

SEVEN
Globalisation, Argentina and Mercosul*
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In Argentina, positive signals of economic growth and price stability, together with an increase in unemployment, poverty and social exclusion, currently coexist. Mercosul, in turn, is confronting increasing difficulties and uncertainties. There is a connecting link that explains those conflicting tendencies, namely, the quality of responses to the challenges and opportunities of globalisation.

Previous studies have developed this conceptualisation. They point to the fact that the existence of a global order confronts every country with challenges. The answer to those challenges will determine its development path.¹ The economic history and the analysis of the current situation of each country are examinable through the 'good' or 'bad' quality of the responses to globalisation. It requires taking into account the complex network of historical, economical, social and political circumstances, which will finally delineate each country's path, and its insertion in the worldwide order. This viewpoint can also be applied to the analysis of a regional integration process, such as Mercosul.

If Argentina and Mercosul now have a poor performance, it is due— from such a perspective—to the result of very unfortunate responses to the challenges of globalisation. In Argentina, the problem is not new,² like indeed in the rest of Latin America.³ Today, mistakes are at a higher cost than in the past because of the overwhelming sphere of globalisation. Allow me here a brief personal reference. At the beginning of the 1980s, in the threshold of the debt crisis, I published a book entitled *Vivir con lo nuestro*.⁴ It suggested that it was essential to put the house in order, balance the international payments and, on those bases, negotiate with creditors. The external liabilities could then be honoured without resigning the fundamental interests of the country. The contrast of that proposal with the hegemonic thought, namely, the 'fundamentalist vision' of globalisation,⁵ still reverberates. In almost all the public presentations of my views, in conferences or meetings, someone always asks about *Vivir con lo nuestro*, about its feasibility in a global world. This possibly displays the underlying suspicion that the direction taken, in the antipodes of that recommendation, has not given good results in the end.

Before making a brief analysis of Argentina's behaviour with reference to globalisation, and the Mercosul situation, it is necessary to identify certain relevant elements of the global order for this analysis.

GLOBALISATION

International capital movements

International capital movements in the second half of the twentieth century have grown much more than real variables of the world economy, such as production, employment, investment and trade. For instance, international net loans stood for 8 per cent of international trade in 1964; at present, it represents more than 100 per cent.

The great majority of funds are concentrated in speculative operations that arbitrate interest and exchange rates and stock price variations. Deregulation of financial transactions and the transformation of markets prompted by the informatics revolution, have created a mega-market on a world-wide scale. This market operates, taking into account the local time differences of the principal markets, practically 24 hours a day, seven days a week.

The increase of financial currents is not reflected in an increase of real productive and social capital accumulation in the world economy. The investment rate is maintained in the order of 20 per cent to 25 per cent. The international financial market is mostly a self-contained system of assets and liabilities transactions. Its influence on the real process of capital accumulation is mostly due to its effects on customer behaviour (the wealth effect), rates of interest and governments' macro-economic policies.

The increase of private direct investment has also been substantial. At present, 60,000 trans-national corporations have 500,000 foreign subsidiaries. The subsidiaries' assets amount to more than US\$4 trillion. Their participation in the world product and capital accumulation is less than 10 per cent.⁶

In summary, on a world-wide average, domestic savings finance more than 90 per cent of real capital formation. The same proportion is valid in Argentina and Latin America. The challenge of investment policy is thus to conciliate financial globalisation and private direct investment with rules that contribute to encourage domestic savings (from enterprises, the public sector and individuals), which is the dominant source of investment financing.

New production patterns

The growth of international trade, financial flows, private direct investment and, especially, of the diffusion of information, data and image processing at a planetary scale have generated a new productive framework, strongly influenced by the global scene.⁷

These facts display the impact of micro-electronics and their multiple applications on consumer behaviour and the organisation of production and markets. Furthermore, they show this impact on the development of new capital goods and products of massive use. In turn, biotechnology and new materials have multiplied and diversified the supply of goods and services.

A remarkable result of the new technologies is the flexibility of the production organisation, due to the incorporation of multipurpose equipment (capable of producing efficiently short production series) and the workforce versatility. In multiple activities, economies of scale have disappeared. Therefore, a new frontier is open to medium and small enterprises that operate at the technological frontier, with high efficiency and competitiveness. These productive units have at their disposal the same informatics and equipment sophistication as the great corporations. In turn, the relationship between personnel and managers of those enterprises is generally more prone to assimilate industrial relations arising from new technologies. The creation of networks, hives and industrial districts of medium and small industries, and between them and great conglomerates, has strengthened the access to markets and financing. These were traditionally a blockage in the development of production units of a relatively small size. These accumulative processes within the productive structure are the principal component of what is actually referred to as the 'new economy', and a source of the productivity, incomes and investment growth.

In this way, capital, technological, organisational and market accumulation, which have been operating since the diffusion of the industrial revolution in the nineteenth century, acquire nowadays, a renewed importance.⁸ The accumulation process not only takes place at company level, but also in the associative networks among companies of different size, in the industrial districts, in the hives of enterprises and in other ways of cross-company relations. This involves simultaneous subcontracting, outsourcing and other linking processes, where the aggregate value engages the participation of different companies. In new relations with suppliers and clients, demands and inventory rationalisation arise, which contribute to increasing the efficiency and competitiveness of the companies.

Many of these changes are usually related to the so-called 'knowledge society', in which the intangible assets (research and development, patents, licences, training, etc.) acquire relevant importance. The telematics, that is the convergence between informatics and telecommunication, is closely associated to this new economy, *based* on knowledge.

Endogenous dimension and global scene

These transformations take place in a context where the opening to the global order and domestic formation of technological capacities converge. Success is related to the ability of each society to incorporate globalisation signals, in order to impulse the endogenous process of capital accumulation and wealth creation.

