it much more difficult for us to eventually overcome our financial straits. This is the case of the scientific and technological gap displayed by almost all the countries of the region: a gap which is steadily growing and already represents a tremendous obstacle to our entering the international economy on dynamic terms. We have lost our proper share in the expansion of world trade, especially in exports of manufactures. In relative terms, the region is now less important for foreign

<sup>2</sup> United Nations, *The Latin American Common Market (E/CN.12/531)*, Mexico City, 1959, United Nations publication, Sales No. 59.II.G.4.

investment. The already visible symptoms of the progressive deterioration of the importance of Latin America –and the developing world in general– as a source of raw materials are so well known that they scarcely need to be mentioned again here. There is a clear excess of supply, face to face with a level of demand which tends to grow only at a snail's pace because, *inter alia*, production increasingly demands more knowledge and information and less natural resources. The prospects are no better for producers of industrial goods, whether these are barely-processed raw materials or medium-technology exports. In both cases the protectionism of the big markets places prohibitive limits on the possibilities of expansion.

And this is only one side of the economic constraints that the region has been unable to overcome. If we add to it the economic instability of almost all the countries of the region, the traumatic alternatives of adjustment policies, and stagnating production with its consequent high unemployment, we have a partial explanation for the growing demoralization of the more educated elements of the population, especially young people. The lamentable period of boundless political repression in the 1970s has left open wounds in many countries. On top of that, we are now in a period of constant constraints, bordering on chaos in some countries. Not surprisingly, their best-trained citizens are once again beginning to migrate to the rich countries. Before, the reason was repression or violence; now it is unemployment, uncertainty and the almost total lack of horizons.

Naturally, the problems are not this extreme throughout the entire region, and in some countries the prospects may even be quite encouraging. The vast majority of the population of the region, however, is living in a truly difficult situation, and moreover has been doing so for more than a decade. For that majority, the brief reference we have made to their hardships is neither tendentious nor exaggerated. It is true that there are positive facts to put on the other side of the scale, such as the spread of democratic political forms, which are undoubtedly an asset. But, at the same time, we also cannot forget that many countries of the region have suffered or still suffer from scourges like political violence or drug trafficking.

I have painted this scene in strong colours because I believe that we must seek the explanation for much of what is happening now in Latin America in the

marks these difficulties and problems have left on the typical Latin American, be he simple citizen or political leader. When facing the rest of the world, and especially the industrialized world, Latin Americans feel like persons in desperate straits, who, moreover, have lost the solidarity of all the other poor countries. In spite of some recent signs of attention by the United States, Latin Americans perceive that the region's problems are steadily losing importance for that country and the other rich countries. The best symbol of this attitude is the title of a book recently published in Colombia which sums up the results of a seminar. The book is entitled *América Latina se ha quedado sola* (Latin America has been left on its own),<sup>3</sup> and despite its somewhat dramatic tone it reflects a state of feeling which explains certain special features of the situation, as we shall see below.

One of these features is this rebirth of the motivation for integration, after this ideal had vegetated for decades, except in the mind's of a few highly motivated people, at a time when the circumstances –especially the degree of macro-economic imbalance affecting almost all the countries– make it particularly difficult to embark on such a difficult enterprise. This interest in integration has clearly returned not only because of the logical need for joint action or bigger scales of production, but also because of the example of the more powerful countries, which have already organized themselves into integrated blocs or are in the process of doing so. A look at the international economy during these years clearly shows effects of the tension of intense competition –today, without a doubt, even stronger than political rivalry, which is diminishing– so it is natural to unite in order to gain increased power. Jacques Delors, one of those responsible for the impact caused by the Single European Act, openly expresses this motivation when he states that the signatories of the Act are competing in a worldwide race where the stakes are economic survival and, ultimately, the capacity for expression and political action.<sup>4</sup>

<sup>3</sup> Alvaro Tirado Mejía, *et al.*, *América Latina se ha quedado sola*, Bogotá, Santillana, 1989.

<sup>4</sup> Paolo Cecchini, foreword to *Europa 1992: una apuesta de futuro*, Madrid, Alianza Editorial, 1988, p. 9.

That is the view of a European who, as we mentioned, was the driving force behind the Single European Act. According to this same Act, by the end of 1992 the internal market of the Europe of the Twelve will have been established as, "a space with no internal frontiers, in which the free circulation of merchandise, persons, services and capital will be guaranteed ...".<sup>5</sup>

The concern that the Single European Act signed in 1986 would lead to a "fortress Europe", closed and protected, was probably one of the reasons that led the United States to sign a Free Trade Agreement with Canada in 1988.

That concern and the evident preoccupation of the United States about the hitherto unstoppable advance of Japan as an exporter of high-technology products also explain the recent negotiations with Mexico to constitute some kind of free-trade area. There was talk that the United States was interested in incorporating Latin America into a similar arrangement, but President Bush's recent proposal to extend the free-trade area to all of the Americas—North, Central and South—was a real surprise. His intention is clear. President Bush was proposing in effect to initiate a process of creating a free-trade area for the whole hemisphere, from Anchorage to Tierra del Fuego.<sup>6</sup> This goes back, in very different circumstances, to an invitation already made to Latin America during the last century by Secretary of State Blaine.

Japan, for its part, has the Pacific Basin as a space in which to progressively build up a bloc of countries with itself as nucleus. Without resorting to any formal integration model, Japan already has close economic relations with the Association of South-East Asian Nations (ASEAN), which, though it too has no formal integration structure, nevertheless functions for all practical purposes as if it did have one. Japan also looks beyond to the great amphitheater which is the vital sphere of its business activities, congregated today in the Pacific Economic Co-operation Conference.

The dizzy changes seen in recent months also raise dramatic questions about the future evolution of the EEC. The reunification of Germany will mean the incorporation of the German Democratic Republic, and the EEC is expected to establish some kind of relationship with the other Eastern-bloc countries too, especially Hungary, Poland and Czechoslovakia.

Thus, as it emerges from the turbulent 1980s, the world is made up of groups of States—blocs is a better word to express their growing cohesion—gathered around the United States, Western Europe, the Soviet Union as it emerges from "perestroika", and Japan. China and India are currently hovering discreetly in the background, but no projection into the future can forget that they will have a decisive place on the international stage, with their billions of inhabitants.

Clearly, a fragmented Latin America can only look forward to a subordinate and passive fate in such a world. What is happening with this new drive towards integration is above all a response from Latin America to a world which is marching inexorably towards large groupings of States, either as common markets or, as is also probable in some cases, associations of States of a federal or confederal character.

<sup>5</sup>Single European Act", art. 13, Ibero-American Co-operation Institute (ICI) and Economic Commission for Latin America and the Caribbean (ECLAC), *Pensamiento Iberoamericano*, No. 15, January-June 1989.

<sup>6</sup>Text of the speech given on 27 June in Washington, D.C.

### III

#### The two phases of reactivation

What has happened with regard to the integration of Latin America in recent years is truly disconcerting. The process that we have described as a rebirth of integration consists in reality of two quite different phases. The first of these was a lukewarm revival, in which an attempt was made to save the existing efforts (basically ALADI, the Andean Group and CARICOM) from stagnation or regression. During this time, the Central American Common Market was suffering the consequences of its armed conflicts and little could be done to motivate it. It was kept formally alive, however, and that in itself was no small accomplishment. As for the other three groupings, ALADI initiated in this period the regional round of negotiations, the reform of the Cartagena Agreement was gradually defined and negotiated, and the Nassau Consensus was worked out at a meeting of the Conference of the Heads of Government of the Caribbean Community, held in 1984. ALADI began its regional round of negotiations in 1985 and ended the preparatory phase in 1987, which was also the year in which the Quito Protocol reforming the Cartagena Agreement was signed. Thus, this first stage of cautious and rather timid reactivation runs from 1984 to 1987.

