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INTEGRATION STRATEGIES IN THE SOUTHERN CONE:
A COMPARISON OF ARGENTINA, BRAZIL AND CHILE.

BY
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Thesis submitted to the School of Graduate Studies and Research in partial fulfillment of the requirements for the degree of Master of Arts in Political Science.

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ABSTRACT

This thesis will demonstrate how the changes in the international system have influenced the Southern Cone countries of South America (i.e. Argentina, Brazil and Chile) to adapt their trade strategies between themselves and the major industrial powers. It will also examine how the domestic forces limit or enhance the ability of a given country to respond to these changes.

It is argued that because multilateralism is insufficient in protecting the interests of the developing economies at the periphery of the major trade blocs (i.e. the United States and its NAFTA partners, the European Union, and Japan and the East Asian NICs), sub-regional integration offers an alternative strategy for these countries. Within this strategy of regional integration, three policy options are available; sub-regional integration as a form of counter balance to the trade blocs, sub-regionalism as a preparatory step into a trade bloc, and unilateral bloc entry.

The policy options chosen by the Southern Cone countries will be influenced by the emerging structures within the international system and by the level of vulnerability these countries have towards the major trade blocs. More precisely, the greater the economic vulnerability of a country, the greater will be the need to diversify the trade relations as posited with the unilateral bloc entry model. In contrast, the less a country is vulnerable economically, the more likely it will pursue a counter-balance strategy to increase its bargaining strength and enhance its access towards either the regional markets or those of the major industrialised countries. States with moderate levels of economic vulnerability will pursue a strategy using sub-regional integration as a preparatory step into the trade blocs, as well as using the sub-regional entity as a forum to protect and enhance their current economic interests.

However, even though it is hypothesised that a high level of economic vulnerability may lead to a unilateral bloc entry strategy, the level of reforms undertaken by a state will also constitute a form of vulnerability. These reforms are associated with certain demands emanating from the major trade blocs as prerequisites to closer trade relations (i.e. reductions in tariff and non-tariff barriers, stabilisation of macro-economic indicators, protection of intellectual property rights, etc.). Thus, the more that a country has been able to institute reforms the greater the likelihood of the unilateral bloc entry model. Consequently, the less a country has instituted reforms, the more likely they will choose the counter balance model. As for those countries that exhibit moderate levels of reforms, the model chosen may be associated with sub-regional co-operation as means to join a trade bloc.

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LIST OF ACRONYMS AND ABBREVIATIONS

ABEIP	Argentina-Brazil Economic Integration Pact
APEC	Asia Pacific Economic Co-operation
CUSTA	Canada-United States Trade Agreement
EAI	Enterprise for the Americas Initiative
ECLAC	Economic Commission for Latin America and the Caribbean
EU	European Union
FDI	Foreign Direct Investments
FTA	Free Trade Agreement
FTAA	Free Trade of the Americas Agreement
GATS	General Agreement on Trade and Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
IMF	International Monetary Fund
ITC	International Trade Commission
MAI	Multilateral Agreement on Investments
MERCOSUR	Southern Cone Common Market
MIGA	Multilateral Investment Guarantee Agency
NAFTA	North American Free Trade Agreement
NIC	Newly Industrialised Countries
NTB	Non Tariff Barrier

OECD	**Organisation for Economic Co-operation and Development**
SAFTA	**South American Free Trade Area**
TNC	**Trans-national Corporations**
USTR	**United States Trade Representative**
VERA	**Voluntary Export Restriction Agreement**
WHFTA	**Western Hemisphere Free Trade Agreement**
WTO	**World Trade Organisation**

INTRODUCTION.

This thesis will demonstrate how the changes in the international system have influenced the Southern Cone countries of South America (i.e. Argentina, Brazil and Chile) to adapt their trade strategies between themselves and the major industrial powers. It will also examine how the domestic forces limit or enhance the ability of a given country to respond to these changes. The major change in the international system which has had a direct influence on trade and investment strategies of developed and developing countries alike, is the shift from a loose bi-polar system towards a multilateral system controlled by a Triad of regional trade blocs. This Triad, in effect, greatly influences the direction and amplitude of the trade and investments between countries in the international system. Developing countries at the periphery of this Triad are thus faced with different options as to how they are going to adapt to these changing circumstances. It will be argued that because multilateralism is insufficient in protecting the interests of the countries at the periphery, regional integration offers an alternative strategy for these countries. Within this strategy of regional integration, three policy options are available: sub-regional integration as a form of counter balance to the trade blocs, sub-regionalism as a preparatory step into a trade bloc, and unilateral bloc entry.

The policy options chosen by the Southern Cone countries will be influenced by the emerging structures within the international system (i.e. the more closed the Triad becomes to market and investment access, the more that the countries will seek alternate strategies to multilateralism) and by the level of vulnerability these countries have towards the Triad. Moreover, the concept of structural change occurring at the international level is similar to that arising at the sub-regional level. Thus, the factors propelling structural change at the international level as well as those at the sub-regional level will be associated with the "deep structures" (i.e. change in the system's ordering and organisation). Thus the more that the international system undergoes change in ordering and organisation, the more that the developing countries will have to alter their relationship with the major industrial countries and with other countries within their region. It is therefore crucial that countries wishing to protect their national interest in regards to the maintenance or enhancement of their power capabilities acquire access to or influence the governing structures. However, the stability of the sub-regional structures will be weaker than those found at the international level. This will therefore increase the region's vulnerability in the new configuration of the international system and thus limit their range of strategic options. This relationship is developed through a discussion on complex interdependence as outlined by authors such as Donald Crone, Robert Keohane and Joseph Nye. Therefore, given the recent structural changes occurring in the international system (i.e. complex interdependence with the formation of trade blocs) and the shortcomings of multilateralism as an approach to overcome the challenge of development in the new global order, sub-regional integration can be seen as an alternative strategy for developing countries.

The concepts of vulnerability and sensitivity as employed by Keohane and Nye are used to define certain variables that will be used in several hypotheses related to the choice of particular strategies associated with sub-regional integration. More precisely, the greater the economic vulnerability of a country, the greater will be the need to diversify the trade relations as posited with the unilateral bloc entry model. In contrast, the less a country is vulnerable economically, the more likely it will pursue a counter-balance strategy to increase its bargaining strength and enhance its access towards either the regional markets or those of the major industrialised countries. States with moderate levels of economic vulnerability will pursue a strategy using sub-regional integration as a preparatory step into the trade blocs, as well as using the sub-regional entity as a forum to protect and enhance their current economic interests. However, even though it is hypothesised that a high level of economic vulnerability may lead to a unilateral bloc entry strategy, the level of reforms undertaken by a state will also constitute a form of vulnerability. These reforms are associated with certain demands emanating from Trade Blocs as prerequisites to closer trade relations (i.e. reductions in tariff and non-tariff barriers, stabilisation of macro-economic indicators, protection of intellectual property rights, etc.). Thus, the more that a country has been able to institute reforms the greater the likelihood of the unilateral bloc entry model. Consequently, the less a country has instituted reforms, the more likely they will choose the counter balance model. As for those countries that exhibit moderate levels of reforms, the model chosen may be associated with sub-regional co-operation as means to join a trade bloc.

The Southern Cone of South America provides a useful context for the comparative analyses of these strategies and their causes because of the inherent similarities and differences associated with the individual countries. For example, although Argentina, Brazil and Chile are all Latin American countries which have faced high levels of debt exposure with periodic flights of capital investments, their differing levels of vulnerability towards economic and social variables has created a distinct set of policy directions related to sub-regional integration as a means to development. How the international system and the domestic variables come to influence integration strategies is, as a result, central to this study.

The first chapter of this thesis will examine the concept of systemic and structural change in the international system. The second chapter will concentrate on the changes occurring in the international system following the demise of the loose bi-polar system, and the third chapter will study the policy directions that are being undertaken at the sub-regional level in the Southern Cone in reaction to these changes. The fourth chapter will examine the degree of vulnerability as it pertains to external trade, external debt and investment, and socio-political forces set for or against reforms. The fifth chapter characterises the integration policies taken thus far in the Southern Cone whereas the sixth chapter elaborates on the forces that have led to these strategic integration policies. The final chapter will conclude by demonstrating the forces that have brought about structural change both at the international level and at the domestic level and by commenting on the impiication that these differences have on future development strategies.

I. THE INTERNATIONAL SYSTEM: STRUCTURAL CHANGE AND IMPLICATIONS FOR DEVELOPING COUNTRIES.

Understanding the policy options that the Southern Cone may undertake in the post-cold war era requires study of the international system because this system takes on its own dynamic which then affects the behaviour of its comprising units (i.e. states). In other words, it is argued that the international system acts "as a constraining and disposing force on the interacting units within it".[1] Nevertheless, although the state apparatus is affected by the international system, it retains a certain autonomy towards the system and, as a result, can influence its further development. As a consequence, what will determine a state's strategic relationship towards other actors within the international system is the structure of this system.[2]

A. The International System and Structural Change.

To study the structure of the international system, Waltz examines three concepts: how the system is ordered and organised, how the states are differentiated, and how power capabilities are partitioned amongst countries.[3] With regard to the organisation and ordering principle of the international system, Waltz accepts the major tenets of realist thought. For example, the contemporary international system remains anarchic because states, in the absence of any central authority, pursue their own self-interest in order to protect the national interest.[4] However,

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[1] Kenneth Waltz, Theory of International Politics, Reading, Mass.: Addison-Wesley Publishing Co., 1979, p.72.

[2] Ibid., pp.90-99.

[3] International structures are defined as the laws of association for the comprising units within the international system. John G. Ruggie, "Continuity and Transformation in the World Polity: Toward a Neorealist Synthesis," in Robert Keohane's Neorealism and its Critics, New York: Columbia University Press, 1986, p.134.

[4] John G. Ruggie, "Continuity and Transformation in the World Polity: Toward a Neorealist Synthesis," Neorealism and its Critics, New York: Columbia University Press, 1986, p.134. For an analysis of realism

neorealism also argues that although the international system is formed by member states, its sheer size and dynamism may be overwhelming for any one state to control.[5]

As for the second concept, how states are differentiated, it is argued that states are in effect similar because they all pursue the same basic goals (i.e. the national interest).[6] However, it is also argued that the national interest will differ from country to country, and that as a result, not all states pursue the same objectives.[7] For example, a small state may pursue political goals that diverge fundamentally from those of a hegemon because of the fact that power is calculated differently relative to the circumstances with which states are confronted in the international system. Self-preservation for a small state may not be associated with the acquisition of power capabilities per se. Rather, the constraining of a dominant power via international organisations and/or alliance structures (i.e. trade agreements) may be a rational strategy to be pursued. Nevertheless, the fact that states pursue national interest policies, regardless of the means by which they are attempted, will lead to a similarity in functionality.

Finally, the concept of the partitioning of power capabilities among different states is an important structural component of the international system because of the fact that different political outcomes from state strategies will result from different power structures (i.e. bilateral versus multilateral structures).[8] It is important to note that this partitioning of the power capabilities is the result of the systems ordering and organisation principle. Thus, it could be said that the level of influence a state exhibits in the international system might become an

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and the protection of the national interest see. Hans J. Morgenthau, Politics Among Nations: The Struggle for Power and Peace, 4th ed., New York: Alfred A. Knopf, 1967.

[5] Waltz, Theory of International Politics, pp. 90-91.

[6] Ibid., pp. 93-97.

[7] Steven Krasner, Defending the National Interest, Princeton: London University Press, 1978, p.41.

[8] Waltz, Theory of International Politics, pp.98-99.

important element in determining the ability to develop its power capabilities or, in other words, defend its national interest.

As for the concept of change and how it pertains to the positioning of a particular state within the international system, Waltz is of the opinion that two types of transformation can bring about structural change: transformations of the order within the international system or transformation of power capabilities.[9] For example, as one state acquires more power, it follows that other states will try to form alliances to balance this new found capability. On the other hand, a change in alliance structure may lead to structural change so as to preserve this new ordering. Thus the national interest can be pursued in an anarchic system either by internal means (i.e. the increase in economic or military strength) or by external means (the bolstering of strategic alliance structures). Furthermore, the nature of the international structure may determine whether shifts in power balance strategies will lead to conflict. Depending on the number of actors holding major power capabilities, the system may be either stable or bellicose. The fewer the number of actors holding power capabilities, the lesser the chance for war.[10] This concept is of major interest because Waltz is of the opinion that the greater the number of major powers the higher the level of interdependence between economies.[11] To manage this interdependence and reduce the chances for conflicts some form of international management by a central authority must eventually be contemplated.[12]

As argued by Keohane and Nye, the international structures are seen as elite networks resulting from intergovernmental and trans-governmental ties initiated by the creation of formal

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[9] Ibid., p. 93. See Ruggie, "Toward a Neorealist Synthesis," pp.142-148, for an argument that structural change can also be affected by system's differentiating principle.
[10] Ibid., p.198.
[11] Ibid., p.145.
[12] Ibid., p.138.

institutions.[13] Furthermore, international organisations are "multilevel linkages, norms and institutions" that were initially created by a hegemonic power.[14] In explaining changes in the international system when force is rendered ineffective by conditions of "complex interdependence", the focus of study no longer is directed strictly towards the individual state actors but, rather, at the international organisations which maintain a certain autonomy in regards to the decline in power capabilities of the state apparatus.[15] This conceptualisation borrows from the Gramsican model of hegemony in which power is also judged in terms of the ideological influence that a state may have on civil society even after its decline in power capabilities.[16] Donald Crone also utilises complex interdependence to explain multilateral regime durability or change even after the decline in the power capabilities of a hegemonic power. He argues that this decline may witness the creation of new multilateral regimes because of the fact that "as disparities narrow due to exogenous power changes, incentives shift to the pursuit of a more institutionalised, multilateral bargaining context".[17] In other words, the fact that a state is in hegemonic decline may force it to pursue further multilateral arrangements to maintain its influence over the international system via the new regimes it creates. As such, lesser powers

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[13] Robert O. Keohane and Joseph S. Nye, Power and Interdependence, Boston: Scott, Foresman and Co., 1989, p.54.
[14] Ibid., p.54.
[15] Ibid., pp. 54-57. Complex interdependence occurs when the following three characteristics are present in the international system. 1) An increase in multiple channels of relations between states (i.e. formal as well as informal exchanges between governments). 2) There is an absence of hierarchy among issues such that no one issue will prevail in the relations between states. As such, the distinction between what constitutes domestic and international issues becomes not only more confused but also creates different levels of conflicts and cooperation. 3) Finally, military force is rendered obsolete in relation with other state entities because security conditions are less bellicose and the cost of linkage between military force and other issues are too high.
[16] Robert Keohane, After Hegemony: Cooperation and Discord in the World Political Economy, Princeton, N.J.: Princeton University Press, 1984, pp. 44-45. See also Robert Cox, "Gramsci, Hegemony and International Relations: An Essay in Method," in Stephen Gill's Gramsci, Historical Materialism and International Relations, Cambridge: Cambridge University Press, 1993, pp. 50-52.
[17] Donald Crone, "Does Hegemony Matter? The Reorganization of the Pacific Political Economy," World Politics, No. 45, July, 1993, p.504.

may be willing to contribute to these initiatives because they may wish to constrain the declining power from possibly reverting to unilateral protectionist policies.[18] Since the organising and ordering principle will greatly influence the ability of states to develop their power capabilities, major powers will vie for control of the global institutions and structures. This may lead to balance of power policies between the major powers so as to better their bargaining position within the international system. As will be discussed, these policies may take the form of closer economic and political ties with developing countries.

However, it is important to note that complex interdependence may be rendered ineffective when force suddenly becomes a viable weapon in order to protect the state from vulnerability dependence. In other words, from "an actors liability to suffer costs imposed by external events even after policies have been altered."[19] As will be discussed in greater detail in the third chapter, vulnerability not only comes from the physical dependence which may be affected by external factors, but also from socio-political forces which limit the ability of a state to adapt to new circumstances. It is of interest, therefore, to examine how developed and developing countries are able to alter their domestic policies to take advantage of changes in the international structures.

B. Implications for Developing Countries.

The concept of structural change and how the international system is organised and ordered is of major concern to developing countries because the pursuit of the national interest may need to be modified to reflect new power relationships and international structures. As long

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[18] Ibid., p.505.
[19] Keohane Nye Power and Interdependence, p.13.

as the international system remains anarchic and that the constituent units (i.e. states) pursue strategies based on the national interest, certain forms of balance of power policies will result. These balance of power strategies will not only be manifested among the major powers, but also from developing countries that may wish to constrain these major powers within new international structures. Two types of policies can be examined that help discern the foreign policy directions of individual states in the international system. The first will be those policies that are internally focused. This strategy attempts to increase the domestic power (in economic and/or military terms) in relation to other actors in the international system. The second set of policies is externally focused and is associated with strengthening various alliance structures.[20]

It thus becomes important to this study to determine which of the two types of strategies is most effective as a means of creating the conditions for development in the Southern Cone: internally focused regional integration which will be associated with counter balancing the major powers in the international system, or, externally focused integration which attempts to develop greater links to the international structures and dominant countries.

[20] John G. Ruggie, "Continuity and Transformation in the World Polity: Toward a Neorealist Synthesis," p.136.

II. THE POST COLD WAR AND STRUCTURAL TRANSFORMATIONS.

To understand the strategies that will be attempted by developing countries such as those of the Southern Cone, it is crucial to examine the new international structures within which new development policies will take effect. It will be argued that the decline of the loose bi-polar system accelerated the economic changes towards the creation of major industrialised trade blocs. It is, therefore, important to determine if the international system in the Post Cold War era will be based on multilateralism and interdependence or whether the system will become regionalized and bellicose.