Solving the strains between the world context and the internal environment is, in the end, the key for development.

The problem is not solved by focusing only on the global market. Exports represent about 20 per cent of world-wide production, which means, on average, that domestic markets absorb 80 per cent of world output. In Argentina, Brazil and other Latin American countries, the percentage is even higher. On the other hand, the percentage of the internationalised production, which can be measured by the intra-trade of trans-national companies, represents less than 10 per cent of world output.

Domestic markets are therefore essential for demand and employment (on average about eight out of every ten workers are occupied in production for the internal demand). The new production patterns require an integrated approach for access to the domestic as well as the international market. Resources should be organised along lines able to satisfy the requirements of an open economy, but integrated in the accumulative endogenous synergy of organisation investment, knowledge, and institutional and social improvement.

Notoriously, globalisation increases the importance of the endogenous dynamic of economic and social development. The historical experience reveals that the success of countries reflects their capacity to participate intensely in trans-national transactions, grounded on the domestic accumulative processes. On this aspect, very little new exists nowadays.

Technical change strengthens the endogenous contents of development. The relative weight loss of primary products in world-wide output and demand reduces the importance of the international division of labour. This is based on the exchange of peripheral countries' primary products for central countries' manufactured products. In the old peripheral productive structure, it was possible to incorporate technology in the primary activity and to participate in some way in the expansive currents of the world economy. This possibility has disappeared. The only means of dynamic insertion in the global order now is by way of 'intra-industrial' specialisation, which requires the existence of a complex productive structure. This cannot be imported 'turnkey'. It requires, on the contrary, the accumulative processes mentioned above. In the contemporaneous global order, the endogenous dimension of development is more important than in any other moment of the past.

Public policies

The significance of domestic market and savings, and of the endogenous dimension of development, reveals how groundless are the *assumptions* of the 'fundamentalist vision' of globalisation. Indeed, it is not true that most transactions take place in the world market, that production is mostly transnationalised, that capital accumulation is nowadays essentially decided by trans-national actors; nor that, consequently, the frontiers and capacity of each

country to decide its own destiny have disappeared. The relevance of public policies has not vanished either.

In fact, nowadays, the quality of the response to globalisation depends largely on the efficiency of public policies and on their capacity to organise available resources, in order to join, in an equitable symmetric, nonsubordinated way, the world order. An example is the experience of medium and small companies in advanced economies. Their development resulted from the coexistence of the initiative of private actors and technological, organisational, financing and trade promotion public policies. To this end, states able to mobilise resources with sufficient autonomy were required.

ARGENTINA

An apparent paradox

Once again, during the 1990s, the Argentine economy was the stage of paradoxical events. The period registered a yearly GNP growth rate close to 5 per cent and a cumulative product per capita of about 30 per cent. This was an outstanding performance, taking into account the extended previous standstill. At the same time, the high inflation installed since the end of the 1940s, and the hyperinflation in 1989/90, were replaced by price stability. Growth registered two interruptions during 1995 and 1998/9. In both cases, it seemed an inevitable consequence of the international financial turmoil.

Other significant events were the expansion of the agricultural, energy and mining natural resources frontiers, and the improvements arising from the privatisation of public services (telecommunications, electric power energy, gas, highways, etc.), the commercial networks managed by great operators, and the banking services. Foreign subsidiaries in the manufacturing sector as well as some conglomerates of domestic capital have induced a profound transformation in the production of basic supplies (aluminium, steel, petrochemicals, oil refineries), food, automobiles, and different products of massive consumption. In these branches, production concentration in few companies and an increase in investment, technology and productivity took place.

These facts are closely related to changes in the world scene and to the policies of President Menem's government. With respect to the former, it is worth remembering the change of direction of the transfer of resources to Latin America. During the 'lost decade' of the 1980s, there was a net transference of resources *from* the region to the rest of the world of US\$220 billion. Since 1991, a considerable increase of private direct investment and financial flows has taken place, generating a positive net transfer of US\$170 billion. This enabled the financing of the Latin American countries' current accounts deficit, and an increase of the international reserves of the monetary authorities.

Regarding the policy changes in Argentina, since the beginning of his administration, President Menem launched a strategy of privatisation, market deregulation and incentives to private direct investment and external financing. Convertibility at a fixed exchange rate at the beginning of 1991 consolidated the new strategy within a price stability context.

A series of circumstances became very favourable for the evolution of the model. The net transference of resources (capital flows minus interest and profits remittances) turned from negative into positive: from minus US\$35 billion in the 1980s, to more than US\$55 billion between 1992 and 1999. At the same time, price stability had a positive effect on public opinion, internal demand and the tax revenue. Fiscal resources also increased by US\$20 billion due to the sale of public enterprises. All these enabled the expansion of public expenditure, private demand, production and income. However, a social uneasiness, and the perception of uncertainty about the future, accompanied this growth, stability and transformation scenario. Let us investigate some causes of this paradox.

Unemployment and poverty have reached the highest recorded levels. Average salaries in manufacturing activities have practically frozen in the 1990s, and have decreased for the major part of the workforce. Wealth and income distribution has worsened in the last years. Argentina is reaching juxtaposition with those countries with the worst record of income inequality.

The advances in some sectors have been accompanied by a contraction in regional economies and in a myriad of small and medium enterprises. Structural changes registered during the last years tend to create a dual economic system and labour market. In one segment, highly productive and growing activities prevail. In the other, low capital, technology and production levels per worker prevail.

