CAPITULOS

Latin America in the International Financial Crisis

Sistema Económico Latinoamericano
Latin American Economic System
Sistema Econômico Latino-Americano
Système Economique Latinoaméricain

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MAY
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The Latin American Economic System is a regional, consultation, coordination and cooperation organization created by its 28 Member States to promote economic and social issues.

Cover:
Blas Castagna
Argentinian
"Barrilete Rokkaku"
(Detail)
1998
125 x 150 cms.
"Solidary Integration of Latin America and the Caribbean".
Traveling Group Exhibit of Kites by Latin America artists.
Caracas, October-November 1999.
XXV SELA's Latin American Council.
MACCSI/SELA/UNHCR

CAPITULOS

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Capitulos is published, in English and Spanish, three times a year by SELA's Permanent Secretariat

CAPITULOS may be accessed through the Internet at SELA's website
http://www.sela.org
or requested from the Office of Information
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Subscription

Latin America and the Caribbean	US$	50
Other countries	US$	60
In Venezuela:		
Three Issues	Bs.	20,000
(includes mail delivery)		

Cover: Pereira & Asociados
Final Arts: Cecilia Zuvic
Publishing: Gráficas Franco

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Two years after the outbreak of the international financial crisis, Latin America and the Caribbean are still suffering from its effects. The region's economic growth rate has decreased across the board and will probably stagnate into a recession by the end of 1999, external financing has become scarce and expensive and the region's external vulnerability has been confirmed once again.

Latin America and the Caribbean must also face the fact that the economic liberalization and institutional modernization policies they began implementing in the 1980's have not made them immune to financial crises transmitted through the current international system.

This issue of CAPITULOS examines the effects on the region of the financial crisis that began in July 1997 in Thailand and spread to Russia in August 1998 and then to Brazil by the end of that year. It considers as well some of the discussions concerning the design of a new international financial architecture in which the countries of the region may play an active role. To this end, we have included the final communique issued by the high level regional meeting held in Mexico at the beginning of September and submitted to the consideration of the United Nations' Secretary General. The document presents a number of recomendations aimed at contributing to the establishment of a stable and predictable international financial system concerned with countries' social development. Finally, we examine the future of our region's relations with Asian countries and the conflicts that have erupted within MERCOSUR due to the "samba" effect.

The crisis we are facing, at the beginning of a new millennium, also causes us to reflect on the development models our region has chosen to implement during recent years and on their prospects for the next decade; their viability in relation to the globalization process that characterizes the world economy and the limitations imposed by a merely unidimensional analysis of a complex phenomenon such as economic activity, one that involves cultural, sociological and political factors.

As a contribution to the examination of this central issue we present , as well, the document **Globalization with Development** prepared by SELA's Permanent Secretariat in view of the UNCTAD X meeting to be held next year in Thailand. In it, a number of issues are discussed that could contribute to a definition of the region's development agenda as well as of the role UNCTAD could play in this regard. The suggestions included in this document are based on the belief that the region does have room for maneuver to define its own development strategies centered on positive action vis-á-vis globalization.

We also include an article in which the power of states is measured by mathematical formula. According to the authors, this type of indicators could become an indispensable tool for the analysis of international relations.

Finally, our Documents section includes the full text of the declarations issued by the Presidents and Heads of State and Government at the Latin America and Caribbean - European Union Summit.

«Solidary Integration of Latin America and the Caribbean»

On this occasion, and in an effort to comply with one of its main objectives, regional cultural integration, SELA's Permanent Secretariat is pleased to present, under this title, not a written study but a visual document.

It is a traveling exhibition of kites by renowned Latin American artists which was initially displayed in MERCOSUR's countries and will now be on view in the countries members of the Andean Community of Nations (CAN). The XXV SELA's Latin American Council (Caracas, October 1999) has been chosen as the first venue of the exhibit's Andean tour.

The work we have selected for the cover of this issue of Capitulos is one of the many 1.25 x 1.50 kites, made in different materials, participating in this show. Many of these kites have already been flown in several capitals, thus allowing the public to participate interactively in the exhibit.

The idea of organizing an exhibition of kites by Argentinean and other artists from MERCOSUR countries was suggested initially by the United Nations High Commissioner for Refugees for South America. Important artists from Argentina, Brazil, Uruguay and Paraguay enthusiastically welcomed the proposal.