The second stage—a radical break from the previous inertia—is characterized by the will to accelerate and deepen economic integration by resorting either to different formulas or simply to greater mutual openness and more rapid action. The Programme for Economic Integration and Co-operation between Argentina and Brazil certainly belongs to this kind of initiative. It was signed in mid-1986, chronologically towards the end of what we termed the first stage, but because of its selective character, which distinguishes it from the usual integration formulas, and its patent audacity, it merits being singled out as part of this more innovative

stage. Uruguay associated itself with the programme, albeit still in general terms, under the 1988 Alvorada agreement.<sup>7</sup>

More typical of this second stage are the recent initiatives that have modified, at least formally, the integration efforts previously mentioned. Chronologically, the first of these initiatives is the Treaty on Integration, Co-operation and Development between the Argentine Republic and the Federative Republic of Brazil (signed in November 1988), according to which the two countries undertake to establish a general free-trade area within 10 years. Next comes the approval of the Strategic Design for the Orientation of the Andean Group contained in the Galápagos Declaration adopted at the Summit Meeting of the Andean Presidents in December 1989. In comparison with the stipulations of the Quito Protocol or the Protocol Modifying the Cartagena Agreement, signed in 1987, this Strategic Design speeds up considerably the constitution of a customs union and also calls for the rapid revision of industrial programmes and another series of steps which must also be taken well before the Protocol goes into effect. This initiative, which signifies a radical acceleration of Andean integration, was preceded by the agreements to intensify trade relations between Venezuela and Colombia, and between these countries and Mexico, Central America and the Caribbean. Also, in December 1989, ALADI took initiatives to widen the scope of certain instruments and speed up the regional round of negotiations. This new attitude resulted in the approval in June 1990 of the regional agreement which substantially reinforces the Regional Tariff Preference (RTP).

<sup>7</sup>The forms of association will be progressively established later. For the time being, three protocols have been signed in this regard.



## IV

### The moment of caution

The contrast between the two phases could not be stronger. The first fully merits Juan Mario Vacchino's characterization of the spirit of the action pursued at that time, namely "... to begin a new phase, more operative, pragmatic and adapted to the conditions of an international scenario whose long-term profile is not easy to establish with any precision".<sup>8</sup> Clearly, it was not sought to make revolutionary changes in the integration schemes, and in the best of cases the aim was to get them working again and thus overcome their stagnation.

As we already mentioned, the regional round of negotiations of ALADI corresponded to this kind of initiative. It took exactly two years to move from the resolution of the Council of Ministers of Foreign Affairs in March 1985 to the adoption of the programme to establish a regional system for trade and payments (March, 1987), and in reality, the concrete results of the round are still meager. The programme put into effect in March 1987 included several specific actions: reinforcing the Regional Tariff Preference (RTP), the Regional Agreement for the Recovery and Expansion of Trade, the commitment to dismantle tariff restrictions, and the creation of a mechanism to offset trade imbalances.

As we can see, the scheduled content of the regional round of negotiations is symptomatic of a more open and decisive attitude towards the intensification of regional trade than the approach taken up till then in ALALC and later in ALADI. However, the initial negotiations were entered upon with reservations, and the results did not come up to expectations.

In the Regional Tariff Preference—the Latin American preference that received so much attention when the ALADI treaty was negotiated—a basic preference of 10% was agreed for countries of the same class, while the maximum preference reached 22% for the landlocked countries. These are useful concessions, but not enough to bring about noticeable changes in trade.

<sup>8</sup> See Juan Mario Vacchino, "Esquemas latinoamericanos de integración. Problemas y desarrollo", *Pensamiento Iberoamericano*, No. 15, Madrid, ICL/ECLAC, January-June, 1989, p. 69.

In its early decisions, the Regional Agreement for the Recovery and Expansion of Trade formulated the ambitious goal of diverting towards the region 30% of imports from third countries, with basic preferences of around 60%. These initial aspirations were considerably reduced in the course of the negotiations, especially in the case of those relating to the percentages of diversion of trade with third parties, which finally stood at amounts varying from 2% to 20%, according to the class of country: certainly far below the 30% originally planned.

The rest of the elements of the agreement were in serious danger of becoming a dead letter. The elimination of non-tariff restrictions did not seem feasible for some countries that depended on those instruments to defend themselves from balance-of-payments problems, and moreover the agreement included a multitude of exceptions which reduced its effectiveness. Apart from progressing on some general definitions, very little has been done to implement the mechanism for lessening the impact of imbalances in regional trade, and still less has been done to put into effect balance-of-payments support mechanisms or systems for regulating State purchases: two issues included in the regional round of negotiations because of their critical importance for regional integration.

In ALADI, the most dynamic elements have continued to be the limited-scope agreements, while the complementation agreements could also become a dynamic element in the future. By way of example, we could cite the agreements that link Uruguay with Argentina, and Brazil with Mexico; those that incorporate the matters negotiated in the integration treaty between Argentina and Brazil; the complementation agreements between Argentina and Colombia and between Colombia and Peru, and those recently drawn up between Colombia and Venezuela. Unfortunately, there has been no progress in establishing systems which would allow for converging limited-scope actions into global multi-lateral action. If multilateral instruments like the Regional Agreement for the Recovery and Expansion of Trade and the Regional Tariff Preference have no decisive effect on trade, then there would be a need for quantitatively significant preferences applicable to

a wide sphere of trade, that is to say, not limited by the mass of current exceptions, and ALADI would most probably become in the future a system of integration in which different velocities would coexist, with all the difficulties one could expect from such a complex network of bilateral relations.

As we will see later, the multilateral instruments could possibly become more important and the system could work more dynamically than in the past. That, at least, is the dominant tone today, in clear contrast with a recent past in which a cautious stinginess prevailed, particularly in the larger countries.

In spite of all these limitations, trade within ALADI grew in 1988 and 1989, the preliminary figure for total intraregional exports in the latter year being US\$10 238 million: 10.5% more than in 1988, when the value of intraregional exports had grown by 12.5% in relation to 1987, thus indicating a more or less steady recovery from the extremely low figure of US\$7 016 million recorded in 1983. Brazil and Argentina provided more than half of these exports in 1988 (56.3%), and a good part of the growth is explained by the increased trade between these two countries. The sources of trade imbalances between the members continued to be the same, and in 1988 Brazil continued to achieve positive trade balances (more than US\$1.9 billion by the end of the year).

In the present situation, the Protocol Modifying the Cartagena Agreement, or the Quito Protocol, now has an almost purely historical value, since it has been basically replaced by the Strategic Design as approved at the Galápagos Meeting. At all events, it is worth briefly examining the features of the reform made in 1987, since it offers an interesting contrast with the attitudes in vogue today.

The reform of the Cartagena Agreement as made in the Quito Protocol of May 1987, corrected an economic integration model which incorporated the technical concepts of integration common in Latin America after a decade of experience with ALALC and the Central American Common Market. With its emphasis on selective industrial programming, it further developed the old formulations of Prebisch and ECLAC which it had not been able to bring to fruition in ALALC nor in the Central American Common Market. The Cartagena Agreement was for that same reason the prototype of an integration system designed to support a policy of import substitution: in no way did it exclude the expansion of

exports to the rest of the world, but that was not an explicit objective either, since the first goal of the integration process was precisely to build a larger domestic market.

The defects that prevented the Cartagena Agreement from fulfilling its goals have been widely studied, and this is not the place to recall them. Suffice it to point out that, formally, the Andean Group had to reform its statutes once it became clear that it was impossible to approve a common external tariff and arrive at a customs union,<sup>9</sup> as called for by the Cartagena Agreement. The reform process that culminated in the Quito Protocol, that is to say, the Protocol Modifying the Cartagena Agreement, began at that time, and the preparation and negotiation of the reform went on for years. The final product, the Quito Protocol reformed the Cartagena Agreement in the following ways: i) it reduced the original demands regarding deadlines, leaving some open, like the one for adopting a common external tariff; it also allowed for restrictive systems, such as managed trade, which in fact limited the sphere of the liberalization programme; ii) several of its stipulations (especially complementation agreements between two or more countries and lists of trade managed by the countries) allow for bilateral arrangements which (as occurred in ALADI) broke the unity of the multilateral system of the original agreement; iii) industrial programming lost the central character it had in the Cartagena Agreement; the Quito Protocol maintained several forms of industrial programming, but it was evident that its use would be very limited and not very effective, especially as there was a tendency—soon becoming a virtual rule— not to assign industries to certain countries.