A. The Decline of the Loose Bi-polar System.

By using Waltz's conceptualisation of structural change, the demise of the Soviet Empire can be seen as a major cause that has affected the international structures. As the super-powers, under which the loose bi-polar system was organised, weakened or disintegrated, new structures based on economic multi-polarism began to take shape.[21] Countries which had been allied under one of the two bloc structures for strategic military reasons, now had to contend with international structures which linked internal economic reform with access to Foreign Direct Investments (FDI), international aid, international organisations, etc. The problem of free riders, countries able to benefit from international institutions and/or regimes without necessarily

[21] Fred Halliday, "The Third World and the End of the Cold War," in Barbara Stallings' Global Change, Regional Responses. The New International Context of Development, New York: Cambridge University Press, 1995. Also see Barbara Stallings and Wolgang Streeck "Capitalism in conflict? The United States, Europe, and Japan in the Post-Cold War World," in Global Change, Regional Responses. The New International Context of Development, New York: Cambridge University Press, 1995.

contributing to their maintenance or adhering to their code, was made more difficult as the major powers began to concentrate more on their own relative economic growth and market share rather than strengthening members of military alliances. Furthermore, as the concept of power becomes more "fluid" in a multipolar system (i.e. power capabilities are distributed more evenly between several poles), there is a greater chance for defection from co-operation with international institutions by the major powers.[22] Alternatively, the greater the discrepancy between powers, the more likely co-operative agreements will be respected (especially by the weaker party). Thus for international institutions to be effective, they must provide their members with greater transparency in order to reduce tensions relating to the motives and actions of other members and to offer an ongoing forum for continued negotiations.

B. Globalisation and the Effects on the Nation-State.

Another major transformation that has occurred in the international system and which has been accelerated since the decline of the loose bi-polar system relates to the impact of globalisation on the nation state. Globalisation has been caused by the internationalisation of both trade and production since the Second World War.[23] Trade and investment flows no longer are the domain of the state apparatus to control. Rather, states are now forced to react to these economic forces in order to influence them. Different policy options exist that countries may use

[22] Beverly Crawford, "Explaining Defection from International Cooperation: Germany's Unilateral Recognition of Croatia," World Politics, Vol.48, No. 4, July 1996, p.486.
[23] See, Robert Cox, Production, Power and World Order: Social Forces in the Making of History, New York: Columbia University Press, 1987, for an analysis of the internationalization of the state and the forces of globalization. Also see, John B.Goodman and Louis W. Pauly, "The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets," World Politics, Vol.46, No.1, Oct., 1993, for description of how capital markets evade state control. Gilles Breton, <<Mondialisation et science politique: la fin d'un imaginaire théorique?>>Etudes international, XXIV, Sep., 1993, provides a description of globalization in the realm of ideas and social relations.

to attempt to benefit or protect themselves from these global forces (i.e. regionalism and/or unilateralism).[24] However, it should be mentioned that economies which are less vulnerable to global forces (but who are still affected by them) are better suited to maximise their trade position relative to other powers in order to attract and/or maintain the favourable conditions for growth. In other words, a country which possesses the capacity to generate the necessary incentives for continued economic growth is more likely to benefit from globalisation (i.e. continued support from external forces such as capital markets) than those countries which are perceived as posing a greater risk to international capital.[25]

As tables 1 and 3 indicate, trade and investment flows in the international system are concentrated around three major industrial blocs (i.e. the United States and its NAFTA partners, the European Union and Japan and the East Asian NICs). Those countries that do not embark on liberal policy reforms imposed by international capital to attract the much-needed FDI risk being marginalized from the increasingly regionalized global economy. Consequently, the policy choices adopted by governments of many developing countries will reflect liberal trade reforms designed to satisfy global investors and hopefully gain access to the export markets of the tri-polar regional centres. For example, if a developing country's reform program fails to assure global investors and/or to attain a favourable trade position with one of the economic

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[24] Arguments on the limits of globalization and its affects see Claire Turenne Sjolander, "Multilateralism, Regionalism, and Unilateralism: International Trade and the Marginalisation of the South," in Elizabeth Riddell-Dixon (ed.) The State of the United Nations: 1993, Providence, R.I. : The Academic Council of the United Nations System, 1994, and Andrew Axline, "Globalization, Marginalization and Integration: The New Regionalism and Developing Countries," Working Paper, Faculty of Social Sciences, University of Ottawa, 1995.

[25] It is argued in Axline, "Globalization, Marginalization and Integration: The New Regionalism and Developing Countries," pp. 17-20, that globalization is limited in its intensity and as a result the spatial distribution of globalization is regionalized towards the major industrial countries.

centres, the result may lead to the loss of the much needed investment capital that these countries have come to depend upon for their economic growth and development.

Furthermore, the countries of the Triad have attempted to limit or enhance the effects of globalisation by forming trade agreements with other countries which are deemed complementary or beneficial to their trade strategies (i.e. trade bloc formations) and/or by the use of unilateral trade actions against certain "recalcitrant" states. Therefore, in the context of new international structures, it is important to determine whether the international system a) is one based on multilateralism and interdependence, or b) is becoming regionalized through exclusive membership into trade blocs.

C. Limits to Multilateralism as a Development Strategy.

It has been argued by Bhagwati that the multilateral trading system is based on four components; market access, non-discrimination among members, trade liberalisation through reciprocal negotiations, and the protection of the rule of law with a dispute settlement system.[26] However, Gilpin maintains that liberal trade regimes can be justified only when three criteria are present in the international system: a hegemonic power, common economic, political and security interests, and finally a common ideological foundation that champions the liberal economic regime.[27] Therefore, it is important to determine, first, if the justification for a liberal

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[26] J. Bhagwati, The World Trading System at Risk, Harvester Wheatsheaf, Hemel Hemstead, 1991.
[27] Robert G. Gilpin, "The Richness of the Tradition of Political Realism," in Keohane Neorealism and its Critics, New York: Columbia University Press, 1986, p.312. Robert G. Gilpin, The Political Economy of International Relations, Princeton: Princeton University Press, 1987, p. 73. For theory hegemonic stability see Charles Kindleberger, The World in Depression, 1929-1939, Berkeley: University of California Press, 1973, Robert O. Keohane, "the Theory of Hegemonic Stability and Changes in International Economic Regimes, 1967-1977," in Ole Holsti et al., Change in the International System, Boulder, Col.: Westview Press, 1980, John Gerard Ruggie, "International regimes, transactions, and change: embedded liberalism in

trade regime within the international system exists and, secondly, whether the contemporary international system is multilateral in scope, which enable all member states to benefit.

a) Multilateral Regime Durability.

A state must be able to act as a hegemon in the international system not only to initiate liberal economic policies, but also to enforce them. This results from the fact that states will be tempted to rationalise short-term optimal gains at the expense of long term benefits emanating from co-operation. Therefore, in order to entice other states to participate in a liberal economy, a hegemon might be called upon to sacrifice its own domestic gains relative to other countries so as to foster co-operation.[28]

The stability of the liberal institutions following the end of the Second World War (i.e. the Bretton Woods institutions) necessitated that the United States act as a hegemon. As a result, these multilateral institutions would benefit US interests because they would establish the conditions for the internationalisation of trade and thus limit conflicts between nations. However, since the 1970s, the power of the United States relative to other states in the international system has declined.[29] Being as it may, what is important is not so much whether the United States remains a hegemon, but rather, whether it continues to behave as a hegemonic power (by design or necessity) in relation to the multilateral institutions it fostered in the past. For instance, the fact that a state is in hegemonic decline may force it to pursue further multilateral arrangements to maintain its influence over the international system via the new

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the postwar economic order," International Organization, 36,2, Spring 1982, Robert G. Gilpin, War and Change in World Politics, Cambridge: Cambridge University Press, 1981.

[28] Ibid., pp.343-344.

[29] Ibid., p.344. Paul M. Kennedy, The Rise and Fall of the Great Powers, New York: Random House, 1987. Robert Gilpin, War and Change in World Politics, Cambridge: Cambridge University Press, 1981.

regional agreements it creates. In order to assess this it is useful to examine Gilpin's second criterion.

Gilpin's second criterion for multilateral and liberal trade regimes is that there must be a common set of values between state actors in relation to economic, political and security interests which allows disparate entities to coalesce. The decline in East-West tensions following the demise of the Soviet Empire, has led to a reduction not only in security conflicts, but the political and economic models sought by nations have also converged on a global scale (i.e. liberal democracy and market economies).[30] This aspect of economic and political convergence between different states in the international system is important because they are the "necessary ingredients for a nation to promote a liberal world economy."[31]

However, it should be noted that although the economic model (market economy) pursued by the vast majority of states in the international system is similar, this does not necessarily mean that economies will become peaceful.[32] In fact, the convergence in the military and political fields may heighten the economic competition between states. At the apex of the Cold War, economic issues were linked to military interests so as to intensify US power relative to the adversarial camp. For example, the United States opened its markets and provided military security to Japan in order to allow the Japanese to reconstruct their economic infrastructure following the Second World War and thus act as an economic counterbalance to

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[30] Thomas J. Biersteker, "The Triumph of Liberal Economic Ideas in the Developing World," Global Change, Regional Responses, The New International Context of Development, pp.184-187.

[31] Gilpin, "The Richness of the Tradition of Political Realism," in Keohane Neorealism and its Critics, New York: Columbia University Press, 1986, p.311. Also see Barry Buzan, "Economic Structure and International Security: the Limits of the Liberal Case," International Organization, 38,4, Autumn, 1984.

[32] Different forms of capitalism do exist, however, which has caused tensions between different trading partners. See Michel Albert, Capitalism vs. Capitalism: How America's Obsession with Individual Achievement and Short-term Profit has Led it to the Brink of Collapse, New York: Four Wall Eight Windows, 1993. Also see Barbara Stallings and Wolgang Streeck "Capitalism in conflict? The United

Soviet influence in the pacific region.[33] With the disintegration of the Soviet bloc, traditional security alliances based on economic sacrifices are suddenly being questioned. The strategy being pursued is the acquisition of economic market share, rather than security alliances.[34] With a heightened sense of economic competition on a global scale, the multilateral institutions could therefore be seen as an ideal to be pursued (i.e. these institutions lower the fear of possible conflicts by providing more information and transparency to the other actors in the international system).[35] To analyse this assertion, it is important to look at Gilpin's third and final criterion.

In regards to Gilpin's third criterion for the demise of liberal regimes (a common ideological foundation), it is argued that following the Second World War, the majority of industrialised states supported liberal and multilateral trade regimes because they had positive economic effects.[36] Not only did states have access to the world's largest dynamic market (i.e. the United States) but they could also pursue Keynesian policies and thus limit some of the effects of economic cycles or competition from abroad.[37] However, the perceived shift in American protectionist strategy and the increase in economic competition may challenge the ideological foundations on which liberal regimes were instituted (i.e. greater access to foreign markets by the removal of tariff barriers). As a result, protectionism and/or regionalism may

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States, Europe, and Japan in the Post-Cold War World," Global Change, Regional Responses, The New International Context of Development

[33] Robert O. Keohane and Joseph S. Nye, Power and Interdependence, 2nd ed., Boston: Scott, Foresman and Co., 1989, p.47.

[34] Barry Buzan, People, States and Fear: An Agenda for International Security Studies in the Post-Cold War Era, 2nd ed., Boulder, CO: L. Rienner, 1991.

[35] It has been argued by Berverley Crawford, "Explaining Defection from International Cooperation: Germany's Unilateral Recognition of Croatia," World Politics, Vol.48, No. 4, July, 1996, p. 486, that defection from cooperation increases when uncertainty exist in a changing international system where power changes limit the protection that this cooperation offered in the past.

[36] Gilpin, The Political Economy, p.343-345.

[37] Ibid., p.344.

become valid policy options for the United States and other countries in the international system following the demise of a unifying liberal trade vision.[38]

At first glance, it appears that the ideology that coalesced different industrialised countries during the Cold War has changed; regional trade treaties are more easily controlled and enforced by dominant countries which, in turn, may help in economic, political and military relations with newer and more competitive powers.[39] In fact, Buelens argues that multilateral systems are a non-zero sum game in which agreements are non-binding and thus prone to instability and failure.[40] Regionalism could thus prove more stable because of the greater enforceability of agreements. Furthermore, it might be easier to achieve consensus with regional formations on issues other than trade (i.e. investments, environmental and labour laws, intellectual property rights, etc.) than with multilateral institutions such as the General Agreement on Tariffs and Trade (GATT). Trade agreements such as NAFTA, the EU, and possibly MERCOSUR may succeed in eliminating non-tariff barriers where the GATT has failed in the past. It is also important to note that given the complexity of regulating the World Trade Organisation (WTO) and other multilateral institutions, the major industrialised nations have come to use the Organisation for Economic Co-operation and Development (OECD) as a forum for devising and implementing new trade and investment rules and regulations.[41] Although membership is limited (29 members), its influence has been extensive. For example, the OECD has greatly influenced the creation of the Multilateral Investment Guarantee Agency (MIGA) in

[38] Ibid., pp.394-406.
[39] Richard Belous and Rebecca Hartley "Regional Trading Blocs: An Introduction" in Belous and Hartley The Growth of Regional Trading Blocs in the Global Economy, Washington: National Planning Association, 1990, pp.10-11.
[40] Frans Buelens, "The Creation of Regional Blocs in the World Economy," Intereconomics, May\June, 1992, p.128.

1988, the General Agreement on Trade in Services (GATS) in 1994 and is currently working on the Multilateral Agreement on Investment (MAI).[42]

On the other hand, multilateral trade institutions may remain valid because the negative effects associated with a decline in these regimes could far outweigh the cost associated with their maintenance. As already mentioned, multilateral institutions provide greater transparency between actors and thus limit the possibility for costly conflicts. Regional trade treaties would thus be limited to increasing the leverage of a country in multilateral negotiations. For example, in the Uruguay Round of the GATT, one of the most contentious issues revolved around agricultural subsidies. Instead of a strictly North-South dialogue, the bargaining strategy of the United States consisted of a unified stance with certain developing countries against the European Union.[43] In fact, it has been argued that the Enterprise for the Americas Initiative (EAI) which coincided with the Uruguay Round, was an attempt to increase the leverage of the American bargaining position within the GATT negotiations.[44] The danger for developing countries, therefore, would be in their exclusion from the decision making process as a result of their inability to enter into a trade bloc.

Thus, it could be argued (using Gilpin's three criteria) that multilateralism is still a justifiable policy option for the central powers of the Triad. A multilateral system allows the declining hegemon and other advanced industrial countries alike, the ability to open and regulate the different international markets through the maintenance of low tariff barriers and the elimination of Non Tariff Barriers (NTBs) which could otherwise become highly competitive. A

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[41] Bernard Colas, "The OECD's Legal Influence in a Global Economy," World Economic Affairs, Vol.1, No.3, Spring/Summer, 1997, p.66.
[42] Ibid., pp. 66-67.
[43] Stallings and Streeck, "Capitalism in conflict? The United States, Europe, and Japan in the Post-Cold War World," pp.84-85.

heightened sense of unregulated economic competition between major powers could increase the possibility of conflicts between trade blocs or regions as well as limiting the ability of the Triad in gaining access to new and growing export markets.

It is important to underline that given the direction towards the creation of trade blocs in the multilateral system, it is essential that the trade blocs remain open to trade relations with third parties.[45] Failure to do so could divert trade patterns away from non-members, and lead to vigorous competition between states for favourable market access and greater market share at the exclusion of other trade blocs and/or countries.[46] An examination of regional trade and investment patterns helps discern whether the international system is open, which in turn aids in determining whether the international structures are multilateral and interdependent in nature or are becoming more regionalized. In analysing the data from table 1, the intra-regional trade since 1980, is larger and has a bigger annual growth rate than is the case for inter-regional trade patterns. For example, whereas the inter-regional trade had, in the 1980-92 period, an average growth rate of 7.7%, the total intra-regional trade for the same period amounted to 8.7%. More importantly is the fact that inter-regional trade amounted to only 11.6% of the total world trade in 1992 as compared to 42.9% for the intra-regional trade within the major trade blocs. Furthermore, although trade patterns from the major blocs towards Latin America have declined (i.e. from 18.0% to 16.9% for trade originating from the US, 6.7% to 4.4% for Japanese trade, and 3.2% to 2.2% for EU trade), trade patterns, for the most part, have increased among the members of the Triad. (Table 2)

[44] Ibid., p. 84.
[45] See Barry Buzan, "Economic Structure and International Security: the Limits of the Liberal Case," International Organization, 38,4, Autumn, 1984, for a discussion on the difference between the concepts of benign and malevolent mercantilism.

TABLE 1

International Trade Patterns, 1980-92. (Billions of dollars)[47]

Territory	1980	% of World Trade	1992	% of World Trade	Ave. Growth 1980-92 (%)
Triad	175	9.2%	427	11.6%	7.7
US-Japan	53	2.8%	145	3.9%	8.7
US-EU	97	5.1 %	198	5.4%	6.1
Japan-EU	25	1.3%	84	2.3%	10.7
Intra-regional	583	30.6%	1,577	42.9%	8.7
EU	385	20.2%	895	24.3%	7.3
Asia	96	5.0%	411	11. 2%	13.0
North America	102	5.4%	271	7.4%	8.5

[46] Diana Brand, "Regional Bloc Formation and World Trade," Intereconomics, November/December, 1992, p. 280.
[47] Stallings and Streeck, "Capitalism in Conflict? The United States, Europe, and Japan in the Post-Cold War World," p.74.

TABLE 2

U.S., Japanese & EU Trade Flows, 1980-92.[48]

	From US		From Japan		From EU	
To	1980	1992	1980	1992	1980	1992
U.S.			31.9	96.7	38.4	92.3
			25.7%	28.4%	5.6%	6.4%
Japan	20.8	47.8			6.7	26.5
	9.7%	10.7%			1.0%	1.8%
EU	58.9	102.9	18.2	62.9	385.2	895.3
	27.4%	23.0%	14.7%	18.5%	56.6%	61.8%
Latin America	38.7	75.7	8.3	15.1	21.5	32.4
	18.0%	16.9%	6.7%	4.4%	3.2%	2.2%

In terms of investment patterns, the results are more complex. Although the majority of investments remain concentrated within the major blocs, they are more evenly dispersed in terms of intra and inter regional investment flows. Stallings and Streeck conclude that with these types of trade and investment patterns, the international system has been witnessing both elements of multilateralism and regionalism in what they call "non-hegemonic interdependence".[49] However, as the data also indicate, the inter-regional trade patterns have placed developing countries in a precarious situation. For example, as already indicated, although inter-regional trade has increased between the major blocs, developing countries, such as those of Latin America, have

[48] Ibid., p.75.

become more vulnerable in the sense that the proportion of trade from the trade blocs towards Latin America has declined. Furthermore, as table 4 demonstrates, the investment flows towards Latin America from Japan and the EU, have decreased in importance relative to the investments towards other trade blocs. Although the investments emanating from the United States have been stable, the increase of Asia as an investment destination may eventually increase the competition between different developing countries to attract these flows. For example, the increase in US investments towards Latin America went from 17.5% in 1979-81 to 18.8% in 1990-92. American investments towards Asia, on the other hand, went from 8.6% to 18.5% for the same period. To help explain why the trade and investment patterns have been uneven between trade blocs and developing countries, it is useful to examine some of the limits associated with the contemporary multilateral system.