SELA's Permanent Secretariat, for its part, acknowledging this exhibit's solidarity goal, its high artistic value and the fact that MERCOSUR and CAN member countries are engaged in negotiations which represent a fundamental stride in the Latin American and Caribbean integration process, proposed to invite artists from CAN member countries to participate in the exhibit. Thus, in Caracas a distinguished group of Venezuelan painters contributed their work. The aim is to gather by the year 2000 a collection of kites by the largest possible number of Latin American and Caribbean artists and to later reach other continents' skies.

We hope that this exhibit will contribute to foster unity among our peoples through one of communication's more authentic and dynamic channels: art.

Carlos Moneta
SELA's Permanent Secretariat

The Economic Mirage

The current worldwide crisis –economic, political or social– and the beginning of a new millenium cause us to reflect on the evolution of Latin America's and the Caribbean's development during recent years and on its unfolding during the next decade. This analysis can not be made without also studying the processes that, under globalisation, are occurring in the world economy as a whole, nor those that are taking place at the intra-regional level. However, as the author points out, this evaluation will be strongly influenced by the framework of reference for interpretation and evaluation that the latest developments in economic sciences provide. The later imposes serious limitations, as it means the application of one-dimensional approaches to a multidimensional phenomenon –economic activity– that involves cultural, sociological and political factors, among others. This article, therefore, examines these limitations in crisis situations and explores the conditions and actors which, considering socio-cultural requirements, can make the economic objectives pursued more feasible.

El espejismo económico

El actual contextò de crisis –económica, política o social– mundial y el inicio de un nuevo milenio concitan a la reflexión sobre cuál ha sido la evolución del desarrollo de América Latina y el Caribe durante los últimos años y sus perspectivas en la próxima década, análisis que no se puede desvinular del exámen de los procesos que comprenden al conjunto de la economía mundial, signados por la globalización, ni los que corresponden al ámbito intraregional. No obstante –según sostiene el autor de este artículo– ese exámen está influenciado por el marco de referencia interpretativo y valorativo que suministra el actual desarrollo de la ciencia económica, la cual impone serias limitaciones al aplicar enfoques unidimensionales a un fenómeno multidimensional –la actividad económica– que involucra, entre otros, a factores culturales, sociológicos y políticos. Por ello, en el siguiente texto se intenta examinar esas limitaciones en situaciones de crisis y explorar las condiciones y actores por medio de los cuales es viable aproximarse a los objetivos económicos buscados, teniendo en cuenta los requerimientos socioculturales.

Le mirage économique

Le contexte actuel de crise économique, politique ou sociale à l'échelle mondiale, conjugué au nouveau millénaire, appelle à la réflexion. Il s'agit de revoir quelle a été, ces dernières années, l'évolution du développement en Amérique latine et dans les Caraïbes, pour en cerner les perspectives de la prochaine décennie. Une telle analyse ne peut se détacher d'un examen des processus en cours de l'économie mondiale, caractérisés par la mondialisation, ni de l'examen du cadre intra-régional. Néanmoins, de l'avis de l'auteur de l'article, un tel examen est sujet au cadre d'interprétation et de valeurs imposé par le développement actuel de la science économique. D'où les sérieuses contraintes à l'application de modèles unidimensionnels pour un phénomène multidimensionnel, à savoir l'activité économique, qui implique des facteurs culturels, sociologiques et politiques. C'est pourquoi, dans cet article, l'auteur cherche à identifier de telles contraintes dans des situations de crise et à cerner les conditions et les acteurs grâce auxquels il est possible d'atteindre les objectifs économiques recherchés, compte tenu des requis socio-culturels.

A miragem econômica

O atual contexto crise –econômica, política ou social– mundial, e o início de um novo milenio concitam à relexão sobre qual tem sido a evolução do desenvolvimento da América Latina e o Caribe durante os últimos anos e seus perspectivas na próxima década, análise que não pode-se desvincular do exame dos procesos que compreendem ao conjunto da economia mundial, signados pela globalização, nem os que correspondem ao âmbito intraregional. Entretanto –segundo manifesta o autor deste artigo– esse exame está influenciado pelo marco de referência interpretativo e valorativo que suministra o atual desenvolvimento da ciência econômica, a qual impõe sérias limitações, ao aplicar enfoques unidimensionais a un fenômeno multidimensional –a atividade econômica– que involucra, entre outros, fatores culturais, sociológicos e políticos. Por esse motivo no seguinte texto intenta-se examinar essas limitações em situações de crise e explorar as condições e atores por meio dos quais é viável se aproximar aos objetivos econômicos procurados, tendo em conta os requerimentos socio-culturais.