The Quito Protocol did, however, have the merit of breaking a years-old impasse, which had affected the credibility of the Agreement and had led to multiple failures to comply with its stipulations. The Cartagena Agreement assumed a more clearly commercial character than before and suffered the weakening of its basic compensation instrument—industrial programming—which was supposed to

<sup>9</sup> The open-economy currents which were beginning at that time (the second half of the 1970s) in Latin America and within the Andean Group partially explain the impossibility of reaching agreements about the level of tariffs.

ensure an equitable distribution of the benefits of integration. But its agencies were able to function normally and use the Agreement's renewed juridical validity to reduce non-compliance with and violations of its stipulations.

This did indeed happen, but the application of the managed-trade lists and escape clauses, as was predictable, were serious obstacles to the recovery of trade. Intraregional exports increased strongly in 1987 (from US\$662 million in 1986 to US\$1 054 million in 1987), but then dropped slightly to remain almost stationary in 1988 and 1989 (US\$974 million and US\$957 million, respectively).

It was clear that unless the managed-trade lists were suppressed, or at least reformed, it was impossible to reactivate Andean integration. That issue, however, like the revision of the industrial programmes which had been approved in the 1970s, was conflictive and urgently needed to be reformed for technical reasons. It was evident towards the end of the 1980s that the Protocol had put off the solution to some fundamental problems –among them, the very definition of the real objectives of the integration formula– while it had created other problems that required an urgent solution, such as the case of managed trade, mentioned above.

## V

### Latin America's way to the cross: the incentive for change

This disconcerting stage of radical change is, in my view, the result of various circumstances facing the region today to an extent that, while no longer surprising, is nevertheless undoubtedly unusual. Sacrificing nuances and shades of meaning for the sake of clarity, these circumstances are the following:

i) The perception of a loss of solvency, influence and prestige in the international sphere, with its inevitable consequence of a deterioration in bargaining power. One element in this perception is the consciousness of the growing lag in the development of activities involving the technological innovation characteristic of modern societies, which are being rapidly transformed by that same innovation and other forces.

ii) The awareness that the overwhelming internationalization of economic life calls for the rethinking of the economic-policy schemes with which the region has functioned up till now and for the adoption of the scheme (or schemes) most suitable for taking advantage of the most dynamic currents in the world economy, assimilating the new technologies, and endogenously generating a capacity for innovation and management of production. Such awareness of the outworn nature of the present structures and of the inevitability of having to take an active part in the international economy in order to take advantage of its drive, with all the risks that might bring, forms the mental background to the positions of the so-called "openness" which prevails today in the region, with a whole gamut of critical and acritical variants.

iii) The influence exercised (or the conditions imposed) by the centres of the world economy to obtain that "openness" –as fully and quickly as possible– as a prerequisite for arriving at solutions to the pressing financial problems affecting the region today. It is no secret that the governments of the United States and the other creditor countries, either directly or through the World Bank and the International Monetary Fund (IMF), impose "policy reforms" or "structural adjustment" as a condition for initiating negotiations in connection with the Brady Plan: the possibility of renegotiations that may loosen the hangman's knot of the external debt is certainly a powerfully effective lure.

iv) The consciousness of a common identity among the people of Latin America, which has grown stronger with recent events, in which many analogies and affinities are perceived, especially the restoration of democratic institutions in the nations that were under dictatorial governments during the 1960s and 1970s. Painful experiences lived in common, such as the constraints created by the external debt, have also contributed to this growing closeness. For these reasons, this seems to be a circumstance that particularly favours the political motivation of co-operation and co-ordination among Latin American States. Unfortunately, however, the balance-of-payments constraints and instability typical of this time of hardship in the region create conditions that militate against the continuity needed for successful economic integration policies.

v) The awareness that an important feature of the period we are entering is the regrouping of forces on the international level in order to compete with the maximum impact and autonomy in the worldwide race to which Delors referred in the quotation cited above. This race could be a test of the nations' capacity to compete and will, in any case, be a confrontation of economic powers for which the countries' need to prepare themselves by joining forces and capacities through economic and, if necessary, political integration is increasingly evident. Something much more important than the possibility of competing depends on this preparation. Paraphrasing Delors, we could say that "economic survival" is at stake, and even "the capacity of expression and political action", that is to say, sovereignty.

It seems to me that these perceptions and concerns have a place in the collective consciousness that spawns new and novel economic and political ideas, which are rapidly gaining support and even

widespread popularity in the region. The concept of "openness" has this characteristic, insofar as it is seen as a way of securing insertion into the international economy. The liberal concepts that insist on a reduced and subsidiary State enjoy similar acceptance. Beyond ideologies, political solidarity and co-operation (and their concrete expressions in joint action) have also gained new esteem on the basis of this background of collective feelings. The desirability of integration has once again come to occupy a leading place, and that may explain this phase of bold, rapid decisions regarding integration policies, in contrast with the slower and more cautious approach of the past. We should not, however, overlook the serious difficulties that these policies will have to face as long as the financial crisis continues and unless something is done to dispel the contradictions to which we could be exposed if greater openness to the world economy is not reconciled with integration in the region. This last point is the basic concern of the rest of this article.

## VI

### A sudden flash of boldness: the vitality and contradictions of the reactivation process

Midway between these two phases, and with only a brief gestation period, came the Argentine-Brazilian Integration Agreement signed in July 1986: the first step in one of the most original initiatives for Latin American integration. At least for those not involved in its creation, this Agreement came as a surprise which aroused sudden interest in the integration of the region. The novelty and audacity of the formula, which broke with all the traditional schemes imposed by the classical integration theory and by the General Agreement on Tariffs and Trade (GATT), were in themselves sufficient cause for the expectations to which it gave rise. But its main effect was the shock it gave to the structure of political and economic relations which had immobilized the region, and especially South America, for many years. The way ALALC (later ALADI) functioned was one of the manifestations of this immobility. If the triangle formed by Argentina, Brazil and Mexico had wanted to, it could have imparted dynamism to trade and the integration of production throughout the region. The

Argentine-Brazilian Agreement was a radical change which could mean a break with ALADI or an injection of vitality. The action of the two countries soon proved that the latter would be the case,<sup>10</sup> if other countries took up the challenge. The upheaval in the old geopolitical concepts was even more patent. Several of the traditional pillars of the relations between Latin American countries were swept away. A powerful Atlantic axis surfaced which called for a complete rethinking of foreign policy and economic integration. The Andean Group<sup>11</sup> suddenly found

<sup>10</sup> The Protocol on the Expansion of Trade and the Protocol on Capital Goods were incorporated into the Latin American Integration Association (ALADI) as a Partial-Scope Agreement and as a Complementarity Agreement, respectively. Uruguay has joined this integration through tripartite decisions.

<sup>11</sup> See Edgardo Mercado Jarrín, "El proceso de integración argentino-brasileña y sus repercusiones en el Pacto Andino. Un esquema general de concertación", Lima, 1986 p. 15, *mimeo*.

itself corralled in the northern part of South America, with Venezuela gravitating towards Brazil and Argentina.<sup>12</sup> Mexico itself, displaced from its relation with the two other large countries of the region, must have felt that it was losing its place in the South and that this was pushing it perilously towards its neighbour to the north, which in turn made no secret of its interest in establishing a special trade relationship with Mexico.

However, the economic situation of Argentina and Brazil was not exactly propitious for in-depth integration, even if it were selective. The Governments of Alfonsín and Sarney—the first democratic and civilian régimes after long years of military governments—were going through the worst moments of tremendously difficult stabilization and adjustment policies. The circumstances at the time, and what happened afterwards, indicate that the motivation was primarily political: one of the first signs of that new spirit, born of frustrating experiences but also of solidarity, which we have tried to describe in the section above.

The formula or model followed by the Economic Integration and Co-operation Programme between Argentina and Brazil has been widely described, so there is no need for us to do so again here. The main point is that it is a selective action of integration and co-operation, concentrating on specific tasks considered by the two countries to be of priority importance. According to the available information, 24 protocols have been signed so far, each one dealing with one of those tasks. Protocol No. 1 concerns capital goods; the last one, Protocol No. 24, refers to economic and social planning. These two are good examples of the character of this enterprise: the objective of the Protocol on Capital Goods is to reach a kind of common market for this sector, even involving commitments regarding State purchases. Protocol No. 24, on economic and social planning, creates machinery for consultation and co-ordination of macroeconomic policies between the two countries. The other protocols contain a series of

initiatives for integration or co-operation in fields as varied as food supply, scientific research (biotechnology) and cultural integration.