[49] Stallings and Streeck "Capitalism in Conflict? The United States, Europe, and Japan in the Post-Cold War World," pp.67-99.

TABLE 3

International Investment Flows, 1980-92. (Billion of dollars)[50]

	1980	% of World Investments	1988	% of World Investments	1992	Ave. Growth 1980-88	Ave. Growth 1988-92
Triad	142	27.0%	411	39.7%	597	14.2	9.5
US to Japan	6	1.2%	18	1.7%	27	14.1	10.6
Japan to US	5	0.9%	53	5.1%	98	35.5	16.7
US to EU	81	15.4%	131	12.7%	207	6.3	12.2
EU to US	47	9.0%	194	18.8%	221	19.3	3.4
Japan to EU	3	0.5%	13	1.3%	35	22.3	28.1
EU to Japan	N.A.	0.1%	2	0.2%	9	19.6	45.6
Intraregional	125	24.3%	285	27.6%	472	10.9	13.5
Intra-EU	50	9.7%	160	15.5%	273	15.6	14.3
Intra-Asia	12	2.3%	35	3.4%	75	14.3	21.0
Intra-N.A.	63	12.3%	90	8.7%	124	4.6	8.4

[50] Ibid., p.77.

TABLE 4

Annual Average U.S., Japanese & EU Investment Flows.[51]

	From the U.S.		From Japan		From the EU	
To	**1979-81**	**1990-92**	**1979-81**	**1990-92**	**1979-81**	**1990-92**
U.S.			1,728	19,324	7,113	4,263
			27.8%	46.9%	32.9%	12.2%
Japan	435	652			202	376
	2.5%	2.4%			0.9%	1.1%
EU	8,090	9,825	548	9,579	5,109	19,428
	46.5%	35.8%	8.8%	23.3%	23.7%	55.4%
Latin America	3,035	5,177	607	776	1,295	2,007
	17.5%	18.8%	9.8%	1.9%	6.0%	5.7%
Asia	1,492	5,073	1,823	6,471	880	1,381
	8.6%	18.5%	29.4%	15.7%	4.1%	3.9%
Africa	306	-482	58	22	671	989
	1.8%	-1.8%	0.9%	0.1%	3.1%	2.8%
Other	4,032	7,223	1,443	5,011	6,330	6,594
	23.2%	26.3%	23.3%	12.2%	29.3%	18.8%

[51] Ibid., p.79.

b) Multilateralism and Developing Countries.

In analysing Bhagwati's four components that make up the multilateral system (market access, non discrimination, trade liberalisation and a dispute settlement system), the structure of the multilateral system is unequal from the perspective of countries at the periphery of globalisation and which are excluded from the major industrial trade blocs. Market access has been limited by unilateral actions (NTBs, anti-dumping claims, rules & regulations, etc.) and/or by the pursuit of regional policies by the Triad. In addition to this, trade blocs go against both the multilateral concepts of non-discrimination against excluded non-members and of trade liberalisation through reciprocal negotiations. For example, countries that are not party to trade agreements are discriminated against in terms of having different set of rules and regulations to adhere to. Although the Uruguay Round could be used as an example of successful reciprocal negotiation, the sheer duration of the process and the inability to make headway on issues such as labour rights and environmental concerns, suggest that many of the developing countries are barred from the formative negotiations that are taking place on a regional basis. Finally, the justification of multilateralism may be questionable for the periphery in regards to the inadequate dispute settlement systems that exist in international institutions. As will be seen, unless the committee reports become binding on the members of the dispute, states at the periphery of the institutional legal system will be unable to protect their interests from arbitrary decisions, unjust standards, unfair treatment, etc.

Although the major industrialised countries have lowered tariffs over the years, it is the NTBs that have come to act as major impediments to increased market access for countries at the periphery such as Brazil, Argentina and Chile.[52] Consequently, it is important to understand why there has been reluctance by major industrial countries to open their markets fully to developing countries, while at the same time forcing the periphery to institute trade liberalisation reforms.

It has been argued that trade protectionism is influenced more by internal politics than by the economic reforms themselves.[53] Furthermore, within the domestic political context, the support for or against protectionism is sector sensitive. Generally speaking, it can be argued that economic sectors, which deal in non-traditional products with greater intra-industry trade, are more likely to support economic reforms than are the traditional and mature product sectors that are characterised by inter-industry competition.[54] The protectionist measures imposed unilaterally on the periphery by a country such as the United States to limit access to their markets and the nature of the exports into these markets are, therefore, of major importance to the Southern Cone region. The protectionist measures include, inter alia; 1) anti-dumping measures, 2) standards and regulations, and 3) regional trade policies. The nature of the exports from the Southern Cone and their ability to diversify their export base will be examined in the next section.

1) Anti dumping Measures.

The unilateral protectionist measures initiated by the United States government have in large part been associated with section 301of the 1988 Omnibus Trade and Competitions Act.

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[52] IMF, World Economic Outlook, Oct. 1988, p.36.
[53] Juan A. de Castro, "Protectionist pressures in the 1990s and the coherence of North-South trade plolicies," Foreign Trade Reforms and Development Strategy, New York: Routledge, 1992, p.167.
[54] Ibid., pp. 166-168. Moreover, it is argued that to compete with industries in cheaper wage countries of the periphery, post-fordist production techniques by national industries have been adapted to limit competition from abroad. See Claire Turenne Sjolander, "Multilateralism, Regionalism, and Unilateralism: International Trade and the Marginalisation of the South," pp. 5-6.

This act gives the U.S. Trade Representative (USTR) the right to impose trade retaliation measures on countries which are deemed to have trade impediments towards American interests.[55] The major trade retaliation measures emanating from section 301 are the anti-dumping duties which "are imposed by the United States when the Department of Commerce finds that imports are being sold at less than fair value, or when the U.S. International Trade Commission (ITC) concludes that a domestic industry is being materially injured, or the establishment of an industry is prevented by the dumping of imports."[56] According to the procedures under this section, when an investigation is launched duties are imposed and are removed only after a decision is made based on the simultaneous investigations of the Department of Commerce and the ITC.[57] With respect to the Southern Cone countries, as of February 1995, four items had anti-dumping duties imposed on exports from Argentina (some dating back to November 1984), 13 for exports from Brazil (with the majority imposed in 1993/94) and one for exports from Chile.[58] (Table 5) In order to protect themselves from retaliatory duties of this type, many countries have been forced to accept Voluntary Export Restriction Agreements (VERAs). These, however, are of short-term duration and do not eliminate the basis for the trade irritants in question. For example, the VERA in place between the United States and Brazil on steel that expired in 1992, led to a plethora of anti-dumping

[55] Steven L Husted, "Western Hemisphere Free Trade and United States Trade Laws: The Role of Section 301 " in ECLAC, Trade Liberalization in the Western Hemisphere, Washington, D.C.: IDB, 1995, p.261.
[56] ECLAC, "U.S. Barriers to Latin American and Caribbean Exports 1994," April, 1995, p.4.
[57] It should also be mentioned that Brazil, Argentina and Chile, have all been placed at one time or another on the priority 301 watch list of countries which are suspected of having questionable intellectual property rights. To avoid retaliatory measures, these countries have been forced to amend domestic legislation to meet American demands without having recourse to formal dispute mechanisms as mentioned above (i.e. Brazil upgraded its intellectual property rights after being put on this priority list). See, Ibid., p8.
[58] Ibid., p. 4.

claims against Brazil by the American steel industry shortly after.[59] It could be argued, therefore, that by using the threat of anti-dumping claims, certain economic sectors might thwart the competitive advantage of countries such as Brazil and force these states into VERAs.

TABLE 5

Antidumping Duties from the U.S. towards Argentina, Brazil and Chile.[60]

Country	*Date Begun*	*Item*
Argentina	11/13/85	Barbed Wire
	11/23/84	Carbon Steel Wire Rods
	5/26/89	Rect. Tubing
	9/26/91	Silicon Metal
Brazil	1/12/87	Brass Sheet & Strip
	12/17/86	Butt-weld Pipe fittings
	11/2/92	Welded Non-Alloy Pipe
	5/9/86	Construction Castings
	8/19/93	Cut to Length CS Plate
	3/14/94	Ferrosilicon
	3/22/93	Lead & Bismuth Steel
	7/10/90	Nitro-cellulose
	5/5/87	Orange Juice
	5/21/86	Pipe Fittings
	7/31/91	Silicon Metal
	12/22/94	Silicomanganese
	1/28/94	SS Wire Rods
Chile	3/20/87	Standard Carnations

[59] ECLAC, "U.S. Barriers to Latin American and Caribbean Exports 1994," April, 1995, p.6.
[60] ECLAC, "U.S. Barriers to Latin American and Caribbean Exports 1994," p.4.

2) Standards and Regulations.

Another form of unilateral protectionist measure used by the United States and other major industrial countries comes from trade standards and regulations which, by their scope and complexity, hinder the ability of foreign industries to compete. These standards and regulations range from bans on products for not meeting certain criteria (i.e. marketing bans for grade, size, quality, maturing, etc.) to the requirement of special licenses and permits for exports into a country.[61] These requirements and standards can become arbitrary when special interest groups help determine the criteria and standards to be used.[62] Thus, even though the trade environment may seem open to external competitors, those industries affected by subjective application of trade standards and regulations may be excluded from valuable markets unless trade dispute mechanisms have been installed to limit the subjectivity of these standards and regulations. These trade dispute mechanisms, as will be discussed shortly, are a to a certain extent ineffective at the multilateral level or exclusive at the regional level. It follows, therefore, that what seems to be the most serious threat to the developing countries is the adoption of regional policies that limit access to the domestic market through the creation of trade blocs as a potential form of trade protectionism.

3) Regional Trade Policies.

Three major trade blocs exist in the current international system which, as already mentioned, form the tri-polar centre; NAFTA, the European Union and a *de facto* East Asian

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[61] Ibid., p.12.
[62] Cited from, Services of the European Commission, Report on the United States Barriers to Trade and Investments 1994, Doc. No. 1/194/94, Brussels, April, 1994, p.55. in ECLAC, "U.S. Barriers to Latin American and Caribbean Exports 1994," p.9.

bloc. These trade blocs constitute a set of bilateral or regional agreements between countries that range from traditional free trade agreements to the creation of supranational unions. Nevertheless, what is important to emphasise in relation to regionalism as a form of protectionism is that as the major industrialised countries begin to enter Free Trade Agreements (FTAs) and/or trade blocs, rules of origin and trade dispute mechanisms will come to play a larger role in the trade relations between the major trade blocs and developing countries.

i) Rules of Origin.

In essence, rules of origin are defined by four different methods; change in tariff heading, value added, specified process and substantial transformation.[63] What is of importance with these four methods is that each principle leads to a complex set of rules for specific types of manufacturing processes in determining the foreign contents of the tariff schedule to be imposed. For example, the specified process involves rules of origin established according to the industrial operations used in the manufacturing operation. As a result, different industries will have a determining role in defining these processes and thus in the creation of these rules. Therefore, where trade expansion for a particular economic sector is seen as worthwhile, the domestic industries may favour rules of origin which will define the manufacturing process in a way as to be more lax than in those sectors where competition is fierce. Consequently, the rules of origin add an element of complexity to the international trade environment as well as potentially adding costs to exporters from the periphery.[64]

[63] David N. Palmeter, "Rules of Origin in a Western Hemisphere Free Trade Agreement," Trade Liberalization in the Western Hemisphere, pp. 192-198.

ii) Trade Dispute Mechanisms.

Also of concern is that countries outside these FTAs and/or trade blocs have no recourse to remedial action or arbitrage that trade dispute mechanisms may offer other than those that exist at the multilateral level (i.e. the WTO). However, of the four types of trade dispute mechanisms that exist in the international system (consultative, conciliatory, advisory arbitration and finally, binding arbitration), the GATT contained no form of binding arbitration such as currently found in regional trade agreements (i.e. NAFTA).[65] GATT was non-binding because the panel reports to the GATT Council had to be approved by consensus. Members of a dispute could, therefore, obstruct a panel report from coming into effect.[66] As for the new WTO, the concept of reverse consensus (i.e. a situation where the motion is deemed to have been approved unless objected to by a member of the trade dispute) has yet to be used extensively enough to determine its efficacy. Therefore, the trade dispute mechanism offered by membership into a trade bloc might enhance the assurance against subjective application of trade rules and regulations. For those countries outside the trade blocs, the actions open to them may be limited to accepting some sort of VERA, and thus limiting their ability to compete, or attempt the successful use of trade dispute mechanisms found within multilateral institutions. Of concern, therefore, is the fact that certain trade grievances or NTBs may not be covered under the WTO and/or other multilateral institutions.

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[64] Ibid., p. 204.
[65] Blair Hankey, "Dispute Settlement in a Western Hemisphere Free Trade Agreement," Trade Liberalization in the Western Hemisphere, pp.245-246.
[66] Ibid., p. 246.

D. Conclusion.

The manner by which the multilateral system has been set up (i.e. the ability by the members of the Triad to defect from their obligations) and the inability of the periphery to use it effectively to seek remedial actions, has increased the vulnerability of the developing countries towards individual trade blocs. It would seem that the policy options likely to be followed by countries of the periphery, including those of the Southern Cone, will most likely be determined by their level of vulnerability towards the Triad and by their ability to reform their state and market apparatus as a reaction to the exigencies originating from the international system. Regional integration is one of the policy options available to these countries. It is an option that has proved to be popular among the Latin American countries, including those of the Southern Cone. Before examining in detail the policy choices of Argentina, Brazil and Chile, it is useful to elaborate on the various strategies that these countries might choose.

III. INTEGRATION STRATEGIES FOR THE SOUTHERN CONE.

It is important to determine the possible foreign policy directions that developing countries may undertake following the end of the loose bi-polar structure and the subsequent establishment of multi-polarism based on a triad of dominant economic blocs. As will be demonstrated, sub-regional co-operation, which had proven ineffective in fostering stable economic growth and development in the past, is once again touted as a worthwhile venture given the ineffectiveness of the multilateral institutions in protecting the interests of the developing countries.[67]

A. Integration Strategies.

Three models will be posited which reflect the different regional strategies available to the Southern Cone countries. These models can be described as: sub-regional co-operation as a counter balance, sub-regional co-operation as a means to join a trade bloc, and finally, unilateral bloc entry.[68]

a) Sub-regional Co-operation as a Counter Balance.

The first model would see the formation of a sub-regional bloc as a form of counter balance to the major trade blocs (i.e. NAFTA, EU, and the *de facto* Asian Pacific bloc). In order

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[67] See Axline, "Globalization, Marginalization and Integration; The New Regionalism and Developing Countries," for evolution of the different integration models. Also see, Julio J. Nogues and Rosalinda Quintanilla, "Latin America's Integration and the Multilateral Trading System," in Jaime De Melo and Arvind Panagariya's New Dimensions in Regional Integration, Cambridge University Press, pp. 279-288.
[68] Augusto Varas, "Latin America: Toward a New Reliance on the Market," Stallings, Global Change, Regional Responses. The New International Context of Development, New York: Cambridge University Press, 1995. p.285. For interpretation of the hub and spoke model and expanding agreements see, Julio J.

to act as a counter balance, this regional grouping would concentrate on increasing regional membership and intra-regional trade. Although it would not necessarily shun closer ties with trade blocs, the emphasis of this strategy is to avoid actual membership into a major bloc. It follows that sub-regional integration will attempt to establish a common bargaining front towards the trade blocs. Furthermore, the institutional apparatus can be seen as an element that will foster closer economic and political ties between members.

What sets this scenario apart from the import substitution models undertaken in the 1970s is its emphasis on creating a sub-regional agreement based on a liberal market economy. The magnitude and dynamism of this integration scheme would act as a hub to other countries in Latin America reluctant to be marginalized further by the major industrialised countries. This scenario would thus offer greater bargaining strength for the member countries in relation to other trade blocs within a multilateral structure. It would not, however, be used as a means to actually insert themselves into a trade bloc of the Triad.

b) Sub-regional Co-operation as a Means to Join a Trade Bloc.

The second model is one in which the objective of a country is to pursue sub-regional co-operation in order to eventually join another trade bloc. The emphasis of this model is placed on policy reforms and co-ordination rather than strictly on inter-regional or intra-regional trade. This scenario is seen as preparatory to the entry of the countries into a larger trade bloc. Members perceive it as a "stepping stone" that provides better chances for gaining access to the larger blocs than they would individually. Bloc accession may be gained as a group or,

Nogues and Rosalinda Quintanilla, "Latin America's Integration and the Multilateral Trading System," p.279.

individual countries might use sub-regional co-operation to prepare for unilateral bloc entry. This is because, a) the bigger the size of the regional market, the better the chances of attaining a favourable bargaining position.[69] b) sub-regional co-operation may act as a preparatory step in which integration is used to force national industries to become more competitive and efficient before it is integrated within a bigger industrialised market, and finally,[70] c) sub-regional co-operation may "lock in" the reforms undertaken so that further negotiations with a trade bloc can be achieved smoothly.[71]

Since the aim of the sub-regional agreement is to enter a trade bloc, the institutional development can remain quite low. The response exhibited by member countries is not to form a bloc of their own, but to gain entry to a larger one. Of interest will be to determine whether accession to a trade bloc will necessitate dissolution of the sub-regional entity.

c) Unilateral Bloc Entry.