The Economic Mirage

Carlos J. Moneta
SELA's Permanent Secretary

"Eyes, ears, tongue, nostrils bring
news of revolt, inadequate councel
to an infirming King"
W. H. Auden, ***Paid on Both Sides***

Introduction

In these times of globalisation it is highly debatable whether we are facing a transition stage or a historical mutation, but several elements indicate that the world is currently going through a crisis[1]. A political crisis, especially now that we are becoming hemmed into a single dominant vision and a widespread feeling of "uselessness" prevails, that is turning into a social one as the mirage of the benefits to be reaped in the economic field no longer works and societies sense the threat of losing to a large extent not just their development possibilities, but also their direction, their will and their projects.

The concept of "crisis" should be understood as indecision. In addition to the disorder and the loss of equilibrium that characterise a crisis, uncertainties arise and pervade our whole society. Although it is in the economic field where disorder prevails, due to the links and interrelation of economics with all other areas of human activity and since, like the economy, beliefs, ideas, values and norms of behaviour soon are affected as well, a social crisis arises. The historical concepts of the past have been dealt a mighty blow which has led to a depreciation of the past and a lack of intelligibility, as well as confusion and uncertainty in the formulation of the future.

On the economic front, the crisis is a global concept that marks a sudden stop in the growth process, a break in the equilibrium. The crisis arises as a mechanism to repair the damages (faults, mistakes) accumulated during the period prior to growth. The crisis, therefore, has a precise economic and social function: it provides the opportunity for restoration[1] or for the construction of a new order.

It is in this context that we are drawing near to the end of a century and the start of a new millennium, two situations that inspire reflection upon how Latin America's and the Caribbean's development has evolved over the past few years and what its prospects are in the coming decade.

Obviously, this analysis can not be made without also studying the processes that, under globalisation, are occurring in the world economy as a whole, nor those that are taking place at the intra-regional level and will be strongly influenced by the framework of reference for interpretation and evaluation that the latest developments in economic sciences provide. The later imposes serious limitations, as it means the application of one-dimensional approaches to a multidimensional phenomenon –economic activity– that involves cultural, sociological and political factors, among others. The object of this article is to examine these limitations in crisis situations and the explore the conditions and actors which, considering socio-cultural requirements, can make the economic objectives pursued more feasible.

I. Elements of the Mirage: the Repetitive Projection of a Distorted Horizon

It has repeatedly been pointed out[3] that the term "globalisation" tends to only be identified with the economic process while the other dimensions are overlooked or minimised. Many of the economic concepts that predominate today affirm and stress the idea of an almighty world market, which both States and citizens are ill- and ineffectively equipped to deal with. Under a mono-causal and linear approach, the multidimensional aspect of globalisation is reduced to just the economic sphere and the other dimensions subordinated to it. In this way, the relationship between, among other things, economics and politics is blurred. One of the essential tasks of politics, to contribute to the establishment of clear social, legal and ecological frameworks within which economic activity is possible and socially legitimate, is thus alienated[4]. Similarly, an important fact is overlooked: that despite the specific nature of economics, its principles and proposed operating laws only make sense and can only be appreciated in terms of social behaviour and values if they are expressed in a much broader, complex and all-encompassing dimension: anthropological culture.

As in any other field of research, when we analyse economic phenomena in an attempt to understand their laws and work out which is the best course of action to take as a result, we do not look at the world through innocent eyes. We see it through a lens that has been shaped by the customs, attitudes and institutions that are associated with our community. Multiple factors related to the family, education, social status, the values and norms of behaviour of each social group make up the universe in which the rationality of "homus economicus", which is currently perceived as dominant due to the waning appreciation or sheer ignorance of this broader context, is understood and interpreted. In short, careful examination leads us to rediscover that behind the inescapable external forces, a kind of demiurge beyond our reach, that drive this economic globalisation, which is widely seen as almost omnipotent, there are societies and specific elements that transcend the economic order. These are the predominant cultural profiles and the collective values and beliefs that are associated with them.