The first segment generates about one-third of the GNP and approximately 20 per cent of total employment. It includes capital intensive manufacturing, privatised public services (particularly those with rapid technological change, like telecommunications), large commercialisation networks, companies in the new natural resources frontier, the most efficient agricultural enterprises, and services where informatics technology has penetrated. These activities have increased the proportion of imported supplies, disorganising previous links with internal production of goods and services (including the science and technology domestic system) and, as a whole (excluding primary product exports), they register a large deficit in their foreign currency transactions. These activities are characterised by a low capacity to generate employment and salaries substantially higher than the average for the labour force. Non-tradable goods and services, such as public utilities, register additional benefits due to the improvement of their relative prices.

The other segment generates about two-thirds of the GNP and approximately 80 per cent employment. These comprise the universe of small and medium companies, the major part of the regional productions and the post-privatisation national, provincial and municipal public service sector. In these areas, informal

employment and a low level of productivity and salaries prevail. These activities produce, almost exclusively, for the internal market and their inputs are essentially supplied by domestic goods and services. The links of these traditional sectors with the modern area of the economy have been weakened since the middle of the 1970s, especially during the 1990s. The inferior growth rate of these activities has been worsened, in the case of traded goods, by the opening of the internal market and the movement of relative prices. They suffer the effect of a fixed exchange rate and the increase of internal costs that cannot be transferred to sale prices. These circumstances have provoked the bankruptcy and disappearance of numerous companies, particularly in metal mechanics, textile and clothing. Others, like those operating in the retail trade, could not survive the competition of the supermarket networks.

This duality of the productive system and the labour market coincides with the loss of competitiveness and the increased external debt. As we shall see later, Argentina has the highest debt ratio in Latin America (after Nicaragua). Debt services generate a growing demand for foreign currency, and those of the public sector represent increasing parts of the consolidated public expenditure. The loss of competitiveness is reflected in the persistent deficit of the trade balance.

The Argentine economy is subordinated to an enormous and growing deficit in its international payments. To the debt, and the operational foreign currency deficit of trans-national enterprises, one must add the loss of competitiveness produced by the deterioration of the productive structure and peso overvaluation. Hence, Argentine exports are largely dependent on commodities and fuels. Thus, there is an increasing gap in the technological content of foreign trade. While exports suffer the relative weakness of international demand and price instability of primary products, imports increase due to the overvaluation of the peso, and the increasing imported input coefficients of the leading economic activities.

In 1999, GNP declined 3.5 per cent, but the trade balance registered a deficit of about US\$5 billion. In the new context, the traditional mechanism to re-establish the balance of payments equilibrium, that is, generating a commercial superavit by a contraction of domestic production, has been weakened. As a result of this sum of events, the need of external financing keeps increasing. At present, it reaches US\$15 billion, equivalent to 4 per cent of GNP.

The conditions that were initially so favourable to the model have changed. No public assets are left for sale, the fiscal situation worsens by the stagnation of tax revenue and the growing burden of the debt services, the behaviour of international interest rates is uncertain, and price stability has exhausted its positive effect on internal demand.

Responses to globalisation

As in many other countries, today in Argentina reforms oriented to open the economy, privatise public services, eliminate regulations and transmit friendly signals to the markets prevail. These reforms were intended to produce a more

efficient use of available resources, promote competitiveness, and increase production and employment. Thus, a better functioning of markets would allow an equilibrated and dynamic relationship with the rest of the world. However, as we have already seen, the results were not those promised. In fact, the new strategy incurred three fatal mistakes: an excessive debt; an indiscriminate inflow of private direct investments; and the renunciation to the management of economic policy. Let us briefly examine these three points.

External debt

The *coup d'état* in 1976 coincided with the rapid growth of international capital movements and the globalisation of financial markets. Since then, the external debt has continuously grown. In the early 1970s Argentina's foreign debt was negligible. At present it reaches US\$145 billion. In the 1990s, it increased 150 per cent. In relation to export values, Argentina shows the worst debt indicator in Latin America (except Nicaragua): 5.3 times against 2.2 of the regional average. Interest on the external debt represents more than 40 per cent of export values in comparison with 17 per cent for Latin America as a whole.

The effect of the external debt on public finance is also notorious. Services of the public external debt actually represent 20 per cent of the consolidated public expenditure, a proportion four times higher than at the beginning of the 1990s.

Private direct investment

During the 1990s, there was an inflow of US\$50 billion. About 80 per cent of those investments were devoted to the purchase of existing assets corresponding to privatised public utilities, and private industrial firms and commercial networks. At present, the presence of affiliates of foreign companies in the Argentine economy is probably the largest in the world. The infrastructure, the largest industrial firms, the banking system, the commercial networks, and the informatics and communication services, belong largely to non-residents. The relationship between profits remittance and exports is more than 10 per cent, while in the rest of Latin America it is around 6 per cent.

Affiliates produce mostly for the internal market, but they import supplies and capital goods, and pay royalties and dividends to their parent companies. The operational foreign currency deficit of foreign subsidiaries represents about one-third of the balance of payments deficit in the current account.

Exchange regime

The establishment of a currency board regime since 1991 was initially due to the imperious necessity of eradicating hyperinflation. The initial parity was overvalued by approximately 30 per cent. Until the convergence of internal and international prices was reached, the gap amounted to around 50 per cent. Since

the beginning (as had already happened with the financial reform in 1977), the international competitiveness of the Argentine production of traded goods and services deteriorated. The opening of the domestic market to imports, together with an overvalued exchange rate, constituted an explosive combination.

Long-term high inflation and eventually hyperinflation destroyed the national currency. By 1990, the dollar largely fulfilled the roles of mean exchange and reserve value. Convertibility, in turn, has led to a chronic overvaluation and reinforced dollarisation of the Argentine economy. The dollar circulates as a mean of domestic payment, in parity with the peso. About two-thirds of the financial liabilities and assets are denominated in dollars. In such conditions, the monetary supply is determined by the evolution of the Central Bank reserves, the rate of interest reflects the 'country risk' and the fiscal deficit is limited by the access to international credit.