The third scenario argues that some of the countries would not necessarily refuse integration at a sub-regional level, but would prefer to negotiate entry into a trade bloc on an individual basis. They would participate in sub-regional arrangements only insofar as it enhances (or does not hinder) eventual entry to the dominant trade bloc. Countries pursuing this model follow national strategies and in no way would they consider limits to their bargaining positions towards third parties. The level of institutionalisation (if any) remains very low at the sub-regional level so as not to encroach on national sovereignty. As a result, the concern is

[69]Donald K. Crone, The Asean States. Coping with Dependence, New York: Praeger, 1983, pp.15-31.
[70] Luigi Manzetti, "Argentine-Brazilian Economic Integration: An Early Appraisal," Latin American Research Review, XXV: 3, 1990, p.115.

towards keeping market shares in both sub-regional agreements and within the trade blocs. The individual approach will have a weakening effect on sub-regional co-operation, as solidarity is undermined and bargaining strength is reduced.

In this scenario, the individual country, rather than the region, will attempt to act as a hub to other countries or regions wishing to access either a trade bloc or a sub-regional agreement. Rules of insertion and rules of origins into a trade bloc or a sub-regional agreement thus become very important for the pursuit of this strategy.

The choice of strategy by a particular state will depend on a number of factors, both internal and external to that country. The concept of vulnerability is useful for explaining the choices of developing countries with respect to the different integration strategies.

B. Relationship between Vulnerability and Integration Strategy.

In essence what these three strategies attempt to accomplish is to lower the sensitivity and/or vulnerability of individual countries towards the trade blocs. Sensitivity refers to the degree to which a state is able to withstand external costs and react to them, while vulnerability is the ability of a state to find alternatives to these costs.[72] However, it should be kept in mind that sensitivity and/or vulnerability within the region may exist if the disparities between regional actors are of a great enough magnitude to render one of the members dependent on the other for its economic security.[73] For the purpose of this thesis, the separate concepts of sensitivity and

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[71] Julio J. Nogues and Rosalinda Quintanilla, "Latin America's Integration and the Multilateral Trading System," p.288. John Whalley, "CUSTA and NAFTA; Can WHFTA be far Behind?" Journal of Common Market Studies, Vol. XXX, No.2, June, 1992, p.127.
[72] Keohane and Nye, Power and Interdependence, p.12.
[73] Crone further argues that sensitivity for developing countries is related to the degree that "a country is connected to the subsystem of the major industrialized nations" and that vulnerability is determined by "the

vulnerability are subsumed into a single variable that is used to measure the overall vulnerability of a country to external influences. An examination of the degree of vulnerability of a country with respect to either the Triad and/or other regional players will help explain the choice of integration models used by the Southern Cone countries.

It will be argued that the policy options of the Southern Cone countries will differ according to their level of vulnerability relative to their economic variables (i.e. trade and investment), and to their level of vulnerability to socio-political variables. It is hypothesised that the greater the economic vulnerability, the greater will be the need to diversify their trade relations leading to a strategy representing the unilateral bloc entry model. In contrast, the less a country is vulnerable towards trade and investments in relation to the Triad and other regional countries, the more likely it will pursue a counter-balance strategy to increase its bargaining strength and enhance its access towards either the regional markets or those of the major industrialised countries. States with moderate levels of vulnerability will pursue a strategy using sub-regional integration as a preparatory step into the trade blocs, as well as using the sub-regional entity as a forum to protect and enhance their current economic interests.

However, for any of these strategies to be successful (but especially the unilateral bloc entry strategy), the state will have to be willing and able to undertake major reforms to comply with the demands emanating from the trade blocs and/or other international institutions. Failure to bring about these necessary reforms may, as a result, constitute another form of vulnerability. It follows, therefore, that the more vulnerable a country is towards instituting reforms, the more it will show a tendency to pursue a counter balance strategy in order to increase its independence

degree to which economic relations are concentrated with any particular country." Donald K. Crone, The Asean States. Coping with Dependence, New York: Praeger, 1983, p.28.

from external forces favouring, in this case, neo-liberal changes. On the other hand, countries, which are able to bring about reforms, will more likely favour a unilateral bloc entry strategy. Thus, the counter balance strategy offers to the dominant regional power, greater independence from the pressures and competition emanating from trade blocs, whereas, countries which already have instituted market reforms with stable macro-economic indicators, will already be in a position to be accepted into the trade bloc. Therefore, even though it is hypothesised that a high level of vulnerability to economic indicators may lead to a unilateral bloc entry strategy, a high level of vulnerability to socio-political indicators is likely to reinforce the choice of counter balance strategy. As will be discussed, one of the factors, which will affect the ability to reform, consists of the concentration of political power at the national executive level. Although different societies may be able to institute democratic and market reforms simultaneously, the position taken in this thesis is that either democratic or authoritarian regimes must be strong and willing enough to institute reforms.

To measure the degree of vulnerability that a country of the Southern Cone may have towards either the trade blocs or to other regional powers, trade, financial, and socio-political indicators will be examined. With respect to trade, the structure of the exports and the relative size and strength of the domestic markets will serve as the indicators chosen to determine the degree of trade vulnerability. The financial indicators will consist of the level and structure of investments as well as the individual country's debt exposure, and finally, the socio-political indicators will be associated with the ability and/or political will of a country to bring about the necessary reforms to adhere to the strategies chosen. Those socio-political indicators used to ascertain vulnerability will be examined through an analysis of past attempts by the Southern Cone countries to bring about structural and stabilisation reforms.

To help explain the choice of indicators used, it should be kept in mind that the fundamental precepts for undertaking trade agreements, either sub-regionally or with trade blocs, is to increase or ensure an adequate level of development.[74] This development will necessitate investments, which originates either domestically or externally.[75] To attract these investments, the state must provide a stable investment environment to minimise risks to potential investors. It has been argued that stable investment environments are usually associated with currency convertibility, political stability, adequate markets and sufficient sources of supply.[76] It has also been argued that the investment site of the FDI will be influenced more by the desire of Trans-National Corporations (TNCs) to penetrate certain domestic markets because of their economic size or growth potential than by the tax incentives offered by the host country.[77] Conversely, the more the FDI is export-oriented, the more it will seek cost incentives (i.e. favourable wage structures and exchange rate competitiveness) as the basis for its location.[78] Thus, the more the FDI is domestic market driven, (in other words, penetrating the host market) the more favourable

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[74] For the purpose of this thesis, development is defined as economic growth and social progress. For a greater discussion on different interpretations of development, see Unesco, Goals of Development, Paris: Unesco, 1988.

[75] ECLAC, Policies to Improve Linkages with the Global Economy, Santiago, Chile: ECLAC, 1995, pp. 225-232. Because of low income and low domestic savings in many developing countries, capital, as a factor of production, must be acquired externally. As a development strategy countries will attempt a "virtuous cycle" where long-term external capital flows will supplement domestic capital until economic growth reaches an adequate level of domestic savings from which it can repay its long-term loans and eventually become net exporters of capital.

[76] United Nations, Incentives and Foreign Direct Investment, New York, 1996, p.41, quoted from E.R. Barlow and I.T. Wender, Foreign Investments and Taxation, Englewood Cliffs: Prentice Hall, 1995. Also see H.J. Robinson, The motivation and Flow of Private Foreign Investments, Palo Alto, CA: Stanford Research Institute, 1961.

[77] United Nations, Incentives and Foreign Direct Investment, New York, 1996, p. 45. Other important factors include "freedom of entry and establishment, national treatment, rules regarding the repatriation of funds" see David Gold, "The Determinants of Foreign Direct Investment and their Implications for Host Developing Countries," The CTC Reporter, 31 (Spring), 1991, pp. 20-24. UNCTC, Government Policies and Foreign Direct Investment UNCTC Current Studies, Series A, No. 17, New York, United Nations. Friedrich Schneider and Bruno Frey "Economic and Political Determinants of FDI," World Development, 13 (February) pp. 161-175.

it will be to trade protection incentives such as tariff and non-tariff barriers to external competition.[79] As a result, as an economy comes to depend more on external capital to finance its development, the more vulnerable it will become to forces affecting investment flows, whether they are economic or socio-political.

The following chapters examine the relationship between the levels of vulnerability as measured by economic and socio-political indicators and the strategies adopted by the countries of the Southern Cone. In chapter IV, Argentina, Brazil and Chile are compared with respect to their vulnerability, whereas in chapter V, their respective integration strategies are examined.

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[78] United Nations, Incentives and Foreign Direct Investment, New York, 1996, p. 47, taken from G.L. Reuber and H. Crookell, M. Emmerson, G. Gallais-Hamonno, Private Foreign Investment in Development, Oxford: Clarendon Press, 1973.
[79] Ibid. p. 47.

IV. TRADE, FINANCIAL AND SOCIO-POLITICAL VULNERABILITY IN THE SOUTHERN CONE.

This section will explore the level of economic and socio-political vulnerability that is found in the Southern Cone. As discussed in the previous chapter, vulnerability with respect to economic indicators will be measured in terms of a country's exposure to external forces such as foreign trade, export concentration, market size, external debt and FDI flows. The socio-political vulnerability, on the other hand, will be measured by the ability of the state apparatus to reform or bring about structural change. An analysis of the effects that these forms of vulnerability will have on strategic directions for Argentina, Brazil and Chile will examined in the next chapter.

A. Vulnerability: External Trade.

When examining the degree of vulnerability of the individual Southern Cone countries, it is important to note that Brazil is by far the dominant state of the region. It has a population base of over 156.5 million and a GNP of $552 billion. (Table 6) Argentina, on the other hand, has a population of 33.8 million with a GNP of $251 billion, while Chile has only 13.8 million habitants with a GNP of $42 billion. It follows, therefore, that the trade relationships between different sized countries of the region, as well as towards the major industrialised countries, may be unbalanced and the effects on the smaller countries more acute. Furthermore, both Brazil and Argentina depend less on trade relative to their GDP (Brazil 12% and Argentina 16%) than does Chile, which had a trade to GDP ratio of 55% in 1994. Also, as tables 7 and 8 demonstrate, Chile has a greater concentration of exports than Brazil or Argentina. For example, in 1993, 83.9% of Chile's exports were primary products compared to Argentina's 68.1% and Brazil's

41.2%. Similarly, Chile's concentration index stood at .322 in 1991 relative to Argentina's .152 and Brazil's .101.

TABLE 6[80]
Market Size and Trade Statistics for Argentina, Brazil and Chile.

	Population 1993 (millions)	GNP 1993 (US$ millions) [81]	Trade/GDP 1994	Exports/GNP 1994	Imports/GNP 1994
Argentina	33.8	251,660	16	6.8	9.2
Brazil	156.5	552,698	12	6.8	5.0
Chile	13.8	42,138	55	28.4	27.1

Therefore, in terms of trade to GDP, export concentration and market size, Chile is the most vulnerable of the three Southern Cone countries, while Argentina is considered moderately vulnerable and Brazil the least vulnerable. These different levels of trade vulnerability, as will be argued shortly, will affect the strategy most likely to be chosen by each individual country. One possible explanation of the causes that have led to vulnerability in trade (as it relates to trade/GDP and export concentration), can be attributable to the debt and investment flows.

[80] World Bank, Trends in Developing Economies 1995, pp. 22, 60, 103.
[81] World Bank, World Debt Tables External Finance for Developing Countries, Vol. 2, Country Tables, 1994-1995, pp. 14, 58, 94.

TABLE 7

Export Concentration for Argentina, Brazil and Chile, 1980-93.[82]

	Primary			Manufactured		
	1980	1990	1993	1980	1990	1993
Argentina	76.9	70.9	68.1	23.1	29.1	31.9
Brazil	62.9	48.1	41.2	37.1	51.9	58.8
Chile	88.7	89.1	83.9	11.3	10.9	16.1

TABLE 8

Concentration Index for Argentina, Brazil and Chile, 1991.[83]

Argentina	0.152
Brazil	0.101
Chile	0.322

[82] UNCTAD, Handbook of International Trade and Development Statistics, 1993, pp. 112-113.
[83] Ibid., p.243. The concentration index ranges between 0 and 1.0, with the latter representing the most extreme concentration.

TABLE 9

Trade Vulnerability Index for Argentina, Brazil and Chile.[84]

	Trade/GDP[85]	Export Concentration[86]	Market Size[87]	Total
Argentina	3	2	2	7
Brazil	3	3	3	9
Chile	1	1	1	3

B. Vulnerability: External Debt and Investments.

In examining the vulnerability of the Southern Cone relative to the financial variables, some of the most important factors that have affected external investments into these countries, are associated with the "debt crisis" that took place in the mid 1980s, and the reform policies instituted as a reaction to it. The debt crisis was essentially the result of an unregulated lending environment by US commercial banks to the region prior to the 1980s.[88] Although the debt levels expanded for all countries, the ratio of long term debt to GNP is greater for Chile than for Argentina and Brazil. (Table 11) In fact, in 1986, Chile's long term debt to GNP stood at 134% compared to Argentina's 51.9% and Brazil's 44.4%. Furthermore, although the debt exposure has diminished in relation to its GNP (49% in 1993), Chile still has approximately twice the level

[84] The scale for the trade vulnerability index is based on values that range from 1 to 3 (1 being the most vulnerable and 3 the least).
[85] A value of 3 was given to trade/GDP below 20%, 2 for 20-50%, and 1 for 50%+.
[86] A value of 3 was given to export concentration representing 50% in manufactured goods, 2 for 25-50%, and 1 for below 24%.
[87] A value of 3 was given to GDP sizes of 500+ million, 2 for 100-500 million, and 1 for below 100 million.
[88] Mathew Shepherd, "U.S. Domestic Interests and the Latin American Debt Crisis," in Richard Strubbs and Goeffrey Underhill, Political Economy and the Changing Global Order, Toronto: McClelland & Stewart Inc., 1994, pp.302-311. ECLAC, Policies to Improve Linkages with the Global Economy, Santiago, Chile: 1995, pp.193-223.

of debt exposure than either Argentina or Brazil.[89] Also, as table 10 demonstrates, the effect of the debt crisis not only reduced the capital flows into the region, but the financing of the debt and its arrears created a net flow out of the region. For example, in the 1983-89 period, the net resource transfers out of the Southern Cone amounted to –5.1% for Argentina, -3.3% for Brazil, and –3.3% for Chile.

TABLE 10

Net Resource Transfers for Argentina, Brazil and Chile, 1982-93.[90]

	1982	1983-1989	1990-91	1992-1993
Argentina	-4.4	-5.1	-2.1	3.6
Brazil	-0.8	-3.3	-1.7	-0.0
Chile	-3.7	-3.3	1.5	3.8

TABLE 11

Long Term Debt to GNP for Argentina, Brazil and Chile, 1980-93.[91]

	1980	1986	1990	1993
Argentina	35.6	51.9	46.0	29.6
Brazil	31.3	44.4	24.9	24.0
Chile	45.5	134.0	67.9	49.0

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[89] Another commonly used indicator of debt exposure is the debt service ratio (debt service as a proportion of export earnings). See, UNCTAD, Handbook of International Trade and Development Statistics, 1995, p.273. Using this indicator, the position of Brazil and Chile are reversed (i.e. Brazil has a greater debt service ratio than does Chile). However, due to the extreme disparity in size of the two economies, the debt to GNP ratio was used because it better reflects the level of debt as a component of the economy. Thus, given the fact that the external trade proportion of the Chilean economy is more than four times that of Brazil, the ability to source external debt will be more sensitive to fluctuations in the domestic economy as well as those of its trade partners.

[90] ECLAC, Policies to Improve Linkages with the Global Economy, Santiago, Chile: ECLAC, 1995, p.196.

[91] World Bank, World Debt Tables. External Finance for Developing Countries, 1994-95, pp.14,58,94.

Of particular importance to the Southern Cone is the effect that the debt crisis had on FDI flows. In examining the FDI flows into the Southern Cone as a percentage of World FDI, all three countries witnessed a diminution in these flows after the onset of the debt crisis. Argentina went from .98% in the 1981-85 period to .58% in the 1986-89 period. Similarly, Brazil went from 3.31% to 1.51%, and Chile witnessed a decline from .60% to .51%. (Table 12) Furthermore, as table 13 indicates, the 1983-89 period, which is associated with a severe debt crisis, witnessed less FDI inflows than the total FDI inflows of 1990 alone. For example, Argentina had $587 million of FDI in 1983-89 compared to $1,836 million in 1990, and Chile went from $300 million in 1983-89 to $590 million in 1990. On the other hand, Brazil's recovery of FDI was not as spectacular. In fact, in 1993, Brazil had accumulated only $802 million in FDI compared to Argentina's $6,305 million and Chile's $841 million. However, as table 14 indicates, FDI flows as a percentage of GNP has come to play a greater role since 1990 in the economy for Argentina and Chile. As a result, it could be argued that these two countries have become more vulnerable to FDI flows as an element to their economic growth.[92]

This resumption (or lack thereof) in FDI flows is also of importance because of the transfers in technology, managerial know how, skills, network access, etc.[93] Furthermore, the greater the size of the debt and external investment vulnerability, the more it will have to rely on

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[92] Another indicator associated with foreign direct investments is the stock of FDI to GDP. Although this indicator further demonstrates that Chile is more vulnerable than Brazil and Argentina (i.e.23.1% compared to 17.8% and 8.7%), this thesis concentrated only on the FDI flows because it gives a better indication of the current trend in vulnerability. Furthermore, much of the stock of FDI may have preceded the onset of the debt crisis. See, UNCTAD, Handbook of International Trade and Development Statistics, 1995, p.240 for data.

[93] ECLAC, Policies to Improve Linkages with the Global Economy, Santiago, Chile, 1995, p. 220. In contrast, short term debt, arising from indirect, or portfolio investment, is more prone to create instability

exports and/or internally led economic growth to service the debt load. Moreover, it should be noted that the larger the domestic market, the more it can depend on its internal economic growth potential as an incentive for TNCs wishing to invest in the host economy. By integrating at the sub-regional level, the larger market can further increase its economic leverage not only by enticing greater amounts of domestic investments and FDI, but also by increasing its bargaining position towards major industrialised blocs who wish to gain greater access to the vast regional market. Those countries with large debt loads and small or moderate sized markets will likely attempt to increase their access to regional markets, as an incentive to foreign investors wishing to expand both within the domestic economy and towards the greater regional market. Only when the debt load is reduced sufficiently with greater market stability, will it then be possible to negotiate a trade agreement with a major trade bloc.

because of its propensity to be very sensitive to any type of internal or external stimulus (i.e. an increase in US exchange rates can reverse the flows of capital towards developing countries).