We realise that the market, as has been well pointed out[5], is a difficult category to define. To many it is the natural place for self-regulation through the competition of capital and labour; to others it is where the exploitation of wage earners is carried out. The question is who determines the market and how. The answer: power relationships determine the market; in other words, in addition to economic agents, culture, religion and political power play a part as well.[6]

–The Phenomena of Refraction: Correcting the Lens

It is in this area of research that I believe we could find different answers to those provided by the field of economic science as we may find out something that substantially improves our knowledge of the profound motivations and attitudes that make us act one way or another in the economic realm. This improved knowledge could facilitate the changes we feel need to be made in the search for solutions to the serious problems we face on the economic level.

Different socio-cultural outlooks produce very different strategies, behaviours and results in response to the need to restructure, modernise and open the economy. In this respect it is worth comparing the strategies adopted by Russia and the People's Republic of China after the fall of the Soviet Union, by Japan and South Korea, or in Europe, by Germany, France, Italy, the United Kingdom and the United States. In each of these cases, the configuration of the family[7] (in terms of the degree of cohesion and integration); the content of the social contract (for example, the different configuration of individual rights and attitudes towards authorities in Asian and Western societies);[8] religious and philosophical influences (e.g. Taoism, Buddhism and Confucianism in Asia[9], Catholicism and Judaism in the West and Islam in the Middle East); cultural stratification and the role of the elite, among other factors, have led to a wide range of responses to any external challenges that have arisen.

–The Phenomena of Refraction: Different Images of Capitalism

At the beginning of the nineties, Michel Albert suggested the existence of two distinct models of capitalism[10]: The eo-American model which is in force in the United States and the United Kingdom and is based on the predominance of individual will, flexibility, obtaining short term financial gains, high levels of consumption and their freedom from State control ; and the "Rhineland" model (which, with certain variations, can also be considered to be in force in Japan and several Asian economies) which is used by preference in Germany, Northern Europe, Switzerland and the Benelux countries. The latter is based on providing incentives for production, savings, investment and long term benefits. Both models differ substantially in terms of conceptualisation and which activities and goods are considered apt for being subjected to market forces. For example, religion, and to some extent, the media, education, health and housing are not tradable[11] in the Rhineland model.

The models outlined by Albert not only differ in terms of the market's role: they reveal different behaviour in crisis situations and savings trends, consumption, production structure and the pre-eminence awarded to production or finances. In a recent critical work[12] on what he calls ""the free-trade utopia", Emmanuel Todd also identifies two forms of capitalism: "Individualist capitalism" which is based on the basic values of the nuclear family that favour independence and individual mobility, flexibility in the labour market, the instability of organisational arrangements, short term business profits, customer satisfaction, excessive consumption and the tendency to import; and "integrated capitalism" which, on the basis of social behaviour that is related to highly cohesive family nucleii, promotes technological research, investment, personnel training and job stability, high savings levels, limited consumption and the tendency to export. Todd, like Albert, but in much greater detail and determination in terms of geographical localisation, explores which developed countries and subregions adhere to one model or the other. As he sees it, the driving logic behind each of these models stems from a specific anthropological system that is derived from these two archetypical family configurations.

II. The Reality with Respect to the Mirage: the Contributions of Economic Anthropology

Beyond this diversity, approaches that focus on the Nation-State, although they use different methodologies and weighted variables and may or may not include the other international and transnational actors and regions, are the ones that predominate in the study of globalisation phenomena in the realm of economic anthropology. In the end, whenever we consider the progressive decline of world growth rates; the destabilising effects of speculative financial flows; the gradual shrinking of internal demand as the undesired effect of the implementation of the current economic model; competitive conditions or the degree of poverty, exclusion and marginalisation, we are referring to real and concrete societies, processes and situations. Differentiated systems within capitalism -countries, companies, organisations, large social groups. They can all be identified and labelled: they are empirical phenomena that escape the theoretical abstractions of "homus economicus" and individual rationality.