In its four years of operation, the Programme has produced positive results, especially if we consider the difficulties of keeping this kind of relation alive during such an unstable period in the two countries.

Bilateral trade grew substantially from 1986 onwards, and the increase in Brazilian exports since 1987 has been particularly noteworthy. Argentina persistently tends to run overall deficits (US\$463 million in 1988), but trade in capital goods under Protocol No. 1—the one of greatest interest to both countries—is in balance. Argentina's exports of capital goods to Brazil trebled between 1986 and 1988, rising from US\$17.7 million to US\$51.4 million, and this increase is entirely attributable to exports of goods on the Common List of that Protocol. Brazilian exports also increased in absolute terms (from US\$45 million to US\$83 million during the same period). The deficit in capital-goods trade thus decreased noticeably, and if we only consider products on the Common List of capital goods, Argentina ended 1988 with a slight surplus (US\$2.5 million). The Protocol has effectively stimulated trade in capital goods, even though the figures did not reach the goals established, which were patently over-ambitious.<sup>13</sup>

The same protocol made it possible to take advantage of part of the potential demand for capital goods in both countries, although for the time being without any significant changes in investments or the structure of supply. Porta and Fontanals conclude that, at least for Argentina, there have been no dynamic effects in the sector,<sup>14</sup> with the possible exception of the sub-branches of machine tools and packaging equipment. The cause of this lack of dynamism would appear to lie in the aftermath of Argentina's recent industrial history, characterized by declines in production and employment, the persistence of recessive adjustment policies, and policies that run counter to the attempts to open up

<sup>12</sup> Hello Jaguaribe, "La integración Argentina-Brasil", *Integración Latinoamericana*, No. 129, Buenos Aires, Institute for Latin American Integration, November 1987, p. 6.

<sup>13</sup> Fernando Porta and Jorge Fontanals, "La integración intra-industrial: el caso del Acuerdo Argentino-Brasileño en el sector de bienes de capital", *Integración Latinoamericana*, No. 152, Buenos Aires, Institute for Latin American Integration (INTAL), December 1989, p. 19.

<sup>14</sup> *Ibid.*, p. 22.

the country to capital-goods imports from third countries. Other elements within the framework of the same formula have not functioned efficiently either: the product-by-product method of negotiation impedes strategies for complementarity; barely any progress has been made in public-sector purchases, and there have been delays in the execution of the protocols on the Investment Fund and the Statute on Binational Enterprises, which could have been decisive in stimulating the restructuring of production in the capital-goods sector.<sup>15</sup>

It is not known what stage has been reached by the Argentine-Brazilian programme at the present time (July 1990). The harsh adjustment policies applied in both countries and the brutal contraction they produced must have provoked a real paralysis of trade. If these efforts are successful, bilateral trade could begin to expand again and a dynamic restructuring process could be gradually put into effect to allow for complementarity between the two countries. This would call for an active and coherent industrial policy, under the leadership of the State.<sup>16</sup> Without such a policy, the possibilities offered by this integration will soon be exhausted, with very little effect for both countries.

Both countries undoubtedly are vitally interested in continuing their integration efforts, as demonstrated by recent decisions which will be discussed later. It is true that the gradual and selective approach taken by this formula has its limits, and it might soon be necessary to broaden the field of integration.<sup>17</sup> The interesting thing to note, however, is that this formula, despite the adverse economic situation, has served and is still serving as a starting point. It is very doubtful that a comprehensive across-the-board system would have been viable in the conditions prevailing at the time. In contrast, with a formula of selective integration, balanced (by specific areas and not intrasectorally) and applied

in a graduated, flexible and progressive manner,<sup>18</sup> it has been possible at least to begin to intensify integration in the higher-priority sectors. It may be noted in passing that this description recalls the theses of ECLAC in the 1950s, when Raúl Prebisch spoke of gradual, balanced (reciprocal) and selective integration.

As if to bow to the criticisms previously levelled at limited sectoral integration, in November 1988 Argentina and Brazil signed a Treaty on Integration, Co-operation and Development which seems a throwback to the orthodox integration model. The objective is to first establish a customs union and then a common market. With a conciseness that is not usually found in Latin American integration instruments,<sup>19</sup> this treaty provides for broad tariff and non-tariff liberalization of trade in goods and services over a period of 10 years. The proposal is ambitious, especially because of it includes services, but negotiating product-by-product could turn out to be a slow and cumbersome process. The common market would come into effect in the second stage, once the necessary harmonization of policies had been accomplished. The Treaty is so vague, however, that its real content remains to be defined. It is an interesting gesture on the part of the two countries, but not much more than that. In reality, the 24 protocols of what is now the "old" pact will continue to be the basis of this binational integration process. The treaty is also extremely laconic about institutions; it only states that it will be directed and administered by an intergovernmental body, without mentioning a secretariat. This is one more manifestation of the traditional aversion of both countries, and especially of Brazil, to anything that sounds like supranationality.

Argentina ratified the treaty on 23 August 1989,<sup>20</sup> but apparently there has not yet been any attempt to put it into effect. One can understand the

<sup>15</sup> *Ibid.*, p. 24.

<sup>16</sup> *Ibid.*, p. 26.

<sup>17</sup> Basically because of the difficulties in harmonizing comprehensive policies with the attempt to limit them to one sector. See D. Chudnovsky and F. Porta, "On Argentine-Brazilian economic integration", *CEPAL Review*, No. 39 (LC/G.1583-F), Santiago, Chile, December 1989.

<sup>18</sup> Juan Mario Vacchiao, "El programa de integración argentino-brasileña y las relaciones de América Latina y Europa. Reflexiones complementarias", *Integración Latinoamericana*, No. 133, Buenos Aires, Institute for Latin American Integration (INTAL), April 1988, p. 59.

<sup>19</sup> And much more concise than the Treaty of Rome, which in Latin America would be taken to be overly regulatory, without being so.

<sup>20</sup> By the Government of Menem. It was signed during the Government of Alfonsín. It is not yet known whether Brazil has ratified the treaty or not.

reasons for both countries trying to introduce a broad integration programme, but in view of the complexities of their economic situation, it is hard to see how it could be implemented any time soon and contribute to reactivating both economies.

At all events, it marks a trend which quickly made its appearance elsewhere in the region. Thus, for example, in the final declaration (known as the Ica Declaration) of the Third Presidential Meeting of the Permanent Mechanism for Consultation and Policy Co-ordination (the Group of Eight), held on 11-12 October 1989 in Ica, Peru, special attention was paid to the question of integration and the problem of the external debt. In the Communiqué which ends the declaration, the Ministers of Foreign Relations, Economics and Finance, and Planning of the Group of Eight were instructed to meet soon thereafter, in December 1989, to examine a series of concrete issues relating to integration which had been raised by the Presidents: the replacement of quantitative restrictions with tariffs, projected complementarity agreements, etc.

The group of Ministers met on 4-5 December 1989 in Argentina, where they issued the Buenos Aires Declaration. This is a relatively brief document, but replete with initiatives for reactivating integration, especially within the framework of ALADI. It sets out four basic lines, namely:

- i) the elimination of non-tariff restrictions on reciprocal trade;
- ii) the broadening and further development of the regional tariff preference (PAR) to cover all products;
- iii) the broadening and further development of bilateral agreements;
- v) the lowering of the tariff levels applied in reciprocal trade, through successive rounds of trade negotiations.

The Declaration lays down specific tasks in respect of each of these points, some with obligatory deadlines. These decisions were to be presented at the Fifth Meeting of the Council of Ministers of Foreign Affairs of ALADI, held in Mexico City at the end of April 1990. One of the points on the agenda of this meeting concerned concrete measures for intensifying the integration process in the areas of trade, transportation, and economic complementarity. Of these, trade was the issue that aroused the most interest. The Buenos Aires Declaration had been specific on some trade policy measures, particularly the further development of the regional tariff

preference, both with respect to levels (a 50% increase) as well as the number of exceptions allowed (reduction by 10%). Because of last-minute difficulties in the negotiations, which we will mention later, the Mexico City meeting was unable to arrive at decisions on these issues. It did take decisions on some other points of interest (the inapplicability of non-tariff restrictions in the list of market openings; elimination of non-tariff restrictions in limited-scope agreements, when such elimination had been accepted in those agreements; a regional programme of economic complementarity and technological co-operation applied to production, etc.), but none of them had the political importance of the issues affecting the Regional Tariff Preference. Finally, on 20 June, more than a month and a half later, the second protocol modifying the regional agreement (No. 4) establishing the Regional Tariff Preference, was signed in Montevideo. This Protocol increases the levels of the preference by far more than the recommended 50%. Thus, the basic preference went up from 10% to 20% and the maximum level (in favour of landlocked countries) rose from 22% to 48%. It was agreed that non-tariff restrictions would not be applied to products covered by the Regional Tariff Preference and the exceptions to this Preference were significantly reduced (by more than the 10% recommended by the Buenos Aires Declaration).