TABLE 12

Foreign Direct Investment Flows for Argentina, Brazil and Chile, 1977-92.[94]

		FDI as % of World FDI
Argentina	**1977-80**	0.72
	1981-85	0.98
	1986-89	0.58
	1990-92	2.11
Brazil	**1976-80**	5.18
	1981-85	3.31
	1986-90	1.51
	1991-92	0.91
Chile	**1976-80**	0.40
	1981-85	0.60
	1986-90	0.51
	1991-92	0.62

[94] Ricardo A. Bieischowshy and Giovanni Stumpo, "Transnational Corporations and Structural Changes in Industry in Argentina, Brazil, Chile and Mexico," Cepal Review, No.55, April, 1995, p.147.

TABLE 13

Net Inflows of FDI for Argentina, Brazil and Chile, 1980-93. (Millions of dollars)[95]

	1982	1983-1989	1990	1993
Argentina	227	587	1,836	6,305
Brazil	2,910	1.470	901	802
Chile	401	300	590	841

TABLE 14

FDI to GNP for Argentina, Brazil and Chile, 1980-93.[96]

	1980	1986	1990	1993
Argentina	.9	.6	1.4	2.5
Brazil	.8	.1	.2	.1
Chile	.8	.7	2.1	2.0

In comparing the countries with respect to an investment vulnerability index (table 15), Chile once again is the most vulnerable of the Southern Cone countries because of its debt exposure and its reliance on external investment flows. Argentina, because of its lower exposure to debt in relation to its GDP, is considered moderately vulnerable, and Brazil, by using these criteria, would seem to be the least vulnerable to investment flows. As will be discussed, these different levels of vulnerability to trade and financial indicators, as well as the differences in

[95] ECLAC, Policies to Improve Linkages with the Global Economy, Santiago, Chile : 1995, p.207.

market size, will affect the relationships of the Southern Cone towards trade blocs and towards themselves. However, before this is undertaken, it is important, at this juncture, to determine the socio-political vulnerability in the Southern Cone countries.

TABLE 15

Investment Vulnerability Index for Argentina, Brazil and Chile.[97]

	FDI/GNP	Debt Exposure	Total
Argentina	1	2	3
Brazil	3	3	6
Chile	1	1	2

C. Vulnerability: Socio-political Reforms.

As already discussed, one element that strongly influences investment and trade policies, is the political stability of the host country. To help determine the ability to provide a stable investment environment necessary for development and to determine the choice of the integration strategy, a state's capability to reform or bring about structural change will be examined. Although it is beyond the scope of this thesis to determine the most stable form of government (i.e. democracy vs. authoritarianism), it is possible to determine certain characteristics that offer stability and reduce investment risks. These characteristics include; consistency and continuity in economic policies and strategies, the protection of private property, the free movement of market prices, as well as social equity in the form of poverty level,

[96] World Bank, World Debt Tables. External Finance for Developing Countries, 1994-95, pp.14,58,94.
[97] The scale for the trade vulnerability index is based on values that range from 1 to 3 (1 being the most vulnerable and 3 the least).

distribution of income and wealth, access to social services, etc.[98] Furthermore, those reforms which are deemed necessary to enhance or regain stability have been argued to require a visionary leader, a coherent economic team, a comprehensive program and a solid political base.[99] The pace associated with these reforms (i.e. shock treatment vs. gradual implementation) will depend to a certain extent on the credibility of the time frame imposed to implement change as well as the level of resources available to undertake reforms.[100] For the countries of the Southern Cone, the level of political and economic stability differ according to the varying degree of success that these countries have had in implementing structural reforms and stabilisation programs without further weakening the social fabric. Furthermore, it would seem that the greater the degree of liberalisation as a component of the reform program, the more the country will seek to diversify its trade strategy. Conversely, the less a country's economy is opened to trade, the more the reform program will be heterodox in nature.[101] These differing types of reform programs will be shown to be associated once again with the size and nature of the economies involved.

a) Chile's Reform Program.

In comparing the different reform programs of the Southern Cone countries, Chile has had the most far-reaching and consistent liberalisation program of the region. The reform

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[98] United Nations, Incentives and Foreign Direct Investment , UNCTAD, 1996, pp.41-51. Ernest Bartell, "Perception by Business Leaders and the Transition to Democracy in Chile," Business and Democracy in Latin America, Pittsburgh: University of Pittsburgh Press, 1995, p.55.
[99] John Williamson, "The Political Economy of Policy Reform," Wall Street Journal, December 31, 1993.
[100] Manual Agosin and Ricardo Ffrench-Davis, "Trade Liberalization in Latin America," Cepal Review, No.50, August, 1993, p.45.
[101] See Jacky Buffet, <<Le Brésil, du miracle à la difficile gestion de l'apres-miracle,>> Cahiers des Amérique Latines, No.14, 1993, for description of major tenets of heterodox reforms and classical neo-liberal reforms.

program that began in 1974 after the Pinochet coup consisted of three stages: the stabilisation phase, the structural adjustment phase, and the recent return to democracy.

The first stage consisted of a set of policies aimed at stabilising macro-economic indicators such as inflation that had reached over 600% during Allende's administration.[102] The reform program consisted of trade liberalisation (i.e. reduction of tariff and non-tariff barriers), reduction of the fiscal deficit, greater monetary restraint, and finally, the privatisation of state enterprises.[103] These reforms were a dramatic departure from the previous administration that had supported import substitution policies with a high level of government expenditures to support the domestic economy. It should be noted that these transformations were implemented at the cost of social liberties. Not only did the military regime limit the political discourse of dissenters, but the Congress was also stifled in continuing its operations.[104] Furthermore, as table 16 indicates, although the inflation rate and the fiscal deficit were eventually stabilised, the unemployment rate went from 3.9% in the period of 1971-73 to 16.5% during the initial stabilisation phase of 1974-78.

[102] Luis Riveros, "Economics and Social Democracy in Chile," World Economic Affairs, Vol.1, No.3, Spring/Summer, 1997, p.43
[103] Ibid., p.43.
[104] Ibid., p.43.

TABLE 16

Chile's Economic Indicators, 1959-96.[105]

	1959-70	1971-73	1974-78	1979-81	1982-85	1986-89	1990-96
Real GDP Growth (%)	4.0	0.7	1.9	7.2	-1.5	7.2	6.2
Inflation Rate	26.5	295.9	206.4	26.5	23.3	18.3	13.5
Unemployment Rate	5.6	3.9	16.5	16.2	24.9	14.1	7.4
Real Wages (1970=100)	73.2	92.1	73.1	103.2	102.4	106.7	121.3
Fiscal Deficit	34.2	16.1	3.6	-2.2	4.1	-0.2	-1.6

Although the reform program continued unabated with further structural transformations occurring between 1979-82 (i.e. the privatisation of the social security fund, which led to the increased level of the savings rate, decentralisation of health and education towards local governments, and more flexible labour laws), the unrestricted investment inflows led to an eventual debt crisis as credit became more scarce following a shift in the US interest rate policy, and revenues from copper exports plummeted.[106] In reaction to this debt crisis, trade barriers

[105] Data taken from Luis Riveros, "Economics and Social Democracy in Chile," World Economic Affairs Vol.1, No.3, Spring/Summer, 1997, p.42.
[106] Manual Agosin and Ricardo Ffrench-Davis, "Trade Liberalization in Latin America," Cepal Review, No.50, August, 1993, p.48.

were raised to augment foreign reserves that would help finance the escalating debt load as well as to limit the escalating account deficits.[107] (Table 17) For example, the average tariff level, which had been lowered from an average of 94% in 1973 to 10.1% in 1980, was progressively raised to 25.8% in 1985.

TABLE 17

Chile's Average Tariff Levels, 1973-1992.[108]

YEAR	Average Tariff (%)
1973	94.0
1980	10.1
1983	17.9
1985	25.8
1990	15.1
1992	11.1

By 1986, however, the second stage of the reform program was initiated in which tariff barriers were once again lowered and greater attention was given to regulating capital inflows (i.e. reserve requirements for short term investments were implemented thus limiting speculative

[107] Ibid., p.48.
[108] Ibid., p.47.

capital flows).[109] Moreover, the privatisation program was revitalised, as was the promotion of exports by the use of currency devaluation and the use of anti-dumping measures against unfair trade practices by foreign competitors.[110] It is important to note that during this period the Central Bank became independent from the government with a mandate to keep inflation levels low. However, unlike other more severe forms of exchange rate restrictions, Chile initiated a "dirty float" which allowed for a 20% fluctuation band on a set of foreign currencies.[111] This provided for greater flexibility in attaining inflation and export targets. Thus, the second stage of the reform program basically continued neo-liberal reforms but at a slower pace and with greater controls on destabilising forces (i.e. external investment flows, exchange rate levels, etc.).

The final stage of the reform program was associated with the transition towards democracy in 1990. The transition towards democracy has been an important facet of the reforms because of the fact that the "Concertation" (a coalition of diverse political groups with far ranging ideological base that unified to win the 1989 referendum) has continued to support the neo-liberal strategy instituted during the Pinochet regime, as well as introducing certain social redistribution policies.[112] Some of these policies included new labour legislation that better protected rights of workers in terms of their ability to strike, protection against wrongful dismissal, and the right to create new unions. These policies also aimed at increasing the real minimum wage (an increase of over 25% from 1989 to 1992), and provided greater monetary support for the poor with better funding of social programs (i.e. the family unified subsidy, the

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[109] Ibid., p.49. Also see Manuel Agosin, "Capital Inflows and Economic Policy in Chile," World Economic Affairs, Vol. 1, No.3, Spring/Summer, 1997, pp.47-51 for discussion on "sterilized" intervention used by Chile to limit inflationary pressures on capital inflows.
[110] Ibid., pp.48-49.
[111] Ibid., p.49.
[112] Ernest Bartell, "Perception by Business Leaders and the Transition to Democracy in Chile," Business and Democracy in Latin America, Pittsburgh: University of Pittsburgh Press, 1995, pp.71-74.

relief pension, unemployment insurance, family and maternity allowance and basic improvements in the health service infrastructure, etc.).[113] This expansion in social expenditures was financed by an increase in the income tax rate and by the introduction of a value-added tax which limited the inflationary effects of these policies.[114] It is important to mention that the ability to introduce social reforms was the result of a business-labour accord.[115] This accord basically recognised the concepts of private property, free markets, and flexible prices in an open economy as well as recognition of the desirability of better income distribution. It is important to note that when these new labour laws were tested in 1991 during the copper industry's CODELCO strike, the resulting agreement was based on wage increases relative to productivity gains. This set a precedent for future negotiations and allowed Chile to remain internationally competitive in regards to its production costs.[116] This agreement further increased the Chilean business community's support for continued social and economic reforms.

A second aspect of the final reform stage in Chile was the policy called "Apertura" which aims at greater insertion into the global economy through the use of FTAs and regional trade agreements.[117] For example, Chile has signed bilateral trade agreements with Mexico and Bolivia, gained membership in APEC, acquired associate membership with MERCOSUR, joined Canada in a FTA and has long been touted as the next partner into NAFTA.[118] Chile has also entered into negotiations with the EU and Japan for greater trade liberalisation. What these

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[113] Archibald Ritter, "The Rise of a Chilean Model of Economic Development," World Economic Affairs Vol.1, No. 3, Spring/Summer, 1997, p.59.
[114] Ernest Bartell, "Perception by Business Leaders and the Transition to Democracy in Chile," Business and Democracy in Latin America, Pittsburgh: University of Pittsburgh Press, 1995, pp.71-74.
[115] Ibid., p.72.
[116] Ibid., p.77.
[117] Archibald Ritter, "The Rise of a Chilean Model of Economic Development," World Economic Affairs, Vol.1, No. 3, Spring/Summer, 1997, p.57.
[118] Ibid., p.59.

agreements and membership indicate is Chile's continued emphasis on a trade diversification strategy as the cornerstone of its neo-liberal reform program. As trade has become more important to the GDP, especially in regards to the promotion of exports as a development policy, Chile has increased the defence of its trade interests and continued market access via trade agreements.

It is important to note, therefore, that Chile has been able to implement a consistent reform program based on market liberalisation. Furthermore, although these reforms were initially undertaken under radical conditions, the latter two stages have been more gradual and the authoritarian regime in place to bring about these economic and political changes has given way to more democratic means.[119] As a result, Chile has a low vulnerability level in regards to its ability and/or political will to bring about economic and political changes. As greater insertion into trade agreements is sought, Chile's ability to meet certain economic liberalisation or stabilisation criteria will already have been met. As will be discussed next, these reforms have yet to be completed as it pertains to Argentina or Brazil.

b) Argentina's Reform Program.

Prior to the election of Carlos Menem in 1989, Argentina was unable to implement a set of economic reforms that would at the same time lower inflation and promote economic growth. For example, as a result of the debt crisis in the mid 1980s and the subsequent reduction in capital flows, Argentina witnessed a decline of –1.2% in its economic growth in 1980-85. (Table 18). Unfortunately, the reform programs attempted to impose price and wage controls without ever attaining success or reaching long lasting consensus and support from different socio-political groups.[120] In fact, although labour and capital worked together in a concerted effort to influence economic policy in the early part of Alfonsin's government (this co-operation between capital and labour became known as the Group of 11), co-operation quickly dissolved following the introduction of the first stage of the Austral Plan in June, 1985.[121] Although the plan met with initial support from the business community, labour was less than supportive of the new regulations relating to price and wage controls. Furthermore, the increasing role of government in setting interest and exchange rates tended to create greater tension between different economic sectors (i.e. the agricultural export sector vs. industrial export sectors).[122] This eventually led to non-compliance by certain sectors of the economy and thus undermined the objectives of the reforms. For example, although the inflation rate was lowered temporarily in 1985, as non-compliance with wage and price levels became more prevalent, the inflation rate went from 90.1% in 1985-86 to 131.3% in 1986-87. (Table 19). As subsequent reform programs were introduced to lower inflation and increase the openness of the economy to foreign competition (i.e. the second and third Austral plan, the July plan and the Spring Plan), the credibility of the government to introduce lasting reforms was met with indifference by the business community.

[119] It is important to note that certain elements of the military regime remain influencial in the political arena. For example 10% of COLDECO's revenues are directed towards the military, and members of the armed forces have assigned seats in the Senate which gives them the ability to block certain policies.
[120] Carlos H. Acuna, "Business Interests, Dictatorship, and Democracy in Argentina," Business and Democracy in Latin America, pp.3-23.
[121] Ibid., p.14.
[122] Ibid., p.15.

TABLE 18

Average Annual GNP Growth Rate for Argentina, Brazil and Chile, 1980-93.[123]

	1980-85	1985-93	1991	1992	1993
Argentina	-1.2	2.1	8.9	8.6	6.0
Brazil	0.7	2.4	0.4	-0.9	5.0
Chile	-0.1	6.9	6.1	10.3	5.8

It is not surprising that with persistent rising inflation and declining economic growth, the Peronists by 1989, had managed to achieve a majority in the Senate, to acquire a majority of elected officials the Chamber of Deputies, and to have Carlos Menem elected as president. The fear remained, however, that with this shift towards Peronism, traditional import substitution policies and strong government intervention to increase domestic demand would once again be the policy of choice.[124] Menem's emphasis on neo-liberal reforms, however, continued the general policy direction of the Radical party, albeit at a more stringent pace. For example, Menem introduced the State Reform Law and the Economic Emergency Law which began to privatise state firms, suspended subsidies to industry and mining, froze state hiring and discontinued job security for state employees.[125] Emergency measures were also introduced to devalue the Austral, suspend export subsidies, and eliminate investment barriers. It should be noted that the impact of the reforms undertaken by Menem's economic team were, nevertheless, still unable to reduce inflation substantially. In fact, as table 19 indicates, bouts of hyperinflation

[123] World Bank, Trends in Developing Countries 1994, pp. 22,55,101.
[124] Carlos H. Acuna, "Business Interests, Dictatorship, and Democracy in Argentina," p. 27.

occurred in 1989 and again in 1990. To remedy these occurrences, the economics ministry under Gonzalez strengthened classical neo-liberal reforms by reducing budget deficits and limiting the ability of the Central Bank to print money.[126]

TABLE 19

Annual Average Growth Rates of Consumer Price Indices for Argentina, Brazil and Chile, 1970-92.[127]

	70-80	84-85	85-86	86-87	87-88	88-89	89-90	90-91	91-92
Argentina	118.2	669.2	90.1	131.3	343.0	3079.3	2314.0	171.7	24.9
Brazil	35.3	222.6	145.0	229.8	682.8	1286.9	2928.9	440.8	1008.7
Chile	127.1	30.7	19.5	19.8	14.7	17.0	25.9	21.9	15.6

It is important to mention that as the reforms became more drastic and prevalent, the executive branch began to acquire and use greater political powers to limit political opposition (i.e. laws limiting the right to strike).[128] The Menem government also began to issue decrees on a much greater scale than ever before and the Supreme Court was augmented from five justices to nine so as to reduce the risk of having a law declared unconstitutional.[129] Thus, by the time that Domingo Cavallo was appointed economics minister, many of the major tenets of neo-liberal

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[125] Ibid., p.29.
[126] Ibid., p.32.
[127] UNCTAD, Handbook of International Trade and Development 1993, p.57.
[128] Carlos H. Acuna, "Business Interests, Dictatorship, and Democracy in Argentina," p.34.
[129] Michael S. Serrill, "Caudillismo: Democracies under strain seein their elected civilian Presidents turn to authoritarian measures," Time, May 15, 1995, p.33.

reforms were already in place with an increased concentration of political power at the executive level. This gave Menem the ability to pursue further market liberalisation policies.

For example, a major aspect of the new reform program initiated with Cavallo was the convertibility plan that would fix the exchange rate at 10,000 austral to the American dollar and create a currency board. The mandate of this currency board would prohibit the Central Bank from printing money unless it was backed by foreign currency reserves, thus making it fully convertible.[130] It is important to mention that ten other tenets were associated with the convertibility plan:[131] 1) privatisation was further extended to lower the budget deficit and increase foreign currency reserves, 2) reduction of the state's role in formulating regulations in the market activity of the economy, 3) reduction of the size of the government apparatus, 4) re-negotiation of debt servicing with external creditors, 5) increase in the tax base with a better implementation of a value added tax, 6) overhaul of the tariff system such that a three tiered system was imposed with a mean tariff level amounting to only 10%, 7) lowering labour cost by reducing compensation, increasing access to temporary employment, etc., 8) increases in wages only by productivity gains, thus limiting price increases, 9) limitation of the role of unions by having negotiations undertaken only at the firm level rather than at the sector level, and finally, 10) limitation of the power of the unions in that workers were no longer required to contribute to the social security fund. Furthermore, these reforms were implemented as Argentina began to seek greater insertion into MERCOSUR.