The consequences

These fatal responses to the challenges and opportunities of globalisation are functional to sectorial interests associated with financial speculation, the appropriation of undervalued public assets and the corruption of decision-makers on issues of vital interest to the country.

Be that as it may, the social and economic consequences were very unfortunate and a lethal blow to the self-determination of Argentina. They installed subordination to external forces without precedent. Let us examine some of the main issues.

Economic policy

The continuous and increasing need of external financing has reduced economic policy to the administration of the debt. Its main objective is to influence the market's expectations. This domestic perception of economic policy is reinforced by the creditors' conditionalities, orchestrated by the Bretton Woods institutions. The evolution of economic activities is essentially determined by exogenous factors, in the first place, by the response of international financing markets and, to a lesser degree, by the evolution of exported *commodities* prices.

The economic policy does not have the instruments to manage the economy. The currency board, which was successful in eliminating hyperinflation, implies, in fact, a situation very close to full dollarisation. The slightest suspicion about the permanence of the peso parity is confronted with the contraction of economic activity and the deterioration of social conditions.

Economic policy is limited to transmitting friendly signals to the international financial markets intended to reduce their perception of the country's risk. Thus, supposedly, rates of interest would decrease, investment would increase, and investment and employment would grow. However, that is mostly wishful thinking, which is rarely confirmed by reality.

The economic policy of Argentina is nowadays residual and it moves within narrow operating margins. Hence, it is to a large extent impotent to mobilise domestic resources and tackle the grave problems of the regional economies, small and medium companies, and the social situation. It is also impotent to face the turmoil of the international financing markets. During the so-called 'tequila effect' in 1995, and in 1997/8 owing to the Russia insolvency and the crisis in several Asian countries, the only feasible answer was recession, unemployment, and the aggravation of the social situation. Changes in the international rates of interest or the modification of the country's risk qualification, introduces an unstable element in the budget and in the international payments, unmanageable with available instruments, namely, without an exchange, fiscal or monetary policy. The same happens with the modification of the dollar and euro parity, which affects the competitive capacity of the country in different markets. The peg to the dollar impedes the rate of exchange from compensating those variations among the main currencies.

A remarkable fact of Argentina's situation is that privatised public services (electricity, water, gas, telephones, highways) have tariffs adjusted by the inflation of the United States. In the last four years, consumer prices in the US increased by 9 per cent, while in Argentina they have not changed. Therefore, whether domestic prices increase or decrease, tariffs go up. This behaviour of one segment of the economy, essential for the overall price level, together with the enormous and uncertain incidence of the debt service, determine that salaries become the only adjustment variable to sustain convertibility and the peso parity, one to one, with the dollar. In this way, Argentina is probably at present the only country in the world in which the reduction of nominal salaries becomes an instrument of economic policy.

The productive structure

Reforms inspired in the Washington Consensus, together with the external debt, the indiscriminate inflow of private direct investments and the currency board regime, produced a drastic change in the rules of the game. The state has not remained aloof on these events. On the contrary, its strategy encouraged capital and wealth concentration and punished the regional productions and those enterprises that could not (or did not have the necessary time to) accommodate to the new context. Changes in demand composition, because of income concentration and the opening of the domestic market, direct a great part of expenditure to sectors favoured by the strategy adopted. The result is the duality that characterises the economy and the labour market.

The inflow of private direct investments consisted mainly of the purchase of public utilities, private companies, assets and trade networks already existent in Argentina. One of the consequences of these events has been the sharp reduction of personnel and the increase of productivity. Frequently, the leading economic activities have closer links with parent companies and foreign suppliers than with

the domestic economy. For many firms, Argentina is at present a market intended to sell imported goods and services or, if they are produced locally, with an increasing participation of imported inputs. The problem lies in the fact that this process does not simultaneously promote exports and competitiveness.

In developed countries and the most successful emerging economies, hives and industrial districts are found that display the integration of the economy. In Argentina, instead, we find a degradation of the productive structure and the fracture of links among their principal agents. Internal links have disappeared and new bonds with the external context have emerged. Thus, globalisation does not promote synergic relations between the world market and the domestic reality. On the contrary, it encourages inarticulation and fracture of the economic system.

These responses to globalisation frustrate the development of medium and small companies, even those intensive in the use of technology. Thus, productive units disappear from the scenery; units that, given the predominant technological changes, could have a wide horizon for development in the domestic and the international markets. Therefore, opportunities of the so-called 'knowledge society' are reduced to concentrated sectors. It is not sufficient to have access to informatics and the Internet, if the rules of the game are hostile to the growth of existing and new domestic productive units.

This context explains the poor effect of current policies to promote the development of small and medium companies and the regional economies. One of the reasons is the limited amount of resources destined to that purpose, owing to the continuous necessity to restrain expenditure, to increase the tax burden and to transmit friendly signals to the international financial markets.

Science and technology

The above-mentioned trends have weakened the links between the production of goods and services and the domestic system of science and technology. The increase in the imported content of capital accumulation has reduced the demand for locally produced technology, machinery and equipment.

Hence, problems in the scientific-technological system depend not only on the limited resources, but understandably otherwise, given the budget restrictions. The neoliberal policies have weakened the links between production and the science and technology system in a decisive way.⁹ Those facts are reflected, for instance, in the reduction of the domestic production of capital goods, the dismantling of research and development departments in numerous enterprises, and the substitution of technology and domestic innovation for imported equipment and 'turnkey' processes.