These latter decisions, which far surpass the terms of the Buenos Aires Declaration, faithfully represent the new spirit of Latin American integration. If the tariff level for third countries is not very low, even the basic preference of 20% (for countries in the same class) would be an interesting stimulus for the expansion of intraregional trade. No important progress was made on the other issues. Unfortunately, the *status quo* was maintained for some of them (financing of payments and trade), but, perhaps quite rightly, the Regional Tariff Preference—a multilateral instrument—was chosen to express the disposition towards openness and solidarity which characterizes integration at this time.

Another result, partially due to the influence of the Group of Eight is the change which seems to have taken place in the Andean Group.

As was to be expected, the reforms introduced by the Quito Protocol soon ran up against the problems created by managed trade, centering especially on the so-called "sensitive" products, which were precisely those that had been the most dynamic items in the

intraregional trade of some of the member countries. Several other important issues remained to be resolved, such as the definitions concerning existing industrial programmes, but they were being worked on. It was obvious, however, that some way had to be found to get round the problems presented by managed trade and continue to make progress. The Board of the Agreement had proposed ending that system, and once again a conflictive situation was created, thereby slowing down the process.

High-ranking officials of the five countries<sup>21</sup> met in May 1989 in Cartagena de Indias in accordance with the commitment they had made in Caracas, at the inauguration ceremony of Carlos Andrés Pérez, to meet on a regular basis (twice a year). In Cartagena, the officials set themselves the task of studying the means of promoting economic integration, which was clearly going through a difficult period despite the recent reforms. The document containing this consensus was named the Manifesto of Cartagena de Indias.<sup>22</sup> It is an interesting document, devoted almost entirely to finding ways to reactivate integration. Its basic points are:

- i) to organize a follow-up system with the participation of the highest authorities of the respective countries.<sup>23</sup> This task was given to the periodical meeting of Presidents, with the support of the Council of Foreign Ministers of the Andean Group, which became the organ of the agreement;
- ii) to stimulate the reactivation of Andean integration. Apart from the mention of concrete measures,<sup>24</sup> the Andean Council of Foreign Ministers was asked to present to the next meeting of the Presidents a strategic design for the orientation of the Group which would have comprehensive coverage and would include short-, medium-, and long-term actions for strengthening subregional integration;

<sup>21</sup> Four Presidents and the Minister of Foreign Relations of Bolivia.

<sup>22</sup> It was the 20th anniversary of the Cartagena Agreement, signed in the same city where this summit meeting was being held.

<sup>23</sup> Manifesto of Cartagena de Indias, Board, of the Cartagena Agreement JUN/ dl 1237, 29 May 1989.

<sup>24</sup> For example, revise and adjust the current minimum common external tariff in order to adapt it to the present needs of the subregion, and other similar actions

iii) to give the Andean process a more comprehensive and less "commercial" character; several foreign-policy initiatives were specifically mentioned in this respect.

It seems likely that these elements of the Declaration will have a decisive influence in the life of the process. The strategic design was in fact presented at the next meeting of Presidents (in the Galápagos Islands), with the effects that will be described below.

The organization for follow-up and co-ordination did serious work, as demonstrated by what happened at the following meetings of the Presidents and the Andean Council. There are signs of an effort to expand the areas of action and deal with non-economic activities also of interest for the process, some of which had been practically abandoned, (for example, labour issues).

By the time the second Summit Meeting of Andean Presidents was held (Galápagos Islands, 17-18 December 1989), six months after the Cartagena meeting, the third meeting of Presidents of the Group of Eight had already taken place (October 1989), and the meeting of Ministers of the group had issued the Buenos Aires Declaration only a few days before. The spirit of these two meetings and their insistence on prompt action no doubt influenced the Galápagos meeting, while what happened in Ica must have also influenced the work done by the Board of the Cartagena Agreement in preparing the draft strategic design requested by the Andean Presidents, which was presented at the Galápagos meeting. The result, for anyone familiar with the way of life of the Cartagena Agreement, was completely surprising and disconcerting.

Thus, at the Galápagos meeting, the Andean Presidents approved a programme of short-, medium-, and long-term action for the Andean Group, covering items ranging from trade up to joint foreign relations and including all the areas of economic integration activity covered by the Cartagena Agreement. They did so almost without amending the draft prepared by the Board of the Agreement. These decisions radically changed the pace of action called for in the 1987 Quito Protocol, and the Andean process was now committed to a programme of substantial acceleration, especially with respect to trade, which was the area that had received the most attention and up till then had been the most conflictive.



In its "Galápagos Declaration: The Andean Commitment to Peace, Security and Co-operation", the summit meeting of Andean Presidents, decided, *inter alia*:

- i) to achieve customs union by 1995 on the part of Colombia, Peru and Venezuela, and by 1999 on the part of Bolivia and Ecuador; these last two countries will have to complete the liberalization programme by 1995 and adopt, the common external tariff by 1999, beginning this process in 1992;
- ii) to reduce by 80% in 1990, the reserve list for industrial programming (already carried out), and do away with the list of exceptions (except for a residue) between 1991 and 1992 for the large countries, and between 1995 and 1997 for Bolivia and Ecuador. These two measures mean a considerable extension of the liberalization programme;
- iii) the above-mentioned radical reduction of the reserve list means in practice eliminating industrial programming as the mechanism designed to guarantee the equity of the process, thus completing the process of rejection of that mechanism which had begun with the Quito Protocol;
- iv) to substantially reduce the Common Minimum External Tariff during the first quarter of 1990. This reduction has been made, and the highest nominal level of this tariff is now 50%, whereas before it was approximately 80%;
- v) to eliminate by 1991 the system of managed trade created by the Quito Protocol, which was scheduled to last, with intermediate reductions, up to 1997.

The Strategic Design contains many other measures, including commitments to harmonize policies, but the above are the most important and immediate decisions. What they involve is, firstly, to define the objective precisely, establish a customs union, and substantially accelerate the process for putting it into effect. In the Quito Protocol, the objective was not defined, there was no deadline for the adoption of the Common External Tariff, and even the improvement of the liberalization programme depended on an evaluation of Bolivia's and Ecuador's situation within the agreement.

Secondly, these changes convert the Cartagena Agreement *de jure* and *de facto* into a classical trade integration scheme. There is virtually no provision for

any mechanism to supplement or correct in certain sectors the functioning of the market. The industrial programme of the Agreement could not reach its goals for several reasons, but now what remains of that programme is functionally innocuous.

As we can see, there is a profound difference between this attitude towards integration and the very concept of economic policy behind it on the one hand, and the attitudes that were prevailing when the Agreement was signed, or even those that still existed only two years ago, when the Quito Protocol was adopted. The changes in ALADI and those observed in the integration between Argentina and Brazil point in the same direction. The governments involved are obviously affected by the circumstances and concerns summed up in section V of this article, which characterize what we called the second phase in this stage of integration in Latin America. If political life had been more normal in Central America, something similar probably would have taken place there, in line of course with the special characteristics of that sub-region. This is only a conjecture, but it has its grounds in the concern that Central America too must be linked to the international economy.<sup>25</sup>

The manifestations of this flood-tide of openness are more and more frequent, so its expression in economic integration should be seen more as a derivative –a special case– of a broader attitude which is attempting at the very least to move the centre of gravity of development policy towards the world market. The reforms in their external trade policies recently adopted by some Latin American countries have that intention, and it is a fact that protection against the rest of the world has diminished substantially. It may be said in those cases that, chronologically, trade with third parties was liberalized first, so that what has taken place with regional integration is only an extension of what was happening in general with foreign trade. Thus, Bolivia, Mexico, Argentina and Venezuela drastically reduced the protection applied in their domestic markets well before the initiatives for regional openness described above took shape. We have not mentioned Chile, whose liberalization process goes back to the 1970s, but Bolivia, for example, opened

<sup>25</sup> See the references to the attitude of the business sectors in Costa Rica and other Central American countries in Alfredo Guerra-Borges, *Desarrollo e integración en Centroamérica: del pasado a las perspectivas*, Mexico City, CRIES-IEC, Ediciones de Cultura Popular, 1988, p. 99.

its economy in 1985 as part of an anti-inflation policy, and this policy of openness has remained practically untouched since that time. In Central America, even though the rules of the Common Market have not changed formally, Costa Rica recently inaugurated a policy of comprehensive liberalization, and the other countries will probably have to do the same once conditions allow the negotiation of a reform in Central American integration.