But are these phenomena cause or effect? Are they not the reflection of other more profound and complex phenomena that not only respond to economic factors but also to socio-cultural ones? In the face of crisis situations such as those we face today, rising inequality, social fragmentation and the distribution of the costs of the crisis, together with the atomisation induced in society's outlook result in a notable weakening of social cohesion and collective beliefs. They also curtail the innovative capacity of the decision-making elite who are psychologically chained to the reductionist mirage of the "only path", "the only way out" response to a crisis which is basically seen as an external threat.

In some concrete cases located particularly in Asia and Latin America, however, there have been visible examples of assertive attitudes, societies that are willing to make sacrifices if they feel their leader classes share their visions and interests. As a result, the public and private elite perform in a different way. In these cases, it is possible to defend oneself better and turn a crisis into an opportunity. Several industrial sectors that were affected by the financial crisis in South Korea, for example, were able to avoid transferring the costs of the devaluation of their currency to the price of their products and thereby facilitated their economic recovery. Malaysia put together a financial strategy that differed from the one proposed by the IMF and the World Bank and is reaching its objectives; a few years ago, Honduras, El Salvador and other Central American countries largely reversed the negative impact that the severe measures adopted by the United States in the area of immigration had on the capital flows from their nationals in the U.S. Not only did they manage to make sure that most of their communities abroad were not affected, they also discovered new export markets among them for a wide range of their products, from food to cultural items.

It should therefore be pointed out that there are significant differences in the main socio-cultural features and in the economic behaviour of different societies. These factors have a profound influence on how the problems of the international economy and the possibilities and courses for development are viewed. These differences will become apparent in the policies and actions adopted with respect to globalisation. The more cohesive societies in which the bond between the individual and the whole is not broken and in which leadership manifests a strong cultural identity with the remaining strata of society seem to be better prepared to design and implement more successful economic insertion policies and development initiatives. The nation's collective support and its institutionalisation favour a more rational and harmonious form of "State economic action."[13]

III. The Resulting Mirages: Unfeasible National Economic Policies?

These considerations lead us to another point in these reflections: to what extent do competition, the spread of technology and managerial practices, the deregulation of national markets, the mobility of capital and trade, boost, as they are supposed to, the convergence of different countries' production and financial structures and of relations between the economy, society and the State?

From what we have said and according to numerous case studies[14], there is no definitive answer to this question, in fact, the scenario is a complex one with no clear lines of evolution for either developed countries (in which there are effectively higher levels of convergence) or developing ones.

Assuming that progress is being made gradually, at varying rates and in different ways according to the regions and countries in question (e.g. inter- and intra-regional comparison of Africa, Asia and Latin America and the Caribbean) towards the convergence of macroeconomic policies; are these societies acquiring the characteristics that in theory correspond to these processes?[15] How and to what extent has national capacity to autonomously adopt different options for development and international insertion been altered?

So far, experience seems to show that there is considerable room for manoeuvre within the realm of macroeconomic policy.[16] As the studies made of Asian and Latin American responses to the Asian financial crisis show, different socio-cultural contexts, social alliances, collective beliefs and ideological profiles produce different programmes of action.[16] Similarly, if we consider the proposals put forward in our region regarding the measures that should be adopted at the regional and global level[17], we notice a high level of agreement among those with similar socio-cultural environments, shared problems and an increase in recent years in the exchange of intra-regional experiences.

A review of the wide bibliography that currently exists on the change in the theory and practice of development in light of the worldwide spread of capitalism shows that it is logical to expect the evolution of variations in the way capital and markets are organised in Asia, Latin America and the Caribbean, Africa, Russia and Eastern Europe. All these countries are suffering frustrations that are derived from the way in which the predominant models of economic neo-liberalism are being implemented, particularly regarding the ability of these models to satisfy the basic needs of the majority of their populations which are currently on or well below the poverty line and to provide real opportunities for growth and development for these societies as a whole. The close association of the "neo-American" or "nuclear" model with the satisfaction of a strong individualism, which correlatively implies the undervaluing of social collectives; the emphasis on performance technologies as the key to paradise which are very difficult if not impossible in some cases to reach; questionable criteria of economic hyper-rationality and the serious environmental damage that these models lead to in practice increase resistance to them.