Saving and investment

Until the debt crisis of the 1980s, the investment rate in Argentina was around 22 per cent. Internal saving financed practically the totality of capital accumulation. The external debt and the indiscriminate opening to private direct investment have changed this situation. In the 1990s, the external debt increased by US\$85 billion, and there was an inflow of private direct investments of US\$50 billion. That is, an aggregate inflow of foreign capital totalling US\$135 billion. Only at the end of the decade did the investment rate recover levels of about 22 per cent. Now, however, the domestic saving finances only 80 per cent of capital accumulation. CEPAL has observed that in several Latin American countries the increase of foreign capital is accompanied by a decrease of local savings. In Argentina, the rate of domestic savings/GNP is 30 per cent lower than it was prior to the debt crisis.

Hence, capital accumulation has deteriorated. Besides, the transference of the most dynamic and profitable sectors of the economy to foreign subsidiaries implies that the allocation of resources reflects the priorities of the parent companies, rather than the objectives of Argentina. Fundamentally, the accumulation process is exogenously determined.

System organisation

In summary, the poor responses of Argentina to globalisation entail that the economy be organised according to trans-national axes: financial markets criteria, subsidiaries policies and Bretton Woods institutions conditionalities. The country has lost a great part of its capacity to conduct its policy and to organise its resources.

In all probability, the worst is not the existence of very real restrictions, but the acceptance by influential economic and public opinion sectors of the inevitability of those facts and their irreversibility. It is a 'fundamentalist vision of globalisation', according to which this may not be the best world, but it is the only one possible.

This scenery is incompatible with sustainable development, social progress and the establishment of a two-way symmetric relationship with the global order. Therefore, the country is dragged out of control by a flow of events. We shall see their effects on Mercosul in the following pages. These problems go beyond the economic sphere and engage the exercise of democracy and sovereignty in Argentina. Let us briefly refer to this point.

Democracy and sovereignty

The increasing restrictions to the management of economic policy and the predominance of the fundamentalist vision of globalisation modify both the rules of the democratic system and the exercise of sovereignty.

Sovereignty, namely, the capacity of the country to decide its own destiny in the global order, requires the existence of social and political actors with the necessary decision-making power to draw relations with the rest of the world. That is, to organise markets and resources according to criteria that, taking into account available means and actual restrictions, pursue the development of a national project.

Democracy, according to the fundamental principles established by the great political thinkers of the seventeenth and eighteenth centuries, John Locke and Charles Montesquieu, and incorporated in the Argentine constitutional order, imply that power lies in the people. In turn, division among the executive, legislative and judicial branches of government imposes the necessary equilibrium to avoid the installation of a despotic authority. Within this framework, people choose their rulers to promote common interests.

These requirements for the existence of a democracy and sovereignty have been altered now in Argentina. As we have already seen, the economy is organised around a trans-national axis, instead of rules aimed to sketch her own destiny in the global order. To influence the perception of markets beyond its consequences, on economic, social development and macroeconomic equilibrium, is the dominant objective of the economic policy.

Consider the concept 'governability of democracy'. It consists of a behaviour of the government, compatible with market criteria. If the first differs from the latter, democracy is 'ungovernable'. This approach violates the principles of democracy. In conclusion, in the new stage, power does not lie within the people. Periodical elections to choose the representatives of the people's will, is to a great extent, a symbolic act *vis-à-vis* markets, which emit their votes every day and decide which direction to follow. To make democracy governable, the executive, legislative and judicial branches of government must satisfy market criteria.

These transformations also alter the theory of conflict. Namely, the resolution of a disagreement between parties requires each one to define its interests. These interests will then be defended by their representatives. This does not apply in the present situation because one of the parties negotiates with the criteria of the other party and, very often, it is represented by people associated with the interests of the counterpart. These facts contribute to explain the deterioration in the credibility of political leaders and of the democratic system as the natural space to defend the identity and own destiny in the global order.

MERCOSUL

Relations between Argentina and Brazil

Now, let us apply this analysis to the context of Mercosul and the relations between Argentina and Brazil, which constitute the nucleus of the regional

scheme. The Foz de Iguazú Act, signed by the presidents of Argentina and Brazil on 30 November 1985, is the starting point of the recent convergence of both countries. In a few years, miscommunication and reciprocal suspicion inherited from the colonial past, different development styles and the hegemonic pretensions following the independence were overcome.

Several events helped to transform the context and intensify the bilateral relations in such a brief period of time. Among them were the return to democracy and the empathy of the new political leaders, the opening of the economy and the reciprocal guarantees regarding the peaceful objectives of the nuclear programmes of both countries.

The new framework liberated the centripetal forces among countries that share a geographical space. Neighbourhood generates potential forces of convergence due to different factors, such as lower cost of transport, reciprocal knowledge and cultural affinities.

Centripetal forces of geography are reinforced by the technological and industrial development level. Let us remember the experiences of the EU, the relations between the US and Canada, and the dynamism of the Pacific Asian Basin interchanges. On the contrary, the regional integration programmes between underdeveloped economies produce poor results, as shown in Latin America, or even more, in Africa.

In the case of Argentina and Brazil, the fact that the Rio-Sao Paulo-Córdoba-Rosario-Buenos Aires axis constitutes the most developed region of South America, is an important element to explain the expansion of bilateral trade. Complementary natural resources have also contributed in the same way.

After the Foz de Iguazú Act, the Argentine-Brazilian Act (July 1986) and the Integration, Co-operation and Development Treaty (November 1988) were both signed. In July 1989, Presidents Menem and Collor established a strategy radically different from that accorded by the previous presidents and founders of the process: Alfonsín and Sarney. To this crucial issue we shall return later on. Finally, with the incorporation of Paraguay and Uruguay in March 1991, the Asunción Treaty, constitutive of the Common Market of the South (Mercosul), was signed.