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[130] Nathaniel Nash, "A Strong Leash for Currencies on a Rampage," The New York Times, February 5, 1995.
[131] Carlos H. Acuna, "Business Interests, Dictatorship, and Democracy in Argentina," Business and Democracy in Latin America, pp.38-41. Also see Célia Himelfarb, <<Convertibilité, stabilisation et dérégulation en Argentine,>>Cahiers des Amérique Latines, No. 14, 1993, pp.51-66.

The greater emphasis placed by Argentina on sub-regional integration resulted from the Argentina-Brazil Economic Integration Pact (ABEIP) in 1986 and was re-enforced in 1990 with the creation of MERCOSUR which added Uruguay and Paraguay to its ranks. It should be pointed out that the ABEIP was an important regional initiative not only for the trade creation that it set out to accomplish, but for the closer political and economic ties between the two biggest South American countries, which was seen as an important step in the transition for both countries towards democracy.[132] Furthermore, the approach undertaken by both the ABEIP and MERCOSUR was gradual in nature and was open to further regional membership.[133] These two elements, as will be seen shortly, are meaningful, first because the gradual approach provided for greater flexibility as the two economies underwent change and secondly, because future entry into these agreements by third parties would further stabilise and enhance the scope of the trade agreement.

This direction towards closer integration is important given the fact that the period preceding closer economic ties between Argentina and Brazil was marked by high levels of protectionism as the economies attempted to limit imports and increase exports as a response to the debt crisis. By 1986, however, both countries began to see exports between each other as an element of their development strategy. Closer regional integration came to be seen as a method by which the respective economies could be liberalised gradually so as to force local industries to become more competitive and thus lower domestic prices. However, for the treaty to become successful, the economic policies would need to be harmonised so that neither country would gain an unfair competitive advantage.

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[132] Luigi Manzetti, "Argentine-Brazilian Economic Integration: An Early Appraisal," Latin American Research Review, XXV: 3, 1990, p.109.

It is also important to note that Protocol 1 of the ABEIP did foresee the implementation of corrective measures. If major trade imbalances occurred between the countries, investment funds would help finance the development of the affected sectors. Unfortunately, the level of funding never reached adequate levels and the harmonising of economic policies proved a Herculean task as the stabilisation and reform plans were implemented at different paces and with contrasting emphases in Argentina and Brazil. Nevertheless, although the trade balance from Argentina to Brazil declined in 1992, it is important to note that the composition of trade did begin to alter. For example, whereas the overall exports to Brazil from Argentina declined, agricultural exports that accounted for 81% of total exports to Brazil in 1984 dropped to 62.1% in 1987. Furthermore, Argentina's industrial exports to Brazil went from 19% in 1984, to 37.9% in 1987.[134]

It is interesting to note that although the reforms have been harsh on the economy as productive resources were transferred from different economic sectors, political support for neo-liberal reforms remains intact. [135] Menem not only was able to pass a constitutional amendment allowing for a second presidential term, but his success at the election polls demonstrates that the alternative options have proven ineffective in rallying strong political support.[136] Furthermore, inflation levels after the implementation of the convertibility plan have been more stable and the resumption of sustained economic growth would seem to indicate that the neo-liberal reforms have begun to show some positive signs. For example, the inflation rate dropped from 2314 % in

[133] Ibid., p.110.
[134] Ibid., p. 122.
[135] Although recent polls and bi-elections may seem to indicate a reduction in popularity of Menem's government, it is too early to determine whether the popular vote will sway during the next presidential election due in 1998.
[136] Menem received 49% of the vote and received a majority in the Senate and Chamber of Deputies, see Michael Serrill, "It's Me or Chaos," Time, May, 29, 1995, p.25.

1989-90 to 24.9% in 1991-92, (Table 19) and economic growth went from a GNP retraction of –1.2% in 1980-85, to an increase of 6.0% in 1993. (Table 18) FDI flows, as indicated in table 13, has also resumed (i.e. from $587 million in 1983-89, to $1,836 million in 1990). Unlike Chile, however, no restrictions have been imposed on capital flows in and out of the country, and the strict convertibility of the exchange rate mechanism has limited the ability of the state to pursue an independent monetary policy such that periodic over valuation of the peso has increased speculative pressures on the Central Bank as well as making exports less competitive.[137] As will be discussed shortly, this strict adherence to a fixed exchange rate has important ramifications in regards to Argentina's trade relationship with Brazil.

Nonetheless, what is important to discern from the reform programs undertaken so far is that Argentina has attempted market reforms to stabilise the economy by increasing its openness to foreign trade and by controlling macro-economic indicators. The success of implementing these reforms can be attributed in part to the fact that greater concentration of political power has been centred on the executive branch which has shown a strong political will, thus far, to bring about stabilisation policies and structural change. However, these reforms have yet to be fully completed (i.e. trade barriers remain in force in certain industries and the level of tariffs is higher than is presently the case with Chile) and it is far from clear that the pace of reforms can be sustainable in face of high levels of unemployment. Based on this analysis it can be concluded that the vulnerability level, as it pertains to the ability to bring about socio-political change for Argentina, is moderate.

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[137] Calvin Sims, "Argentina, a Victim of Mexico's Fall, Tries to Recover," The New York Times, March 12, 1995.

c) Brazil's Reform Program.

Compared to the Chilean reform program and the recent Argentine reform strategy, the Brazilian reform experience is inconsistent. After the transition towards democracy in 1985, the government of President José Sarney (1985-1989) undertook five different economic plans following the import substitution policies of the previous military regime (the Cruzado Plan I, Cruzado Plan II, the Bresser Plan, the Social Pact in 1988, and the Summer Plan of 1989).[138] These programs, in short, were seen as failures because they were incapable of bringing forth long lasting reforms especially in regards to currency changes and price and wage freezes. Efforts at stabilising macro-economic indicators were, therefore, unsuccessful. For example, inflation for the period of 1988-89 amounted to 1286.9% and economic growth was limited to 2.4% in the 1985-93 period. (Tables 18 and 19) Furthermore, the inconsistency in the implementation of the reforms (i.e. price freezes without lowering input costs) and the lack of political resolve led to the eventual non-compliance by a growing number of industries in the economy.

With the transition to the Collor de Mello government in 1989, the reform programs initiated proved once again ineffective. The Collor Plan introduced in 1990 and the second Collor Plan in 1991 by finance Minister Zélia Cardoso de Mello attempted to privatise state enterprises, reduce government expenditures, and control inflation. It also brought forth greater structural reforms in terms of implementing greater trade liberalisation policies and limiting the amount of trade regulations (i.e. it abolished import prohibitions for over 1800 items and

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[138] See Leigh Payne, "Brazilian Business and the Democratic Transition: New Attitudes and Influence," Business and Democracy in Latin America, Pittsburgh: University of Pittsburgh Press, 1995 for domestic support for the proposed reforms and Ernest Bartell, "Perceptions by Business Leaders and the Transition to Democracy in Chile," for limitations associated with the reforms. Also Jacky Buffet, <<Le Brésil, du miracle à la difficile gestion de l'après miracle,>> Cahiers des Amériques Latines, No. 14, 1993.

eliminated import quotas and removed foreign exchange allocations), dismantled the indices used to index prices and wages levels, controlled interest rates, and, most notably, froze savings accounts.

These plans, unfortunately, were unsuccessful in controlling inflation and in reducing the budget deficit. For example, the pace of privatisation, which would have increased government revenues, was too slow. The privatisation of state enterprises did not reach anticipated levels, and those companies that were sold, were transferred mostly to the Brazilian pension funds (this was due to the restrictions imposed on foreign investments). Furthermore, tariff reductions, which further lowered revenues, were not matched by a reduction in transfer payments to state and local governments as required by the constitution. Although constitutional reforms were attempted in 1994 to limit the transfer payments to state and local governments (a major source of the fiscal deficit), these initiatives were thwarted. Constitutional change, as it pertains to social transfers, thus remains an important component to making the Brazilian economic reforms successful.[139]

These reforms, although unsuccessful in their early implementation, were, however, an important departure from prior reform initiatives of the Sarney administration. Whereas the Cruzado plans followed a heterodox reform program, the Collor plans returned to the traditional reforms (often supported or imposed by international institutions such as the IMF) where lowering budget deficits and reducing the money supply controls inflation.[140] Supporters of the heterodox reforms, on the other hand, believe that budget deficits and inflation were the direct result of the debt crisis. Thus, budget deficits are seen as a result of inflation rather than its

[139] Ernest Bartell, "Perceptions by Business Leaders and the Transition to Democracy in Chile," p.91.
[140] Ibid., p.81.

cause. Remedies will therefore attempt to lower inflation by freezing price levels. In lowering inflation and subsequent reductions in interest rates, the budget deficits, it is hoped, will also be reduced. In fact, the Cruzado plan, with a set of heterodox reforms, did initially lower inflation. However, the price freezes led to an eventual increase in consumer spending. With subsequent price and interest rate readjustments to compensate for these distortions, the behaviour of economic agents increased inflationary pressures as pre-emptive price increases were taken.[141] The more orthodox approach of the Collor Plan and the Real Plan, on the other hand, rested on controlling the level of demand by reducing budget deficits, lowering the money supply (i.e. limit of $1000 (US) per bank account), as well as better enforcing price and wage freezes. Furthermore, the greater trade liberalisation that ensued forced domestic industries to lower their prices so as to meet international competition.

TABLE 20

Overall budget Surplus/Deficits for Argentina, Brazil and Chile, 1985-94. (% of GDP).[142]

	1985	1990	1992	1993	1994
Argentina	N.A	(2.5)	0.6	1.7	0.0
Brazil	0.3	(1.4)	(0.2)	0.1	N.A.
Chile	N.A.	3.3	3.0	1.2	1.7

This classical approach to neo-liberal reforms was followed under the administration of President Itmar Franco as well as under the administration of Fernando Henrique Cardoso. For

[141] Ibid., p.81.
[142] World Bank, Trends in Developing Countries 1995, pp.103, 60, 22.

example, the stabilisation plan implemented in December 1993 by Franco aimed at attaining a balanced budget as well as introducing of a new currency, the "Real" (its eighth in five years). This new currency was backed by foreign reserves (Brazil had accumulated over 30 billion in reserves by this time)[143] and central bank interventions to maintain the Real pegged to the American dollar.[144] It is important to note, however, that what became know as the "Real" Plan was implemented without congressional approval. In fact, over 150 thirty-day renewable presidential decrees were initiated under Cardoso in his first year in power.[145] Thus, although the recent reform programs have met with greater success, (i.e. the inflation level has been estimated to be 12% in 1996, compared to 2,928% in 1989-90)[146], the effects of ruling by decree on the democratic institutions, may have longer term implications in regards to political stability.

It would seem that, similar to Argentina, Brazil has been forced because of its debt and its need to stabilise its economy from inflation, to bring about structural reforms. The difference, however, is that the two reform programs did not coincide (i.e. Argentina imposed greater structural reforms with increased macro-economic stability prior to Brazil). Furthermore, although the Brazilian executive branch has exercised greater political power to initiate and legislate reforms, constitutional changes regarding transfer payments to the state and local governments, remain problematic. For example, in June 1997, the leader of the government in the Lower House, Luis Eduardo Magalhaes (seen by some as Cardoso's next running mate) failed to pass an important constitutional amendment that would have lowered transfers to the

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[143] Peter Cook, "Brazil Campaigns against Inflation," Globe and Mail, May 16th, 1994.
[144] The currency band had to be widened in 1995 to limit speculation pressures following the Mexican peso debacle. Reuters News Agency, "Brazil Widens Currency's Trading Range," The Globe and Mail, March, 1995.
[145] Michael S. Serril, "Caudillismo: Democracies under strain see in their elected civilian Presidents turn to authoritarian measures," Time, May 15, 1995, p.33.
[146] Matt Moffett, "Brazil's Rising Imports May Sap Recovery," The Wall Street Journal, Nov.13, 1996.

state and local civil service.[147] Based on this analysis of socio-political factors, it can thus be argued that Brazil remains the most vulnerable of the Southern Cone countries because of its inability and/or lack of political will to institute reforms.

D. Conclusion.

From these different measures of economic and socio-political vulnerability, it can be seen that although Chile is the most vulnerable country in the Southern Cone as it relates to economic indicators, it is the least vulnerable when socio-political indicators are examined. Therefore, it can be argued that Chile's reform program, although harsh, has been consistent in so far that it has maintained its support for liberal trade policies based on export promotion. Whether the economic and socio-political reforms could have taken place under a democratically elected government is difficult to determine. It is possible to argue, however, that the pace of the reforms was more abrupt during the initial phase than in the latter two stages which paid greater attention to regulating capital flows, establishing competitive exchange rate policies, and attempting better wealth redistribution. These reforms not only have allowed Chile to stabilise macro-economic indicators and influence micro-economic progress that allow it to be internationally competitive, but the reforms undertaken two decades ago have also allowed it to take greater advantage of trade liberalisation agreements today. However, since the regional market remains attractive for Chile's interests, it is important for Chile not to be completely excluded.

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[147] "Not-so-magic Magalhaes." Latin American Weekly Report, Jun 17, 1997, p.286.

Brazil, on the other hand, is the least vulnerable as measured by economic indicators, but the most vulnerable when measured against socio-political indicators. Furthermore, it attempted structural changes before economic stabilisation. As a result, it has faced greater levels of macro-economic instability. Although recent reform programs (i.e. currency convertibility) have been implemented which has helped curb inflation, it has remained reluctant to fully liberalise its economy and it remains vulnerable in regards to the diffusion of political power between different levels of government.

In Argentina, the economic vulnerability is moderate and its economic reforms have been somewhat problematic to implement. Unlike Chile, this may have resulted from the fact that Argentina has a more complex economy. The conflicts between labour and capital, as well as those between different economic sectors, are as a result more accentuated. Furthermore, democratically elected governments that have faced persistently high levels of inflation have implemented stabilisation and structural reforms. This has limited the ability of governments to implement long lasting reforms. However, the election of a Peronist government in May 1989, far from reverting to import substitution and heterodox reform policies, actually accelerated the neo-liberal reforms attempted under the Radical party of Raul Alfonsin. Furthermore, because its reforms have increased the openness of the economy to outside competition, attaining access to foreign markets for trade purposes has become an important element in its development strategy. It is arguable, therefore, that regional integration within MERCOSUR represents one of the initial phases of a reform program that will allow Argentina to become more competitive to meet its trade objectives. Furthermore, by basing MERCOSUR in a formal multilateral treaty rather than simply negotiating a series of trade agreements, reactionary forces within the country are, to a certain extent, more limited in their ability to oppose the liberalisation reforms undertaken.[148]

It is important to note that a crucial element associated with the continued ability to support reform strategies by these three countries is the social cost associated with economic change. By examining different social equity variables, it would seem that Argentina has had over the years a better income and wealth distribution than Brazil or Chile. In Argentina in 1989 the top earning 10% of the population received 36.4% of the income share compared to Brazil's 51.3% and Chile's 48.9%. (Table 21)

TABLE 21

Income Share by Quintile for Argentina, Brazil and Chile, 1989.[149]

	1st	2nd	3rd	4th	5th	Top 10%
Argentina	4.8	9.4	13.5	20.2	52.1	36.4
Brazil	2.6	5.2	8.8	16.3	67.2	51.3
Chile	3.7	6.8	10.3	16.2	62.9	48.9

Furthermore, although the per capita income has fallen for all countries of the Southern Cone since 1980, Argentina still has a more equitable distribution. For example, in 1994, its per

[148] Luigi Manzetti, "Argentine-Brazilian Economic Integration: An Early Appraisal," Latin American Research Review, XXV:3, 1990, p.128.
[149] Werner Baer and William Maloney, "Neoliberalism and Income Distribution in Latin America," World Development, Vol.25, No.3, 1997, p.317.

capita income stood at $3,845 to Brazil's $1,866 and Chile's $2,803. (Table 23) However, it should be pointed out that although the per capita income has recently begun to increase (as well as the per capita GDP), the level of urban unemployment remains problematic especially for Argentina (i.e. the urban unemployment rate went from 2.6% in 1980 to 11.5% in 1994, whereas Brazil and Chile have actually lowered their unemployment levels, see table 23).

Therefore, in evaluating the reforms undertaken to increase development, it is important to keep in mind the exacting costs that these changes have had on the countries of the Southern Cone. As a result, whether Argentina can maintain a high level of unemployment is important to determining future support for the reform programs. Similarly, Brazil's lower level of unemployment is certainly not matched by a better income distribution or access to social services. (Table 22) As the neo-liberal reforms begin to take effect in Brazil, it is questionable whether they will be able to maintain this social disparity. As for Chile, although the policy platform of the "Concertation" underlined the need for better income and wealth distribution, it is clear from the data provided in table 22 and 23, that further progress is still necessary. How these countries come to handle and define the objectives of development will therefore prove to be a crucial undertaking as it pertains to their society's growth, prosperity and stability. As mentioned throughout this thesis, regional integration either sub-regionally or with trade blocs, is seen as the means to achieve this development. It is now important to determine the actual foreign policy directions taken by Argentina, Brazil and Chile to meet their development objectives and the forces that have led to these policy choices.

TABLE 22

Social Services and Poverty Levels for Argentina, Brazil and Chile.[150]

	Medical Doctors 1990 (Per 1000 hab.)	Illiteracy Rate 1992	Schooling 1991 (12-17 years old)	3rd Level Education 1991
Argentina	3.03	4.5	79.1	43.4
Brazil	1.49	17.9	74.3	11.7
Chile	0.46	6.2	86.6	23.3

[150] L'Etat du Monde. Annuaire économique et géopolitique mondial, Montréal: Editions de Boréal, 1995, p.452.