At least for the countries mentioned, these facts bear out the previous affirmation about the apparently subsidiary nature of the present emphasis on accelerating the trade element of economic integration. This conjecture is strengthened when one thinks of what has happened with those integration instruments that are different from the classical forms of trade integration, i.e., according to the case, liberalization or preferential tariff programmes and a common external tariff. In contrast with the decided support for openness that has been prevalent in recent initiatives with respect to these instruments, there has been no significant progress in other fields (some of them critically important), such as systems for settling payments and balance-of-payments support.

This might, at all events, be too hasty a judgment, since there may be different and equally intense motivations for comprehensive openness and for regional openness. In that case, however, there should be a clear concept of the functions that each one would have to fulfill in the new development model, with the corresponding delimitation of spheres and the consequent discrimination of policies. Judging from the decisions made up to the present, there are no indications that the measures taken correspond to a strategic concept of the objectives that regional integration should accomplish within a model of comprehensive openness. This is a serious concern that, so far, the facts have not yet put to rest.

The question is important, not only because some of the countries that have already begun these reforms are the heavyweights of regional trade, but also because practically all of the Latin American countries seem to be heading in the same direction. Colombia has already substantially changed its system of foreign trade, including its methods of protection (tariff and non-tariff), while Ecuador has begun to reform its tariffs and its foreign-trade policies. That will also probably be the option of countries like Brazil, which has in fact already begun to open up its economy: a process it will very likely intensify as soon as it finishes its "shock treatment". Peru's new government will most probably follow the

same path. Information on Central America and the Caribbean is not available, but a similar inclination is predictable.

Apart from governments' sincere conviction—which they undoubtedly hold—that a policy change along these lines is genuinely needed, a realistic appreciation of the forces pushing for a policy reform is important for our view of the future. Decisive among these forces is the pressure of the multilateral credit agencies, which have almost arbitrary power in renegotiations of the external debt and consider structural adjustment of the economy to be a prior condition for this. Structural adjustment means profoundly changing key macroeconomic policies regarding exchange rates, interest rates, tariffs and other instruments for regulating foreign trade, as well as modifications of legislation governing investment, apart from the policies for different productive sectors. The theories in vogue with respect to protection are well known: a low and uniform national tariff, to ensure a low effective protection with effects that are as neutral as possible on the different activities. A single equilibrium exchange rate is supposed to compensate for the tariff reduction and be the basic instrument of protection from then on. Its effectiveness should not be diminished or distorted by quantitative restrictions on imports, nor by incentives to invest in productive activities other than those needed to promote exports in order to compensate for the bias arising from the existence of an import tariff, if there is one.

Recommendations on "structural adjustment" are naturally much more complex and contain elements that fit in with the conditions of each country. There is no need to go into detail about them here. We will only describe what we consider to be the essential nucleus of the recommended reform, which, as far as we know, effectively tends to be substantially the same in all the countries. That nucleus, together with the suggestion for overall deregulation, constitutes the basic direction of the changes that our countries are beginning to make in their foreign-trade systems and policies. By way of example, we may take the case of one of them, Venezuela, which has made changes characteristic of this new trade policy and which demonstrates better than the other countries the objectives being pursued, since it is further along the road to reform.<sup>26</sup> The change is directed, for the

<sup>26</sup> Decree No. 239 of 24 May 1989, providing for a New Integral Economic Strategy, *Gaceta Oficial*, No. 34230, 30 May 1989.

moment, at the manufacturing sector, and will consist in the adjustment of tariffs and the progressive elimination of non-tariff restrictions (article 2). By June 1989 the reduction of the *ad valorem* tariff should leave it at a maximum of 80% for consumer goods and 50% for intermediate and capital goods and raw materials (article 5), as a measure of transitory protection, to be reduced in time. That measure has already been adopted. With two intermediate steps, the objective of the tariff reform is scheduled to be achieved in 1993, when the maximum tariff will be 20%, with only two tariff levels (article 9). At the same time, as from 1989, all non-tariff restrictions on imports and tax exemptions on imports of manufactured goods will be progressively dismantled. Article 12 even establishes the commitment to move toward eliminating public and private import monopolies, in addition to the deregulation of exports referred to in article 17, and the creation of an export subsidy linked to the

level of import tariffs, by anticipating the lowering of this subsidy as tariff reform advances (article 18).

This undoubtedly important change, it is worth mentioning, was adopted before the decisions of the Ica meeting of the Group of Eight that sought to revitalize ALADI, and before the Galápagos summit, which tried to do the same for the Andean Group. The spirit of openness evident in Venezuela's Decree No. 239 preceded consideration of integration issues, so we can say that the latter derived from the former. This conclusion becomes evident as soon as we read the text of article 13 of the Decree in question, where it says that the National Executive will negotiate Venezuela's commitments under the Andean Pact and other international agreements in line with the provisions of this decree. It is clear, however, that commitments as precise as a maximum tariff level of 20% by 1993 are more a negotiating position than material for later renegotiation.

## VII

### Desirable and feasible levels of regional integration in the context of openness

In the present situation, with its inclination—which seems to be spreading—towards uncompromising openness to the world economy, at the same time that a recessive adjustment process persists in almost all Latin American countries, the future of regional integration is extremely uncertain, even though it is true that a series of sudden decisions have been taken which seek to reactivate that integration, and that this is undoubtedly the will of the governments involved.

It might be asked, however, if such reactivation or relaunching is really feasible in the context of trade liberalization with third parties, as already discussed. That is a prior and unavoidable question, which, if answered in the affirmative, still leaves intact other concerns about the kind of integration that would be best for Latin America in the present circumstances of the international economy, the region's need to be linked to the more dynamic currents of that economy, and the financial constraints in which the region would presumably have to develop in the foreseeable future.

The nature of this article demands that we generalize and refer to Latin America as a whole. That abstraction conceals the consequences of the diversity of the national economies and prevents us from arriving at specific conclusions. We hope, in any case, that the conclusions of this article will be pertinent and will allow whoever so desires to examine them in the light of national realities.

The first question implies a more general query: can indiscriminate openness to the international economy be reconciled with regional integration? In customs union theory, the question was usually posed as a dilemma, that is, presented as two mutually exclusive options. In the eyes of that theory, free trade was more beneficial than regional integration, which was only acceptable as a step towards free trade, if it served as a net creator of trade. The consideration of other benefits, among them the possibility of increasing exports as a result of regional liberalization and the dynamic effects of a greater interest in development, gave more arguments, however, for justifying the inherent attraction of

regional integration. Finally, opting for regional integration meant giving preference to liberalizing trade within the integration zone rather than opting for unilateral, non-reciprocal liberalization with respect to the whole world. They were clearly mutually exclusive options, even if integration were understood as a temporary state which would make it possible to increase exports and develop comparative advantages in order to later compete dynamically in the international economy.

At least *a priori*, it does not seem that the Latin American countries have opted for a form of regional integration that excludes the comprehensive liberalization of trade. The two processes have progressed together, and in reality, the expressions of openness preceded the most recent decisions to reactivate integration. We have to suppose, however, that when it comes to intensifying the processes, an option for one or the other will have to be made early on, and logically, we should expect that that option would be in favour of regional integration, while continuing to open up trade within pre-established limits. It could even be accepted that this option might be of limited duration, lasting up to the time when a desired level of development (for all or some activities) was achieved, in order to later open up more to international competition. In any case, the immediate effects are interesting for our question, and in those effects regional integration would have to predominate over greater openness.