Integration requisites

Although the historical restrictions for the Argentine—Brazilian convergence were removed, other events, essential for the success of integration between countries that share a common geographical space, have not yet been resolved, in particular, the following.

Member states self-determination

An integration strategy imposes great challenges for the national policies of each party. A sufficient degree of control on the strategic macroeconomic variables

(balance of payments, budget and money supply) is required. Otherwise (i.e. severe external debt and vulnerability *vis-à-vis* speculative financial flows), the economic policy is subject to uncontrollable factors that will inevitably affect the relations of the participating countries.

Common policies are essential integration tools. Critical areas, such as science and technology, leading industries and infrastructure, require joint strategies for the development and reasonable distribution of costs and benefits.

Common actions on those fronts and the harmonisation of macroeconomic measures are possible if the parties keep control of their respective economic policies. Otherwise, it is impossible to harmonise the macroeconomic strategies and sectorial common policies are difficult to implement.

Social development

Social development is another determining factor for integration. Fairness in income distribution, employment, cohesion among social sectors, among other factors, contribute to the convergence of nations that share a geographical space. On the contrary, countries with a strong inequality in the distribution of income, a high unemployment level and indigence, and deep and historical fractures in the social order cohesion suffer internal strains that will inevitably affect the integration process. When negative contexts of such a nature prevail, the common market shrinks, possibilities of interchange diminish, and the integration itself can be used as a scapegoat for evils that have other origins.

National strategy convergence

For integration to achieve a fair distribution of its costs and benefits and the development of all participating countries, it is necessary that national policies converge in a growth strategy. This is required for an intra-industrial division of labour, which is indispensable for the simultaneous transformation and development of partner countries. On the contrary, if national policies have different objectives (i.e. only one of the partners privileges industrialisation), the benefits are unfairly distributed, which provokes strains within the system. If this happens, a 'central peripheral relation' is established in the regional division of labour, which is fatal for the future of integration.

World views affinities

The decision to integrate a pluri-national space is intended to widen the common market, increase available resources and strengthen the negotiating capacity *vis-à-vis* the rest of the world. This implies that member countries share a vision of the global scene and a common project for their international insertion. Integration means much more than trade promotion through the liberalisation of reciprocal changes. Above all, integration is a political project based on a shared

vision of the world. If the parties have different ideas on these issues, they will adopt different positions in their relations with the rest of the world. Sooner or later, these divergences will surface and the integration frontiers be narrowed.

The years between the Foz de Iguazú Act and the late 1990s constituted the 'period of grace' of the Argentine—Brazilian relationship. It was then when the impact of the above-mentioned favourable factors for the convergence of both countries was operational. At present, the consequences of the 'original sins' are emerging; those related to external vulnerability, social dissatisfaction, asymmetries in the national development strategies and the ideological crisis of globalisation.

It is in these critical issues where the actual problems of the Argentina and Brazil relationship lie. They are restraining the centripetal force of geography and narrowing the bilateral integration and the Mercosul frontiers. Let us briefly investigate each one of them.

The four original sins

Dependence

Argentina and Brazil suffer a serious external vulnerability. This is a historical characteristic of the underdevelopment of these countries, which has been aggravated in the last few years.

The situation in Brazil is less critical, albeit serious as well. The external debt increased more than 100 per cent during the 1990s. The external debt/export relationship is the worst in Latin America, after Argentina and Nicaragua. The external debt, loss of competitiveness, and the trade balance deficit, all converge in a deficit of the current account, which in 1998 represented 60 per cent of exports. The accrued interest plus profit remittances represented 44 per cent of exports in 1999.

In January 1999, the exchange policy collapsed in the course of a few months, owing to a speculative attack: two-thirds of international reserves were lost. After devaluation, the external situation started to recover. However, in Brazil the continuous need of external financing is also a main determinant of economic policy.

Brazil's flexibility of the exchange policy allows a certain level of autonomy in the management of macro-economic policy, non-existent in Argentina owing to the convertibility regime. Anyway, a central variable of the bilateral relation, the peso—real parity, is determined by exogenous factors. In such conditions, co-ordination of macro-economic policies is only an impractical wish. Integration policies are therefore the residual element in a framework exogenously determined by the extreme external vulnerability of both countries.

Financial globalisation influences the policy of all countries, but only in those indebted and vulnerable (such as Argentina and Brazil) does it provoke such a restriction on the management of economic policy.

The problem is aggravated, probably much more in Argentina than in Brazil, by the predominant 'fundamentalist view' of globalisation. According to this vision, the actual is the only world possible. Therefore, only policies that adapt the criteria prevailing in the world power centres and financial markets are realistic and viable. This vision has an amazing capacity of survival even after the greatest catastrophes provoked by neoliberal policies.

Poverty and social exclusion

Argentina and Brazil face serious social problems. Brazil, according to President Cardoso, 'is not an underdeveloped country, it is an unfair country'. Brazil is certainly one of the nations with the greatest inequality in the distribution of income and wealth. Conspicuous consumption coexists with indigence and poverty, prevailing in the majority of the population in the vast national territory. In spite of its considerable development during the twentieth century, Brazil was not able to overcome the inheritance of the slavery regime and its colonial past.

The evolution was different in Argentina. Immigration of European origin from the second half of the nineteenth century transformed the demographic composition, and practically the whole population was integrated into the market economy. The abundance of fertile lands in the Pampas region enabled a high productive agriculture system, which sustained the considerable development of the country until the 1920s.

In spite of a significant income and wealth concentration, economic growth and a successful public education policy, it conformed to an integrated social system. The industrial development following the crisis of the 1930s intensified those characteristics of the Argentine society.