TABLE 23

Trends in Selected Socio-economic Indicators for Argentina, Brazil and Chile, 1980-94.[151]

		Per capita GDP	Per Capita Income	Urban Unemployment
Argentina	**1980**	4129	4072	2.6
	1986	3655	3355	5.6
	1990	3255	2924	7.5
	1992	3757	3478	7.0
	1994	4158	3845	11.5
Brazil	**1979**	1880	1850	6.4
	1987	2056	1936	3.7
	1990	1916	1792	4.3
	1992	1839	1742	5.8
	1994	1957	1866	5.1
Chile	**1980**	2315	2228	9.0
	1987	2255	2015	11.9
	1990	2601	2319	6.5
	1992	2972	2596	5.0
	1994	3172	2803	6.3

[151] United Nationa, "Social Panorama of Latin America 1995," ECLAC, appendix 131.

V. INTEGRATION STRATEGIES OF THE SOUTHERN CONE COUNTRIES.

This section will examine certain policies undertaken by the countries of the Southern Cone. This will help characterise the foreign policy strategies followed in relation to sub-regional integration. Although an elaboration of a state's foreign policy will invariably necessitate certain judgements on the part of the researcher as to the policy intent of a country, some strategic directions associated with the postulated models can be discerned. It should also be indicated, that these policies are constantly evolving, and may change as the circumstances dictate and/or allow. In examining the integration strategies of the Southern Cone countries, it is also important to remember that foreign policies are to a certain extent, limited by the international structures. As will be demonstrated in this chapter, although certain forces may mitigate for or against a certain policy, sub-optimal outcomes might result because of the external political environment. In light of this, the less vulnerable a country is towards external forces, the more able it becomes in controlling its development destiny.

a) Chile: Constrained Unilateralism.

Chile is an example of a country that has been forced to alter its foreign policy due to external circumstances. It is for this reason that Chile's integration strategy is best defined as "constrained unilateralism". For example, although Chile may wish to follow a unilateral bloc entry model (in fact, it was ready to join NAFTA in December, 1994), the reluctance or inability of the American Congress to grant "fast track" to the American Executive branch might force

Chile to follow an alternate strategy.[152] In fact, this inability to undertake negotiations to enter NAFTA has led Chile to negotiate bilateral treaties with other individual countries such as Canada and Mexico. It has also indicated that it may pursue a separate treaty with the United States rather than continue their pursuit of NAFTA.[153] In conjunction to these bilateral treaties, Chile has also undertaken steps to increase trade relations with the Southern Cone by becoming an associate member of MERCOSUR.

These agreements and Chile's recent reluctance to negotiate entry into NAFTA has important ramifications in terms of its foreign policy directions. In entering NAFTA, Chile would have been required to grant the same trade concessions negotiated with third parties (i.e. NAFTA) to its new regional trade partners (i.e. MERCOSUR). This results from chapter 1, article 8 d), of the treaty of Asuncion which stipulates that members "shall extend automatically to the other States Parties any advantage, favour, exemption, immunity or privilege granted to a product originating in or destined for third countries which are not members of the Latin American Integration Association".[154] However, Chile may be reluctant to offer similar concessions made towards NAFTA to its MERCOSUR trade partners. For example, NAFTA includes trade liberalisation in telecommunications, services and investments which are not currently present in MERCOSUR.[155] Furthermore, the rules of origin are stricter in NAFTA than is currently present in MERCOSUR (i.e. 60% compared to 35% value added). It is also important to mention that an example of preferential treatment which Chile could not receive

[152] "Agreement with US getting Closer," Latin American Weekly Report, Sep. 2, 1997, p.6.
[153] "Bilateral FTA with the US?" Latin American Weekly Report, Aug. 19, 1997, p.386. It is interesting to note that this possibility was endorsed by the leader of the Democratic minority in the US House of Representatives, Richard Gephart, while in Santiago, Chile, in August, 1997.
[154] "MERCOSUR Approach to FTAA Advances," Latin American Weekly Report, Aug. 5, 1997, p.364.
[155] Ibid., p. 364.

were it to enter NAFTA is in the trade concessions (i.e. barriers to short term capital flows) made by Canada towards Chile in their recent FTA.

These examples are not an indication that Chile will necessarily shun closer economic ties with trade blocs, but rather, that so far, its trade bargaining strategy has been limited to bilateral FTAs. That being the case, unless the members of NAFTA are willing to open up negotiations to the current trade agreement, it is likely that Chile will continue a diversification strategy based on individual trade treaties. It is not, however, an example of a counter balance strategy. All the FTAs undertaken so far by Chile have been limited to trade liberalisation and not towards the creation of a separate "counter balance" bargaining stance. The question remains, however, as to whether Chile would favour a Free Trade Agreement of the Americas (FTAA) and if so whether it should be based on the a) "building bloc" approach where sub-regional trade treaties are first negotiated to later form linkages between the different set of agreements, b) the creation of certain criteria which once met, leads to automatic integration (i.e. a Maastrich like approach), or c) the American option which is based on expanding NAFTA.[156]

Although it is still far from certain that the political will in countries of the Western Hemisphere can be sustained to form the FTAA, it can be argued that until such a time as it becomes clear that the United States is ready to expand NAFTA, Chile, as already mentioned, is limited to the building blocs approach.[157] But, as also demonstrated, this policy decision has been followed with the utmost flexibility in the sense that it has allowed itself the option to seek FTAs unilaterally with the trade blocs rather than pursuing a unified bargaining stance under a counter balance strategy. In regards to the Maastrich approach, because no commitment criteria

[156] "US Sees AFTA as Expanded NAFTA," Latin American Weekly Report, Jan 28, 1997, p.55.
[157] "MERCOSUR Approach to FTAA Advances," Aug. 5, 1997, p.364.

have yet been established, this option is currently unavailable. However, it is interesting to note that Canada and Mexico have recently agreed to enter into negotiations for a bilateral agreement with MERCOSUR using the 4+1 format, thus further increasing the prestige of the "stepping stones" approach.

b) Brazil: A Latin American Counterbalance.

In contrast to Chile's trade strategy, Brazil's strategy is a clear example of the counter balance model. Although it has taken steps as a member of MERCOSUR to increase its ties with NAFTA by becoming a signatory to the Rose Garden Agreement, the manner by which it has adhered to the agreement indicates that it has probably favoured an alternate strategy to eventual bloc integration. For example, as already stated, the inability to implement a reform program that would work towards the removal of impediments to trade and investment flows as stipulated in the Rose Garden Agreement (see chapter 5, art. 4) indicates that Brazil has favoured a slower pace to liberalisation and is less concerned in meeting the criteria set forth in this framework agreement. This inability and/or unwillingness to meet the requirements of the Rose Garden Agreement is important because this agreement was to become a pre-cursor to further integration into NAFTA.[158]

It should also be pointed out that Brazil is a good example of the counter-balance strategy because of the emphasis placed on MERCOSUR as the mechanism used to increase its trade interests in the region. For example, unlike Chile, which has taken a series of steps to negotiate individual FTAs with different countries, Brazil has favoured the creation of a regional customs union (i.e. MERCOSUR). It is through MERCOSUR that closer ties with other countries have been constructed (i.e. Chile, Bolivia, and possibly the Andean Group, Canada, Mexico and the EU). This being the case, the integration process within MERCOSUR can be deeper than would a mere FTA. For example, MERCOSUR established formal organisational structures including the Council of the Common Market and the Common Market Group. The Council (see Chapter II, art. 10) is the body responsible for political leadership and decision making, while the Common Market Group (see Chapter II, art. 13) is the executive organ responsible with monitoring compliance, enforcing decisions adopted by the Council, proposing measures for applying the trade liberalisation program, co-ordinating macro-economic policies, negotiating agreements with third parties, and finally, drawing up programs of work for the formation of the common market. However, it is important to note that these bodies are made up from representatives of ministries of Foreign Affairs and, thus, do not represent supra-national entities. Also, all decisions by either the Council or the Common Market Group must be taken by consensus. Nevertheless, the institutional bodies are more extensive than would be the case in a FTA. How far integration could be undertaken as an element of the counter balance model is hard to determine. Some recent declarations however show certain directions that Brazil could undertake with the sub-regional bloc. For example, in June 1997, at the gathering of MERCOSUR's general staffs, Brazil indicated that the sub-regional bloc could be taken as a foundation for a regional defence bloc.[159] Also of importance is the fact that Brazilian finance ministers Pedro Malan has been known to support the creation of a common currency and the

[158] The Rose Garden Agreement was the framework agreement signed between MERCOSUR and the United States as part of the EAI to begin closer relationships between the US and Latin American countries.

[159] "New Military Thinking in MERCOSUR," Latin American Weekly Report, Jul. 1, 1997.

establishment of formal mechanisms for macro-economic co-ordination.[160] What these proposals indicate is Brazil's attempt to strengthen the integration process and institutional scope of MERCOSUR. In doing so, it will be able to use MERCOSUR as the "stepping stone" from which further regional integration will progress and which could eventually lead to a FTAA.[161] To that end, talks are ongoing between MERCOSUR and the Andean Group that could eventually lead to the South American Free Trade Area (SAFTA), a pre-cursor to the FTAA.[162] It is also worth noting that after the Summit of the Americas between the NAFTA partners and the rest of Latin America (which is to take place in March 1998), it is possible that an EU-Latin American summit will be undertaken.[163] Whether Brazil will embrace this new initiative for closer economic ties with the EU remains unclear. However, the fact that Cardoso has proposed Rio as the venue for these talks may indicate Brazil's desire to diversify the trade options of MERCOSUR between the different trade blocs, rather than full integration of the sub-regional bloc into NAFTA.

c) Argentina: A Hybrid Strategy.

As for the trade strategy undertaken by Argentina, the current reform policies would seem to indicate that it is presently pursuing sub-regional integration as part of a counter balance strategy. Argentina is a founding member of MERCOSUR and has indicated that as a member

[160] This common currency would be a unit of account between trading partners rather than the more extensive adoption of the EMU as is touted in the EU. "Common Currency Soon for MERCOSUR?" Latin American Weekly Report, Jun. 10, 1997, p.267.
[161] By using the sub-regional bloc as the focus of the efforts to create the FTAA, the agenda can be influenced by Brazil. As such, Brazil and the other regional partners could force greater liberalization in agriculture and manufactured goods as opposed to the United States emphasis on the liberalization of services. "Last Minute Concessions by Brazil Helps to Avert Clashes at MERCOSUR Summit," Latin American Weekly Report, Jun. 24, 1997, p.1.
[162] "MERCOSUR Approach to FTAA Advances," Latin American Weekly Report, Aug. 5, 1997, p.364.

of the 4+1 agreement that it would not seek unilateral entry into NAFTA.[164] Furthermore, Argentina has not pursued multiple bilateral trade agreements, as has been the case with Chile. Rather, it has favoured increased membership into MERCOSUR as a method to increase the scope of its trade liberalisation program. In addition, recent trips by American envoys to Argentina to gauge this country's reaction to eventual entry into NAFTA or the creation of a bilateral FTA with the US, have been met with a less than enthusiastic response.[165] Argentina has also been a staunch defender of MERCOSUR against criticism emanating both from the World Bank and the US as it pertains to the sub-regional bloc's auto parts industry regulations.[166] However, the difference between Argentina's counter balance strategy and Brazil's is that the former has been much more consistent in the implementation of a trade liberalisation program that was agreed to in the Rose Garden Agreement. As a result, although it is too early to determine whether it favours the creation of the FTAA, it is clear that trade liberalisation, so far, is limited to the sub-regional bloc. It could therefore be argued that in so far as MERCOSUR serves as an adequate means to liberalisation, Argentina has not altered its reform course by seeking other FTAs. However, this strategy could be reversed should Brazil become unable or unwilling to sustain its own reform program and thus render trade relationships between MERCOSUR members unworkable.

Another facet that differentiates Argentina's integration policy from that of Brazil is in the fact that it has continued in its efforts to being granted "principal non-NATO ally" status by

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[163] "Pushing Ahead the European Link," Latin American Weekly Report, Jun. 3, 1997, pp. 258-259.
[164] "MERCOSUR Partners Worried About Argentina's Stance on NAFTA," Latin American Weekly Report, Jun., 1994.
[165] These trips were undertaken by Mexican president Ernesto Zedillo and former US president, Jimmy Carter. "US Sees AFTA as Expanded NAFTA," Latin American Weekly Report, Jan 28, 1997, pp. 54-55.
[166] "US Trade Policy Takes a Drubbing," Latin American Weekly Report, Jul. 15, 1997, p.331.

the United States.[167] This strategy, however, is perceived as being disruptive to regional integration because the balance of power in the Southern Cone could eventually be undermined. For example, Frei declared that "assigning special privileges or entering into non-consulted associations with one particular Latin American country would hamper confidence in the region and create uncertainties within our sub-regional blocs."[168] Therefore, it would seem that Argentina might impose certain limits to the scope attributed to sub-regional integration. It has been willing to initiate closer trade and economic ties within the region, but its development remains associated with closer ties with the United States.[169] As such, this stance may eventually lead to the disintegration of MERCOSUR, in which case, integration into a trade bloc would then become the best way for Argentina to insert itself into the global economy. For this reason, Argentina's actions would seem to be indicative of a strategy that uses sub-regional integration as a means to eventual integration into a trade bloc.

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[167] "Menem Unwitting Instrument of US Attempts to Upset MERCOSUR," Latin American Weekly Report, Sep. 2, 1997, p.1.
[168] Ibid., p.1.
[169] It is also interesting to mention that Menem has indicated that he did not support Brazil's bid for a permanent seat on the UN Security Council because it would change the balance of power within the Southern Cone. Ibid., p.1.

VI. VULNERABILITY AND INTEGRATION STRATEGY IN THE SOUTHERN CONE: AN ANALYSIS.

After having examined the regional strategies that are being pursued by Argentina, Brazil and Chile, it is now important to proceed to a study of the economic and socio-political forces that influence these policy options. It is important to underline that although all integration strategies are to a certain extent externally focused, these strategies do differ on the degree that they are attempted or contemplated. As will be seen, the more externally focused the strategy, the more likely that trade diversification is an important force in development. Conversely, the less externally focused the strategy, the more that the country is able to follow an independent development strategy. In other words, the existence of vulnerability will affect the strategic options. To verify these assertions, the economic and socio-political forces within Chile, Argentina and Brazil will be examined in closer detail.

a) Chile.

Chile, with its high level of vulnerability, is very concerned with maintaining an appropriate integration strategy that will continue to protect its trade and investment interests. With a market that represents only 13.8 million inhabitants and a GDP of $42,138 million, it would seem that the FDI flows into the Chilean market will be directed towards the export sector. Since Chile already has a high level of diversification (in terms of export destinations), it would be in its interest to garner trade agreements to expand or protect its market access (as defined by the unilateral bloc entry model) with as many partners as possible. In this way, Chile could promote to foreign investors its economy as an entry point to other markets. However, although Chile's bargaining position as a member of a sub-regional agreement (i.e. MERCOSUR), might increase *vis à vis* third parties, its vulnerability towards the dominant members of the region (i.e. Argentina or Brazil) may also increase, thus making the counter balance scenario impracticable. Furthermore, vulnerability may also be increased if trade relations with other blocs are endangered or limited as a result of their accession to a sub-regional treaty. For example, if the common external tariff of MERCOSUR is deemed too high, this may result in retaliatory measures by the Triad.[170] Since Chile is the most vulnerable country of the Southern Cone as it pertains to trade, the retaliation measures may be more damaging to it than to Argentina or Brazil. However, because both Argentina and Brazil constitute an important potential export market for Chile (see table 25), the latter would most probably favour some sort of bilateral agreement with the sub-regional bloc. For example, in 1994, Chile exported $637 million to Argentina and $605 million to Brazil. These figures represent a 559% increase in trade to Argentina since 1990, and a 24% increase to Brazil for the same period. Therefore, what becomes important for the unilateral bloc entry model to be feasible is for the rules of insertion, within the sub-regional as well as the major trade blocs, to be flexible enough to allow joint membership.

In regards to its ability to insert themselves into trade blocs, Chile, because of its economic and political stability, has often been touted as the next member into NAFTA.[171] Although the accession clause of NAFTA is vague, it has been argued that accession would be limited to extending the current NAFTA agreement to new members.[172] Although MERCOSUR may be reticent to allow multiple membership from its members with other trade blocs, the fact

[170] It is interesting to note that Chile left the Andean Pact in October 1976 because of the incompatibility of the liberation reforms undertaken and membership with a sub-regional group. See Julio J. Nogues and Rosalinda Quintanilla, "Latin America's Integration and the Multilateral Trading System." p.285.
[171] Drew Fagan, "NAFTA Gets Fourth Amigo," Globe and Mail, December 12, 1994.
[172] Ibid.

that Chile remains theoretically detached from actual full accession to the sub-regional Customs Union may allow the Chilean state to have limited forms of participation with other blocs.[173] Certain members of MERCOSUR might even welcome this. Having a member such as Chile with multiple associations within other trade blocs and/or major industrialised countries may increase MERCOSUR's access to other markets via successful applications of the rules of origin.[174] Furthermore, successful entry into trade blocs, by a country such as Chile, may provide MERCOSUR, or its members, with an example for future entry negotiations. However, as already mentioned, the unwillingness of the United States' Congress to grant "Fast Track" has recently forced Chile to favour bilateral treaties. Still, Chile's integration strategy remains based on a diversification of trade partners via bilateral agreements and/or trade bloc accession.

TABLE 24

Export Destination for Argentina, Brazil and Chile, 1980-92.[175]

		Europe	North America	Japan	Eastern Europe	Latin America
Argentina	1980	32.1	9.5	2.6	22.4	24.5
	1985	25.2	12.9	4.3	17.4	22.1
	1992	31.5	11.5	3.1	0.9	33.4
Brazil	1980	34.0	18.6	6.1	6.5	18.1
	1985	29.5	28.8	5.5	4.0	9.7
	1992	30.8	20.8	6.4	0.7	22.4
Chile	1980	43.0	11.5	11.1	0.5	24.7
	1985	35.8	23.4	10.6	1.4	15.0
	1992	34.4	16.1	18.7	0.4	14.9

[173] Treaty Establishing a Common Market Between the Argentine Republic, the Federative Republic of Brazil, the Republic of Paraguay and the Eastern Republic of Uruguay, Chapter IV, Article 20.
[174] Ibid. Chapter I, Article 8 d) They shall extend automatically to the other state parties any advantage, favor, exemption, immunity or privilege granted to a product originating in or destined for third countries which are not members of the Latin American Integration Association.
[175] UNCTAD, Handbook of International Trade and Development Statistics, 1993, pp.112, 113, 114.