IV. Possible Images and Routes with Respect to the Mirage: Latin America and the Caribbean

In this context, we can expect the introduction of changes in the economic liberalisation policies that are adopted in Latin America and the Caribbean, Asia and Eastern Europe at the start of the next century[19], without including Sub-Saharan Africa in this analysis, which unfortunately faces even an more profound and complex deterioration. Like any ideology, the future of the models currently being implemented in developing countries largely depends on their capacity to satisfy the expectations they generate. If contrary to what they promise, growth does not occur or, as is currently happening, benefits accrue only to relatively small strata of society, due to the model applied and local structural situations, as in the case of the disproportionate concentration of income in Latin America, a vision of decline, of involution will permeate society, and an increase in social resistance to the current form of implementation of these models and highly serious threats to democratic governability can logically be expected as a result. As long as our societies see no improvement in their living conditions (or at least a halt in their decline and the attainment of a certain stability), enthusiasm for the wholehearted adoption of the institutional and political reforms associated with the neo-liberal model will be limited to the social groups that have benefited from them and to some of the decision-making elites.

In the preceding paragraph we pointed out that changes can be expected and that these will vary according to the developing region in question. Once again, not only will the chosen economic models influence the situation, but also external factors and the web of underlying socio-cultural profiles. These profiles will vary according to whether the region in question falls mainly under the sphere of influence of Japan, the United States or the European Union. As has been stated in this and other works[20], the Asian development model (the "Rhineland" or "cohesive, integrated" model) favours high savings rates, low consumption levels, family-based social security networks and a relatively high degree of selective State intervention. The very swift recovery from the financial crisis this region suffered (though still fragile, this recovery was brought about in only two years with the additional benefit of an increase in international competitiveness) could tell us much –once the different cases have been duly studied– about the weight, orientation and influence of non-economic factors in the achievement of those results.

Latin America and the Caribbean are in a different situation, however. Given its shared history, Latin American culture consists of the co-existence of European, Latin, Afro-American, Caribbean and indigenous cultural elements. Each one represents particular outlooks and interests[21] that lead us to different identities that co-exist and interact. We consequently share a multicultural space that, despite having some features that are different from other cultures –the European, the North American- and others that are the same, is currently on the way to establishing a regional identity of its own if the integration merely commercial profile and takes on a cultural dimension.

These cultural factors permeate our societies. Due to our inheritance of the Spanish, Portuguese and Italian family structure (most of our immigrants came from Spain, Portugal and Italy) we are linked to the cohesive, model, but other immigration flows have added more egalitarian and liberal elements as well. If we consider the cultural flows as a whole, we notice a greater inclination to associate our socio-cultural aspects with those of European countries and the "market" aspect with the United States.

This state of affairs will nevertheless vary in time and space. In the past few decades, the simultaneous expansion of the American image in the mass media and hemispheric trade and investment flows have intensified and extended the spread of the neo-American model. Furthermore, the historical ties forged by each of the subregions with these two powerful external centres –for example, Central America with the United States and Mercosur with Europe– also make some features more noticeable than others in different areas.

Latin America and the Caribbean are therefore increasingly experiencing, as far as socio-cultural trends are concerned, the influence of flows from two different realms –the Anglo-Saxon and the European– which in a broad approximation correspond to the "neo-American" (or individualist) and the "Rhineland" (or cohesive) model, respectively. As we have seen, both models differ significantly in terms of their strengths and weaknesses, in the subconscious suppositions that shape their vision of the world and in their ways of acting in the world.

V. The Study of Light Phenomena: the Structure of Mirages

Without attempting to present more than a rough sketch and assuming that this is only intended to promote some thoughts in this direction, it seems that our debate on the options for national development and international insertion need to include the exploration of the causal relationships among: i) the various capitalist models and their socio-cultural roots; ii) the impact and ways in which these models have been absorbed and rejected –seen as "options"- in Latin America and the Caribbean and other developing regions; and iii) the harmonious and innovative use of both kinds of factors –those that represent the paradigms of the "real economy" and those that operate at the subconscious level– in order to increase Latin America's and the Caribbean's room for conceptual and operational manoeuvrability in terms of economic policy and at the political level.

(e.g. discussion of internal and external evolution scenarios throughout society; the building of consensus for action).