The situation changed drastically during the last quarter of the century. The economic standstill, external vulnerability, hyperinflation registered in various periods and neoliberal policies, increased the income and wealth concentration. Nowadays Argentina suffers indexes of unemployment and poverty unknown during its whole historical trajectory. Insecurity, corruption and social strains reflect the consequences of these tendencies.

The social situation prevailing in Argentina and Brazil is an obstacle to integration. It affects the development of both countries and reduces the common market dimension. Also, the bilateral problems in the trade field are used to explain the problems, which convey more complex internal reasons: for instance, the treatment given by Argentina to the devaluation of the real at the beginning of 1999. Although exports to Brazil represent only 3 per cent of the Argentine GNP, the idea that all problems in the country were due to the 'Brazil dependence' was disseminated.

Fear of contamination and danger that the convertibility regime could collapse deepened the adjustment in Argentina and its consequences on the economy and society. However, the problem was not provoked by the Brazilian situation, it was due in the first place, to the external vulnerability of Argentina.

The social problems of both countries constitute one of the 'original sins' of the integration process, which has tended to be aggravated during the last years.

National strategy asymmetries

The third 'original sin' of the bilateral relationship is the asymmetry of the national development strategies. In the long term, Argentina's strategy has been more erratic. Brazil has maintained, in spite of all domestic contingencies and changes in the international context, a policy oriented towards industrialisation and promotion of technical changes. This policy has not been sufficient to defeat, definitively, the underdevelopment and dependence, or to resolve serious social problems. However, Brazil has created a considerable industrial system and a scientific-technological base to sustain it. The development of the domestic market and the leading role of the Brazilian businessmen are a traditional characteristic of the Brazilian situation.

In opposition, Argentina has led an erratic strategy and development path since the crisis of the 1930s. Starting with the military dictatorship installed in 1976, an extraordinary policy of dismantling the industrial apparatus, destruction of the scientific-technological bases and the external indebtedness started, whose consequences still prevail and have not yet been overcome. Argentina suffers the absence of a critical mass of leading entrepreneurs with the willingness to accumulate power in the national scene and to project themselves to the international market. The associative and subordinate behaviour towards trans-national finances and organisations has not enabled a consolidation of a nucleus of local entrepreneurs and financiers, powerful enough to make feasible an 'Argentine capitalism'.¹⁰

The government of President Menem consolidated the subordination to exogenous factors through a successful stabilisation policy and the foreignisation of the principal nucleus of the Argentine economy. The asymmetry of the national development strategies is reflected in the modification of the relative weight of the two economies. Until 1950, the Argentine GNP was higher than the Brazilian one: at present, it represents only one-third. The different population growth rate has been an influence, but the main reason lies in the prolonged stagnation of the Argentine economy since the second half of the 1970s. As we have already seen, the 1990s recovery was due to the exceptional conditions of external financing and the initial impulse of price stability.

The asymmetry of the national development strategies is reflected in the bilateral division of labour. In Argentine exports and in Brazil's manufactures, commodities prevail, revealing the creation of a 'centre periphery' regime. This narrows the integration frontier. The only model that makes integration and

development of each party compatible in the long term is ‘intra-industrial specialisation’. The integration strategy of Menem and Collor’s governments validated the current predominant style of the bilateral relationship.

International insertion divergences

The agreements of Presidents Alfonsín and Sarney show that their governments shared a common project of insertion in the world-wide order, and an interpretation of globalisation. Foundational documents and declarations reveal that the two governments were certainly worried about the dimension of their internal problems, and what they considered necessary to modify their relations with the rest of the world in order to solve them. Debt, external vulnerability and creditors’ conditionalities were problems in which a co-ordinated approach would strengthen the negotiating force of both countries. They did not pretend to be isolated or ignore the existing restrictions, but they did intend to defend, together, the interest of each party. They aimed, in conclusion, to define an adjustment and development strategy alternative to the *Washington Consensus*.¹¹ This implied not only the co-ordination of the foreign policy, but, at the same time, a style of division of labour within the common space. Hence, the *intra-industrial integration* strategy of leading sectors, in which the protocol referred to capital goods, was the most relevant.

The strategy was drastically modified by Presidents Menem and Collor. Since the Buenos Aires Act (July 1989), the *intra-industrial* sectorial integration was substituted by linear and automatic reduction of imports tariffs. The market then assumed the command of the process, and policy practically disappeared from the scene.

Argentina also adopted revealing decisions in which her strategic option was not the integration with Brazil, but the unconditional alignment with the US. (Thus, the dollarisation proposal and the relationship with NATO.) In turn, Brazil took diplomatic initiatives, such as negotiations with Mexico, which also revealed the loss of the strategic significance of the relations with Argentina.

In different stages of the Menem government, from the official sphere and influential private groups, accusations were made about the ‘Brazil dependence’ and promoted the strengthening of the unconditional alignment with the US, including the preference of the American free trade zone in opposition to Mercosul. Within this context, the relationship with Brazil was maintained only by the centripetal forces of geography, and the private interests related to bilateral interchange expansion. Political initiative disappeared, and the Argentina and Brazil relationship was reduced to the insufficient formal reiteration of integration objectives.

The situation changed with the triumph of the Alianza. In its electoral campaign, the coalition recovered the strategic meaning of the relationship with Brazil, and the foundational principles of convergence. However, the new

position of the President de la Rúa government has to face the problems inherited and the 'original sins' of the process.

Current problems

The notable expansion of the reciprocal trade since 1985 shows the influence of the favourable factors of the 'period of grace', mentioned at the beginning of this chapter. The increase of total imports of Argentina and Brazil, sustained by the abundance of international financing, has also contributed.¹²

Once the external vulnerability fell again in a critical phase and economies entered into a recession, the Argentine-Brazilian trade diminished. In fact, in 1998 and 1999, the tendency installed since 1985 was interrupted.