TABLE 25

Regional Patterns of Trade for Argentina, Brazil and Chile, 1989-94. (Millions of $).[176]

		Argentina		Brazil		Chile	
Argentina	1989			1,124		350	
	1990			1,423		462	
	1991			1,489		488	
	1992			1,671		581	
	1993			2,814		592	
	1994			3,208		868	
Brazil	1989	710				693	
	1990	645				484	
	1991	1,476				677	
	1992	3,040				923	
	1993	3,661				1,110	
	1994	4,174				909	
Chile	1989	110		523			
	1990	114		487			
	1991	257		448			
	1992	456		452			
	1993	589		406			
	1994	637		605			

b) Argentina.

In the case of Argentina, trade strategies like the one undertaken by Chile, albeit enviable, may prove premature if not impracticable at this time. Argentina may not yet have achieved the economic reforms required to pursue a unilateral bloc entry strategy (as it pertains to closer economic ties with a major trade bloc) to a sufficient degree. MERCOSUR, on the other hand, offers Argentina the ability to undertake a set of economic reforms that may eventually allow it to pursue a more independent external strategy. It should also be noted that for Argentina, Latin America and in particular Brazil, represents a more important component of the formers' trade strategy than is the case for Chile. (See tables 24 and 25) Latin America, for example, accounted for 33.4% of the country's total exports in 1992, with exports to Brazil amounting to $3,208 billion in 1994. As already indicated, Argentina has also a more diversified export structure than Chile. (Table 7) With more emphasis being placed on the export of manufactured goods (31.9% compared to Chile's 16.1%), Argentina will be inclined to increase its entry into the growing regional markets of MERCOSUR which has witnessed greater demand for these goods. Since Brazil offers such a market (in 1994 the total industrial manufactured exports to Brazil amounted to $1,377 million, or nearly 38% of its total manufactured exports)[177] it would seem to be in Argentina's interest to secure effective trade dispute mechanisms and favourable rules of origins to help render Argentina's industries more competitive at the sub-regional level.

However, it should be indicated that as Argentina's economy becomes more exposed to external trade relative to their GDP, a strategy similar to that of Chile's, based on trade diversification, may prove worthwhile. For example, in examining the export statistics since the creation of MERCOSUR, serious fluctuations in Argentina's trade balance towards Brazil have occurred. (See Table 25) Although the period from 1989 to 1991 saw favourable trade balances

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[176] IMF, Direction of Trade Statistics Yearbook 1995, pp.103, 134, 152.
[177] Centro de Economia International, Comercio Exterior Argentino, Mayo de 1995, Vol.3 No.5, p.3.

for Argentina towards Brazil, the 1992 to 1994 period witnessed negative balances (i.e. $1,205 million in 1989-91 compared to -$3,182 million in 1992-94).

It is of particular interest, therefore, to determine whether Argentina would be better suited as a member of a major industrialised trade bloc such as NAFTA, or as a member of MERCOSUR. The problem with the latter is that Argentina, being the smaller partner, risks being more vulnerable towards a country such as Brazil (i.e. differences in economic policy may give Brazilian industries a competitive edge).[178] On the other hand, it is conceivable that in order to retain Argentina as a trade partner, Brazil may be inclined to grant certain trade concessions to the smaller more vulnerable partners.

In using Gilpin's three criteria to justify a multilateral trade regime and applying them to sub-regional trade blocs, it could be argued that Brazil would not only need to show regional leadership at the expense of its own national interest, but it would also need to find a common set of values in relation to economic, political and security interests, as well as establishing a common ideological foundation. The problem, however, is that Brazil is limited in its ability to offer the needed leadership. Brazil has faced severe debt problems such that the resources available to offer concessions to weaker partners are smaller in scale compared to those that may be offered by trade blocs. For example, the fact that the United States did secure funds to stabilise the Mexican economy after its drastic devaluation exemplifies the political will and financial resources that are available within a major trade bloc. Unlike sub-regionalism, the concerns of a major industrial power are no longer tied to the resources available for leadership, but rather to the political will to do so. Thus, although both Argentina and Brazil may converge

[178] An example of this occurred in March of 1997, when Brazil imposed new import financing rules. See "Brazil Hopes to Douse MERCOSUR Import Row," Reuters, April 1, 1997.

on a common set of economic, political and security interests (i.e. development), the ability of a regional hegemon to provide necessary leadership may be wanting due to the limited resources of the regional entity.

It would seem, therefore, that Argentina favours sub-regional integration, not as a counter balance to the trade blocs, but as a temporary reform policy that will allow it to access growing trade markets. Furthermore, with increased access to these markets, Argentina will attract greater amounts of FDI, which are concerned in gaining both domestic market share and a foothold into other export markets. The costs associated with a counter balance scenario would prove too high for Argentina given the fact that it still remains vulnerable towards Brazil. Any strategy, which may hinder access to important trade markets, must therefore be undertaken with great care.

c) Brazil.

Brazil, on the other hand, would seem to be the Southern Cone country most likely to continue pursuing a counter balance scenario. Although it has witnessed an increase in its manufacturing share of exports from 37.1% in 1980 to 58.8% in 1993, (table 7), most of the anti-dumping claims by the United States have been directed towards their industrial sector (see table 5). Brazil may therefore wish to limit its dependence on the Triad as an export destination. Greater emphasis on Latin America as a trade partner could, therefore, be seen as a means to strengthen its commercial position. Indeed, the increase of Latin America as an export destination (from 9.7% in 1985 to 22.4% in 1992, see table 24) has been coupled with an increase in export growth (the period 1985-1990 had a 7.6% growth rate and 1991-92 saw an increase of 14.1%). (Table 26)

TABLE 26

Annual Average Growth Rates of Exports for Argentina, Brazil and Chile, 1980-92.[179]

	1980-85	1985-90	1987-88	1988-89	1989-90	1990-91	1991-92
Argentina	-0.3	9.9	43.6	4.9	29.0	-3.0	2.1
Brazil	4.9	7.6	28.8	1.8	-8.6	0.7	14.1
Chile	-3.3	19.9	38.2	16.2	4.7	5.5	11.9

Furthermore, because Brazil enjoys a net advantage over other Southern Cone countries in terms of its relative economic size and its lower level of economic vulnerability, it would be in a favourable bargaining position towards other regional members. Its bargaining advantage could thus open the way for greater market penetration for Brazilian industries. Also, while not necessarily opposing closer relations with the trade blocs, Brazil would probably rather set the stage for future negotiations, between blocs or within multilateral organisations, by using its position in MERCOSUR to increase its bargaining leverage. With an increase in membership, the bargaining strength of MERCOSUR, which Brazil could effectively dominate, would thus increase. Trade blocs wishing to increase their trade relations towards these growing markets would, as a result, be more inclined to bargain in good faith and offer trade concessions to the benefit of Brazil. This type of trade strategy (counter balance) pursued by Brazil is witnessed by its support of the creation of SAFTA prior to proceeding into negotiations with NAFTA in the

[179] UNCTAD, Handbook of International Trade and Development Statistics, 1993, p.18.

creation of the FTAA.[180] In establishing SAFTA as the political unit to greater integration within South America, Brazil may come to challenge the influence of the United States in the region.

The risk for Brazil is that by forming and leading a sub-regional bloc, members of the Triad may look upon Brazil as creating trade barriers towards the major industrialised countries, particularly if trade liberalisation is deemed too limited or its pace to slow. Therefore, countries wishing to limit Brazil's sphere of influence in the region may attempt bilateral agreements with the smaller countries of the Southern Cone. As already discussed, this may increase the pressure on Brazil to provide trade concessions to sub-regional members as it competes with the Triad in enticing participation in sub-regional agreements. It is important to note, however, that the major trade blocs may be willing to foster sub-regional integration so as to increase the reforms contemplated by developing countries. For example, the EAI favoured "framework agreements" with sub-regional trade blocs so long as the regional agreement instigated liberal trade reforms.[181] It was as a result of this policy direction that the Rose Garden Agreement was signed in 1991 between the United States and MERCOSUR.

At issue, therefore, is not the concept of sub-regional integration per se, but rather, the regional policies associated with them. The United States would most likely favour the integration of MERCOSUR into NAFTA, so as to form the FTAA initiated under Clinton at the Miami summit in 1994. Brazil, on the other hand, by following the counter balance model, would be inclined towards making MERCOSUR the hub for trade agreements with other major blocs.

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[180] Oxford Analytica, "US, Brazil Wary Partners in Move Towards Free Trade," Globe and Mail, March 31, 1997.

[181] Julio J. Nogues and Rosalinda Quintanilla, "Latin America's Integration and the Multilateral Trading System," pp. 302-307.

The ability of Brazil to lead a sub-regional bloc of this sort will depend on its external debt and investments. In contrast to Chile's tendency towards unilateral bloc entry and Argentina's possible use of regional integration as a preparatory step into a trade bloc, Brazil will be more tempted to pursue a counter balance strategy because it represents a large enough market on its own to attract foreign investments. Therefore, the trade policies pursued by Brazil will not necessarily be designed for trade expansion, but rather for attracting foreign investments into the host market to supply the domestic demand. Both tariff barriers and non-tariff barriers could be seen as useful instruments to limit external competition and thus create incentives for TNCs to set up in the host country. Furthermore, Brazil's delay in implementing an effective reform program, aimed at lowering inflation, could be attributable to the desire not to stifle the domestic demand as the engine to economic growth. Thus the manner by which the ratio of debt to GDP will be decreased would be by increasing the size of the domestic market rather than by basing their development strategy solely on the promotion of exports.

Yet external trade remains an important component of the Brazilian economy. By creating MERCOSUR, Brazil could further increase its position in terms of offering an even greater market for those TNCs wishing to increase their investment exposure to the Southern Cone. Furthermore, since its bargaining leverage within the sub-regional bloc is strong, it could influence and protect its regional interests better than if it was to enter a trade bloc where its own sphere of influence would be greatly diminished.

The disadvantage to this counter balance strategy is that direct investment by TNCs, as well as other forms of investment flows, may shy away from this bloc if its combined policies do not meet with certain risk standards. For example, if Brazil continues to devalue its currency for domestic political reasons and/or to increase the competitiveness of its exports, this may not only have an eventual disintegrative effect on the other members of MERCOSUR who are no longer able to compete fairly, but foreign investors may be reluctant to invest in a hyper-inflationary economy. This might explain the reluctance of a return in FDI flows into Brazil as compared to the experiences of Argentina and Chile. This reluctance may help explain the reduction in investments in machinery and equipment (a crucial element in industrialisation).[182] For example, whereas Argentina or Chile have remained stable or increased their share of investment in this sector, Brazil has gone from 8.0% of GDP in 1978-81 to 4.7% in 1990-94. (Table 27) Therefore, although the counter balance scenario may offer greater independence in relation to the Triad, the risk of development failures also increases.

TABLE 27

Investment in Machinery and Equipment for Argentina, Brazil and Chile, 1978-94.

(As a % of GDP in constant currency for each country)[183]

	1978-1981	1982-1984	1985-1989	1990-1994
Argentina	7.8	7.4	7.2	7.2
Brazil	8.0	5.4	5.5	4.7
Chile	6.6	3.9	7.9	11.9

[182] Graciela Moguillansky, "The Macroeconomic context and investment: Latin America since 1980," CEPAL Review, No.58, April, 1996, p.86.
[183] Ibid., p.82.

VII. CONCLUSION AND APPRAISAL OF SUB-REGIONAL INTEGRATION.

The international system has witnessed structural change from a loose bi-polar system towards a system based on multi-polarism. Under these new structures, new power capabilities and relationships will emerge forcing individual state actors to implement new strategies in order to access the new levers of power. These strategies which concern the national interest, will either be internally or externally focused. Strategies, which are internally focused, will favour the increase of domestic power while external strategies will have a tendency towards balance of power policies through alliances, treaties and co-operation. To determine the propensity of a country to follow either one of these strategies will require an examination of the dynamics of the new international structures as well as certain domestic variables.

The new international structures, based on or affected by globalisation and interdependence, will invariably lead to the international positioning between states to form and control new multilateral institutions that will regulate the international system. However, as demonstrated, developing countries are limited in their ability to access or influence the actions of multilateral institutions because of the existence of trade blocs and/or exclusive decisional bodies, such as the OECD, that prevents smaller and more vulnerable countries the ability to independent action. Since the national interests of states, such as those of the Southern Cone, are currently based, to a large extent, on economic progress, trade and investment strategies will thus be determined by the relationship existing between the dominant Triad and themselves. This relationship with the Triad will be determined by the level of vulnerability these countries have either in terms of external trade, external debt and investment, and finally, in terms of socio-political forces set for or against reforms. Moreover, three strategies have been posited that may help explain the strategic directions that the Southern Cone countries are most likely to take within the new international structures: unilateral bloc entry, sub-regionalism as a means to enter a trade bloc, and a counter balance regional trade bloc.

In examining the different trade and investment variables, as well as the socio-political ability and/or will to reform, it can be seen that vulnerability will affect the policy choices of the developing countries. However, it is important to mention that both the unilateral bloc entry strategy and the regional integration as a means to enter a trade bloc are dependent on the willingness of the trade blocs to accept new members. Since the United States has failed to grant "fast track" authority to the executive branch to negotiate accession into NAFTA, the Southern Cone countries may be limited to the counter balance strategy, or at the very least, seek alternate FTAs with individual countries. Although it may be argued that a counter balance strategy may actually be in the interest of all Southern Cone countries because it limits the scope of the liberalisation reforms needed to enter a trade bloc (i.e. Chile could maintain its investment restrictions which it could not do as a member of NAFTA), it has to be remembered that not only will countries miss an opportunity to reform and become more competitive in sectors such as services, telecommunications, government procurements, etc., but they will also be excluded from taking part in the formative blocs that influence and govern the international system. Furthermore, as the data in table 24 indicate, trade relationships with the trade blocs remain an important component of the economies in the Southern Cone. Since the counter balance strategy does not guarantee better relations with the trade blocs, but may actually increase the chances for conflicts, this strategy may remain sub-optimal for countries facing higher levels of economic vulnerability.

As for the domestic variables, it was demonstrated that Brazil is by far the dominant regional power. Furthermore, because of the size of its domestic economy, it is better able to attract FDI who wish to access this domestic market. However, because of the debt crisis of the mid 1980s and the instability inherent with its high inflation rate, Brazil has come to see exports as a valuable component of their development strategy. Not only do exports provide a source of foreign currency to finance foreign debt, but also the export strategy will necessitate greater efficiency and will act as downward pressure on domestic prices and thus limit inflation. To have a successful export strategy Brazil will, as a result, further require an increase in foreign investments as a means to access capital as well as technological and managerial innovations. Thus, to increase the inflow of investments, Brazil has been forced to undertake market and political reforms. The nature, pace and scope of these reforms were determined not only by the size and nature of the economy, but also by the political will and/or ability to engineer structural and stabilisation reforms. Since Brazil implemented its structural changes prior to its stabilisation reforms (which have allowed it to reap certain trade advantages), it has favoured the counter balance model. This strategy, as manifested by the creation of the ABEIP and later MERCOSUR, allows Brazil to increase its exports to the region as well as influencing the direction and nature of the relationship that the Southern Cone has towards the major trade blocs. The greater the size of the regional trade bloc, which it can dominate because of its own economic power, the more Brazil will be able to influence the agenda in the multilateral institutions within the international system.

Thus, the manner by which Brazil has attempted to position itself within the new international structures is by developing an internally focused strategy by which sub-regional integration is used as a means to counter-balance the power of the existing Triad. In opposition to this strategy, is the externally focused strategy adopted by Chile.

Rather than creating a sub-regional bloc that would act as a basis from which to negotiate with members of the Triad, Chile has embarked on a diversification strategy where insertion into the trade blocs is pursued on an individual basis. The reason for Chile's unilateral bloc entry, stems form the fact that its vulnerability towards Brazil would make Chile subservient to Brazil's ability to offer an adequate market for its exports. Although the regional market has grown, the Brazilian economy remains volatile. Chile has thus favoured a policy based on trying to negotiate entry into individual trade blocs because of the stability inherent with a developed market. For a country of Chile's size, the relationship with the dominant power will be unbalanced regardless of whether it takes on the form of sub-regional integration or a treaty with a major industrial trade bloc. Since Chile's economy has undergone structural changes and is stable in terms of its macro-economic variables, it is as a result, better able to meet the requirements for accession into trade blocs

Argentina's regional strategy seems to indicate a hybrid of the two previous approaches. Similarly to Chile, Argentina is faced with an imbalance in the power relationship with Brazil. To offset Brazil's dominance in the sub-regional treaty, it is therefore in Argentina's interest to increase the membership of MERCOSUR. Thus SAFTA would seem to be welcomed only in so far as it is able to provide a counter balance to Brazil.

Therefore the Southern Cone countries have all undertaken reform strategies based on integration as a means to development. How well their respective strategies will accomplish their vision of insertion into the global economy, has yet to be fully appraised. However, in examining the current trends, it would seem that Chile is most likely to succeed in inserting itself into the global economy. Not only has it been able to negotiate FTAs with various countries, but also many of the neo-liberal reforms have already been instituted with consistent levels of economic growth. Argentina, on the other hand, is heading towards a trade deficit of approximately 2.6bn – 3bn, even though it will have record levels of economic growth (estimated at 8% for 1997).[184] Thus the account deficit which is presently equivalent to 2.7% of GDP may begin to exert speculative pressures on the Central Bank to devalue its currency, on which much of Argentina's reform program rests. As for Brazil, a similar situation is occurring where current account deficits (4.3% of GDP) are cause for concern in their ability to maintain a strong "Real".[185] Thus, how Brazil is able to sustain stability in their macro-economic indicators may well prove the deciding factor on their ability to lead and influence sub-regional integration as means to closer insertion into the global economy.

[184] Ken Warn, "Rising Red Ink Blots Expectations," Financial Times, Sep. 19, 1997.
[185] Geoff Dyer, "Nerves on Edge as Storm Clouds Gather," Financial Times, Sep. 19, 1997.

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