Under these conditions, the two processes would be reconcilable in either of the following situations: a) comprehensive openness only up to a level that allows for discrimination (also comprehensive) in favour of the countries belonging to the integration area; and b) selective opening-up to the whole world for certain activities, which would allow for the functioning of a form of regional integration (also selective) for all those activities not included in the comprehensive openness.

Judging from the character of the liberalizing reforms adopted up till now, the predominant direction would be comprehensive openness, with minor exceptions for a minimum of activities (for example, the motor industry in Venezuela, Colombia and Ecuador). Moreover, the position of the United States Government, the World Bank and the IMF is precisely in favour of comprehensive openness, and this is what characterizes the policy reform commitments undertaken with them by several Latin American countries, with certain specific

concessions. We will return to this aspect when we speak of the kind of regional integration that would be best for Latin America in the present situation. For now, it is sufficient to note that the reform is moving towards comprehensive openness, so that we can see the possibility that the situation described in point a) above will take place. It would exist if study of the characteristics of openness shows that there is room for discriminating sufficiently in favour of regional markets. In the usual terms of Latin American integration, that is the equivalent of posing the problem of the so-called regional *margin of preference* and evaluating its adequacy with respect to the liberalization policies in vogue.

Obviously, in the current situation it is impossible to rigorously evaluate the existing or proposed preference for regional production. The reform of foreign-trade policies is presumably still underway in all of the countries, and even if it has been completed somewhere, the local circumstances vary so much from country to country that we would need far more information and macroeconomic evaluations than it would be possible to handle within the limits of this article. We can only conjecture about where current trends towards openness could lead, using our personal experiences as a basis for venturing an opinion, which can only be an expression of concern or preoccupation about the evolution of policies that, at least superficially, do not seem to correspond in most cases to well-thought-out plans for development.

Even with these reservations, a judgment about the adequacy of a margin of preference requires a prior comment about the instrument or instruments which would most probably have to be used to discriminate in favour of regional production. Our view is that this instrument should be the import tariff, not only because regional integration has primarily used tariff concessions or liberalization (even occasionally common external tariffs) to promote trade, but also because the very direction of the reform of foreign-trade policies makes tariffs the only instrument possible—even though in a very limited and uniform way or with rather limited discrimination—for protecting the domestic market over and above the basic protection given by the exchange rate. In theory there are several instruments other than tariffs which could be useful for discriminating in favour of regional integration, and they could possibly be developed in the future, but experience so far in their use is rather negative.

Regional integration policies have failed in their handling of direct-allocation instruments, such as industrial programming, and even in the little-used complementarity agreements the central mechanism used has been tariffs. Such policies have been unable to mobilize State purchases, even in the case of the selective integration between Argentina and Brazil. For this same reason, regional trade integration in Latin America basically uses tariffs to allocate a margin of preference for regional production. With respect to the reform of general foreign trade policies, we should remember that the essential components of the reform include the elimination of non-tariff restrictions and the limitation or elimination of other means that could sidetrack the market signals, such as State purchases (State monopolies, State-owned enterprises, etc.).

In practice, and if there are no unforeseen changes, the tariffs remain the only instrument capable of giving a margin of preference to regional or subregional production. If we go by the known goals of the reforms promoted by the multilateral agencies, which are similar in all countries—maximum tariffs of 20%, with only two tariff levels—the conclusion is that for many activities (especially those that involve a certain technological complexity) the possible margin of preference, given the instruments in use, would not be sufficient. This is evident almost *a priori* in the case of ALADI's concessions, where the norm<sup>27</sup> is a reduction of tariffs, not total liberation. And that is true both for limited and regional agreements.<sup>28</sup> There could be some doubt in the case of goods that are totally liberated in intraregional trade—for example, those already duty-free in the Andean Group—but even there, in the majority of the countries the list of products that would be interesting to develop but for which the margin of preference is insufficient is quite long. Naturally, those who would suffer the most from that situation would be the less developed countries, since this would make trade integration even more inequitable, with all the consequent problems for its future stability.

<sup>27</sup> The formal exception consists of the concessions made in the list of market openings for the relatively less developed countries, in which imports are exempted from duty.

<sup>28</sup> Recall our previous remarks about the tightness of the margin in the case of the basic regional preference of 20%; if the level of the external tariff were 20%, the regional preference would only be 4%.

Despite the fact that we are at the beginning of a period of change, experience shows what could happen: after evaluating the Protocol on Capital Goods between Argentina and Brazil, Porta and Fontanals indicate that the tendency to open up to third parties has already created a contradictory scenario, since on the one hand there are attempts to open up markets, even giving priority to the indiscriminate liberalization of imports in the capital-goods sector, while on the other hand the margin of preference for complementarity becomes uncertain and tends to be even less.<sup>29</sup> This has helped, as the authors point out, to prevent integration from having had dynamic effects on that sector in Argentina.

The same concern exists, and very strongly too, in the case of the other integration efforts, and thought is being given (rather unrealistically, in our judgment) to mechanisms which could make up for the lack of a margin of tariff preference: for example, provision of financing for the buyer has been mentioned.<sup>30</sup>

It should be pointed out that most products would not need high tariffs against third countries in order to achieve the desired effect. Transportation costs can in some cases be an effective barrier which hardly needs to be complemented by a tariff. There are other circumstances, however, which demand (even though temporarily) tariffs of a certain level and the support of other instruments which the countries must learn how to use: such is the case, for example, for certain nationally-produced capital goods that meet with resistance because their origins or brands are little known. Here, joint action between producers, major users and governments is to be recommended. In this and other cases, however, a margin of tariff preference is still a useful and frequently indispensable instrument, as shown by the experience mentioned above.

<sup>29</sup> Porta and Fontanals, *op. cit.*, p. 24.

<sup>30</sup> See David Mootesuma, "Integración económica, deuda externa y perspectivas para los años noventa", Report of the Seminar on Economic and Social Integration: Perspectives for Latin America and the Caribbean in the 1990s, Mexico City, Society for International Development (SID), September, 1989, p. 81.

Recent events<sup>31</sup> raise the spectre of even more adverse circumstances: negative margins for intraregional trade. Trade arrangements with the United States and other industrial countries, which ignore the most-favoured-nation clause stipulated by all the instruments of regional integration, and even more seriously, the linking of certain Latin American countries with the United States and other industrialized countries in free-trade areas—linkages which imply ignoring the most-favoured-nation clause of regional agreements—would extend a situation of negative margins<sup>32</sup> that leaves no other solution for the countries involved than to openly opt for one or other system of preferential trade.

The conclusion of this summary reflection would appear to be that if these trends in economic policy remain and spread, there will be no room for a regional economic integration process of any significance. That does not exclude the possibility that political and even economic co-operation in concrete projects and initiatives could continue and even grow stronger. But without a margin of significant preference it would be useless to propose the integration of markets, and much less of production. There is no doubt, however, that the Latin American countries have in recent years once again shown a real willingness to reactivate and accelerate regional integration. In spite of the contradictions brought on by the need to find a different centre of gravity for their economic policies, that will for union has been expressed in the series of recent initiatives described above. We should, therefore, radically change the direction of our analysis and, instead of asking what kind of regional integration would be compatible with openness to the exterior, we should try to find out directly what are the characteristics of the openness to the exterior that could be compatible with the regional integration that Latin America needs for its development. The answer to this question would allow us to spell out the conditions needed in order for such openness to be compatible with an authentic and dynamic form of regional integration. In reality, this is the logical sequence for reconciling the options facing the region today.

<sup>31</sup> Basically this refers to the difficulties at the last meeting of the Council of Ministers for Foreign Affairs of ALADI in achieving unanimous approval for the Protocol for Deepening the Regional Tariff Preference.

<sup>32</sup> That is to say, a tariff preference even greater for third parties than that given to countries of the region.

As we mentioned above, there are at least three elements that must be taken into account in order to define the form or kind of viable integration that Latin America needs.