The devaluation of the real in January 1999, drastically modified the exchange parity between both currencies. This is not new.¹³ The volatility of parity is the consequence of one of the 'original sins': external vulnerability of both countries. It is now particularly serious because of the current economic situation in Argentina.

Given the Argentine exchange regime, although a certain revaluation of the real is expected in the short term, a loss of competitiveness of Argentina is feasible, with its consequences in the bilateral trade balance. In this scene, problems arise one after the other: footwear, textiles, milk products, rice, chickens, pork, paper, steel, etc. Only the administered trade areas, such as automobile and fuels, remain practically outside the consequences of the exchange turmoil.

The difficulty of solving these problems is not due to the lack of common institutions, like the Commission of the EU. During the 'period of grace' direct negotiations between the governments were sufficient and successful in the treatment of the questions discussed. The real problems lie in the 'original sins'.

All comparisons of the Mercosul experience with the EU are of limited value, among other reasons, because none of the four 'original sins' of the Argentina and Brazil relationship existed during the French—German convergence and the signature of the Rome Treaty in 1957. Attitudes of public and private actors of Argentina and Brazil towards integration reveal the complexity of the situation.¹⁴ Recent events have weakened the strategic priority that the bilateral relation had for the two countries in the foundational times.

The 'period of grace' of the Argentina and Brazil convergence is exhausted. Advances achieved in the bilateral trade and closer relations of public and private actors will probably be maintained. After all, the gravitation of the centripetal forces of geography is there. However, the concretion of the original project seems, at the moment, a distant possibility.

The four 'original sins' now present challenges that can no longer be ignored. We should ask ourselves if two vulnerable countries, with enormous social problems, different development strategies and remarkable asymmetries in their international insertion, could achieve objectives as those stated in the Foz de Iguazú Act and in the Argentine-Brazilian agreements previous to the Asunción

Treaty. The answer is no, unless the 'original sins' are tackled. It would be necessary to remove the external vulnerability and to recover enough operational freedom in the execution of national policies, in order to install an effective convergence of the macro-economic strategies. This is a precondition difficult to achieve in the near future. A sensible improvement of the social situation is also difficult to attain.

However, the problems arising from asymmetries of the development and international insertion strategies could be solved, if the foundational spirit of Argentina and Brazil convergence is recovered.

In summary, the bilateral relation and its future depend on the removal of the political and ideological barriers. This is a necessary condition to work jointly in the resolution of the external vulnerability and the social situation, i.e. of the underdevelopment and dependence of these two countries.

The new stage

The relaunching agenda of the foundational project of the Argentine-Brazilian convergence includes the following priorities.

Ideological crisis solution

It is necessary to recover a realistic vision of the development process, which is necessarily endogenous and open to the world. The fundamentalist vision of globalisation should be rejected. It is necessary to recognise the coexistence of a global dimension with the decisive weight of internal resources and markets, and that development has always been and still is a process of political construction, social cohesion and aptitude to decide their own destiny in the global order. It is in these inspiring ideas where the revival of the Argentina and Brazil convergence lies.

Recognition and understanding of each country's problems

Precisely due to the existence of the 'original sins', Argentina and Brazil convergence is facing complex problems. Argentina should recognise that the devaluation of the real in January 1999 was not an autonomous decision of the Brazilian economic policy. On the other hand, Brazil must understand that Argentina will remain, for an undetermined period, crucified to convertibility. With her hyperinflationary experience, the country is terrified of descending from the cross, to face what lies below, in the real world of flexible variables, including the peso parity. While Argentina does not resolve her exchange dilemma (which is an unsolvable obstacle for macroeconomic effective coordination), *ad hoc* mechanisms, compensatory of brusque changes in the peso-real parity, should be found.

In these as in other issues, it is essential to defend the strategic objective with a frank and comprehensible discussion of the problems that each country is facing.

Harmonisation of the regulatory framework

The Programme of Activities for year 2000, approved in December 1995, included joint actions, within Mercosul, in issues like the custom code, competence defence, services trade, antidumping standards, trade barriers, mutual recognition of national standards in health matters, purchase regimes of the governments and social security, regulation and supervision of the financial sector. In all these issues, a strong political support would enable harmonisation of the regulatory framework of integration.

Emphasis on the sectorial agreements and the common policies in strategic areas

It is necessary to recover the decisive importance that sectorial agreements had in the foundational project of the Argentine-Brazilian convergence. In the main economic areas, it is possible to establish agreements that will promote trade and investments within a model of *intra-industrial* division of labour. The automobile agreement is an example in this subject.

In science and technology, the possibilities of association are numerous. For instance, in the nuclear sector, it is possible to create a common strategy for the development of the nuclear energy applications, as electricity production, food preservation, medical uses and training of human resources. In this field, the Atomic Energy Commission of Argentina has proposed the creation of an *Argentine Brazilian Agency on Nuclear Energy Applications*, to programme the common development. In other areas, like biotechnology and informatics, the possibilities of association are also numerous.

As in the origins of the Argentine-Brazilian convergence, the initiative depends, in the first place, on the political leadership. If the ideological crisis can be unravelled, and development and international insertion strategies converge, better conditions to remove the external vulnerability and to resolve the great social problems of both countries would be created.

The future of Mercosul and the development of Paraguay and Uruguay, as well as the widening of the common market with the incorporation of Bolivia and Chile, depend on the Argentinean and Brazilian capacity to remove the 'original sins' that hinder their bilateral relations.

NOTES

*This chapter was translated by Mrs Alicia Semino and revised by the author.

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