The first element is the present international economy and its circumstances. We hardly need to insist that the great force for change behind the competition prevailing in the world today is the extraordinarily dynamic process of technological innovation. As happened in the case of the great technological changes of the past, but even more markedly now, the truth is that he who possesses and exercises the capacity to innovate is in a position to take control of the most dynamic functions of international specialization. The gap between rich countries and developing nations is now basically a question of knowledge, and this is probably the hardest to overcome. In the graphic words of David Landes, capital is not the main problem. Theoretical knowledge and know-how are increasingly esoteric and obscure, and hence more difficult to acquire.<sup>33</sup> The potential advantage that latecomers traditionally had is becoming increasingly problematical, because the costs of crossing the technological threshold are now very high. For that reason, it is vital that Latin America should do everything it can to close the technology gap without delay and not fall further behind.

There are other phenomena in the international economy which are also important, especially the internationalization of capital and certain services, but the technological gap is one of the most crucial and is also the ultimate justification for opening up to the exterior.

The second element concerns the wave of liberalization of foreign trade (and other external transactions) now prevalent in our economies. We have already mentioned that this liberalization responds to the growing conviction that the development model needs to be changed to make exports the motor of economic growth. Openness can stimulate exports and is an incentive for greater efficiency in existing activities, but if we want to put our development on a firmer basis we must obviously modify the structure of exports by gradually incorporating more products with a high component

<sup>33</sup> Richard T. Ely, Lecture, "Why are we so rich and they so poor", *American Economic Review*, Papers and Proceedings, vol. 80, No. 2, May 1990, p. 9.

of knowledge, be they primary or industrial goods or services. In other words, our present productive base is unable to take full advantage of an open economy. The only export structure that can lay the foundations for stable progress is one based on the new conditions of technology. In terms which have now become common, openness is justified to the extent that it allows for the development of dynamic comparative advantages in a world whose forthcoming evolution will depend on technological innovation.

It is a fact, however, that theoretical knowledge, technical skills, know-how and innovative capacity are all manifestations of a social quality—scientific and technological progress—which is impossible to assimilate or incorporate through openness alone. As Landes said, it is obscure and elusive. Openness may help to foment competition and create a more propitious atmosphere for knowledge and contact with the outside world, and even for foreign investment, but the final results will depend much more on a complicated set of national policies in the fields of science and technology, education, production, etc., to say nothing of social motivations, which are by their nature even more elusive.

It is precisely in such a decisive area of national policy, involving high costs of innovation and difficulties in learning and disseminating technology, that regional integration could be most useful, especially if combined with an openness that breaks with the *status quo*. ECLAC treats this issue in its recent report entitled *Changing Production Patterns with Social Equity*, calling it the "symbiosis between external and regional demand".<sup>34</sup>

If this is so, then that combination should be carefully studied, establishing the content of the regional integration effort and reserving areas that would not be included in the overall liberalization process, or at least would not be included on the same lines as the rest of the activities. That means discrimination with respect to third parties and inevitably "protection", in order to induce an action in an area where there are obvious disadvantages in comparison with the outside world.

<sup>34</sup> An attempt should be made to promote the gradual improvement of comparative advantages in those sectors where technological development and learning are facilitated by regional action". ECLAC, *Changing Production Patterns with Social Equity* (LC/G.1601-F), United Nations publication, Sales No. E.90.II.G.6. Santiago, Chile, March 1990, p. 166.

In this case, the content of integration programmes is probably much more important than the efficiency of the instruments of discrimination, among which, in theory, tariff preferences would not be the most efficient. Nevertheless, for reasons already given, these preferences have been the only valid instrument so far. If more suitable instruments can be found, so much the better, but for the time being, even for reasons functional to the liberalization processes, a preference that would give a clear stimulus has to be maintained.

The third element that has to be taken into account in order to move towards viable integration is the climate of persistent financial constraint and instability caused by the external debt crisis, the adjustment policies, and our own past and present errors. A recent analysis<sup>35</sup> examined the effects of this extreme situation on integration. The consequences were devastating in the first years of the crisis (1983-1986), and in spite of the accommodation which has taken place with the passage of time, regional trade is still affected and is still below its 1980-1981 figures. Unless we solve the debt problem and recover adequate external financing, the immediate future looks equally foreboding.

What kind of regional integration could best weather the storm and contribute more positively to the future of Latin America in this period of constraints and liberalization? There are obvious priorities which have not been implemented: for example, strengthening the systems for settling payments and for balance-of-payments support. With regard to intraregional trade, the crisis has meant in fact that one kind of selective unilateral liberalization has predominated. This kind of liberalization has now been moderated, but has still not disappeared. This is seen by the treatment given to key products.<sup>36</sup>

Despite that, as we have seen, all the schemes have included substantial reforms to accelerate and broaden regional liberalization, and moreover a process of comprehensive external openness has been initiated which looks as though it will be profound in its effects.

<sup>35</sup> Víctor Urquidí and Javier Villanueva (eds.), "Integración latinoamericana: problemas de hoy y nuevos rumbos", *Crisis y crecimiento en América Latina*, Buenos Aires, Raúl Prebisch Foundation, Editorial Tesis S.A., 1989, pp. 321-370.

<sup>36</sup> It should be noted that the choice of existing activities, perhaps the least efficient, was purely defensive.

It would be interesting to know what could happen with regional integration. If the reforms substantially expand intraregional trade, at least some of the stagnation of priority productive sectors will have been offset and we would be better able to take advantage of the opening to the exterior. We fear, however, that the serious disequilibria in intraregional trade will persist and that this will lead once again to paralysis. This would be much more likely if liberalization with third parties leads to balance-of-payments problems, which is probable at least in the medium term. The danger points would, of course, be the weaker countries, because the integration systems have now become more inequitable than before.

These concerns lead to a question worth exploring. Would this not be a good time to study certain programmes on which regional integration could be selectively concentrated, while continuing as far as possible with the reactivation now being initiated? Obviously, the priority issues would be indicated, at least partially, by the need for changing production patterns.

With these comments on the three elements, we can finally give a summary opinion on the thrust that should be given to regional integration in these difficult times when it is exposed to so many contradictions and, at the same time, so essential for the future. As we have already stated, we must necessarily speak in general terms and not refer to any particular effort.

For various reasons, selective integration would be easier to reconcile with the general trend towards openness, and more importantly, could better serve the development needs of the region. Existing integration schemes need not be formally modified, but efforts should be made to maintain or establish in the selected areas a minimum of policies discriminating against third countries.

In order to define the aspects of the integration processes which could most usefully be emphasized, two main objectives should be pointed out:

a) The need to preserve and increase the most dynamic currents of intraregional trade; it would be an aberration if premature openness to third countries led to a contraction in intraregional trade and affected the lines of production with the most rapidly growing sales, especially if they involve scale effects and external economies, which indicate the existence of unused potential;

b) The need to stimulate the development of activities (production of goods and services) with a high knowledge content, as well as those of critical importance for furthering the change in production patterns. We have already stated our case in this regard; the only thing to add is that all the countries should be given the opportunity to participate in the structural change: the more advanced, through activities on the frontiers of technology;<sup>37</sup> the less developed in this respect, through forms of production that do most to further the learning process and the dissemination of technology.

Tariff preferences are indispensable as incentives for proper management in these areas. The margin of preference can be ensured by placing limits on comprehensive openness or by reducing regional tariffs. Especially for the areas chosen in function of point a) above, integration would have to undertake complex action<sup>38</sup> and develop mechanisms for promotion which in the terms used some time ago by Professor Tinbergen, lead to the authentic integration of *positive* production, that is to say, not mechanisms based on merely removing obstacles.

Clearly, the proper linking and co-ordinating of the processes of comprehensive and regional openness is not a job that can be improvised. Difficult strategy definitions need to be studied and political decisions have to be negotiated. If the countries, integration agencies, the Latin American Economic System (SELA) and ECLAC itself do not immediately take up this task, it will be too late and an opportunity will be lost which may not present itself again for generations to come.

Moreover, a preoccupation still exists which the facts have not yet been able to put to rest: at the moment of truth, will all or most Latin American countries still have the political will to keep open a field for significant regional integration? We have presupposed an affirmative answer in this article, but only the future will tell if our assumption was right.

<sup>37</sup> See Chudnovsky and Porta, *op. cit.*, pp. 141-144.

<sup>38</sup> The relevant action for technology is referred to in ECLAC, 1990, *op. cit.*, especially chapter VI, section 2, pp. 164-170.