The first of these points has been studied in some detail. The conclusions reached when considering them all will contribute towards clarifying and broadening the theoretical debate in the face of the reductionism of "single-maxim approaches" and will facilitate the identification of viable options for development strategies and policies. Examining these points will help us specify the different elements that make up the development options that respond positively or negatively to our cultural make up. For example, regarding our behavioural patterns and beliefs, which models could work best and be more in tune with the characteristics of our region? To what extent and how can savings, consumption and investment patterns be altered? On the basis of which socio-cultural elements can we bring about a change in the present highly unfair structure of income and benefit distribution? Which elements could influence alterations in our axiological frameworks and in the drawing up of "mental maps" of the world that favour the establishment of new economic, technological and political ties with other regions, countries and subnational agents? What, in short, are the "strengths" and "weaknesses" of Latin America and the Caribbean's socio-cultural set up, in terms of its relations among the State, the market and society?

We know we are far from sharing the characteristics that the Japanese-Asian version of the Rhineland model displays, and this is a reason (without denying, in fact quite to the contrary, the huge possibilities a close alliance with those countries offer for our development in terms of our basic socio-cultural structure), to consider the successful adoption of a Japanese of Singaporean model as highly improbable. Some elements of the European (Rhineland) model and also the neo-American model are already present, in varying degrees according to country or sector in question, in our economic adjustment, restructuring and opening processes, in the building of institutions and in the paths chosen for the furthering of subregional and hemispheric integration in Latin America and the Caribbean.

In this respect, the attitudes displayed in favour of one model or the other at the symbolic level are reinforced by concrete factors stemming from the economic, technological and media power of the large powers and their ability to direct the processes in their favour (e.g. the so-called "Washington consensus") in the world's international trade and finance institutions. This situation is already widely acknowledged to be a reflection of the distribution of power in the international system[22] which reveals the existence of areas of influence that are subordinated to one of the poles of the system: Latin America and the Caribbean to the United States; Eastern Europe and much of Africa to the European Union, and Pacific Asia to Japan.

–Mirror-images

The question should be raised as to what extent it is necessary for these dominant poles in the world system to make the countries within their areas of influence into mirror-images of themselves by trying, in different ways, to impose values, outlooks, institutions and economic practices that replicate theirs. In this respect, many elements seem to indicate that a free market and free trade economy such as that of the United States depends substantially on the countries in its area of influence mimetically adopting[23] its principles, ideology and institutions in order for it to maintain its dominant position. This explains the systematic attempts to impose ideologies, institutions and rules in bilateral and multilateral economic relations. If Latin American and Caribbean were to seek a more antonomous external strategy in the realm of international economics, this factor would acquires particular significance as it demands the use of more sophisticated and complex approaches than those that might be required, for example, by the Asian countries with respect to Japan, whose basic core interests can be satisfied by the mere establishment of free trade.

–The hemispheric mirages

Setting aside internal factors for a moment, various elements indicate that Latin America and the Caribbean have not benefited much from their position within the United States' direct sphere of economic influence.

To many members of the public and private decision-making elites of the countries in our region, entering into broad trade liberalising agreements with the United States constitutes an essential element for tackling shrinking internal demand, the problems of access to external markets and the availability of financial flows from one of the main world markets. Certain features of the United States model could, however, endanger this objective without offering compensatory advantages.

Unlike Latin American societies, civil society in the United States plays a very important role with respect to the State that limits the latter's competence in external economic relations and national economic policy. Madison's pluralistic vision of relations between State and society, enshrined in the U.S. constitution, are based on the deliberate fragmentation of authority, the promotion of conflict and the negotiation of diverse interests within the institutional framework in order to prevent a concentration of power.[24]

Civil society participates in the policy formulation process, preferably through a Legislative Power that has great influence over the Executive Power in the area of foreign economic policy. At present, a large segment of civil society in the United States does not support trade liberalisation. This represents a significant obstacle when seeking Congress' approval of the Free Trade Agreement of the Americas (FTAA) and makes it harder for our region to advance its position on several issues to be discussed at the forthcoming "Millennium Round" of the World Trade Organisation (WTO).

On the other hand, it is true that trade in goods and services between the United States and Latin America and the Caribbean has grown significantly compared with the very low levels to which it had sunk by the mid-eighties. The figures are still lower, however, than those recorded in the fifties. In 1950, our region represented 27.9% of the United States' exports and 34.1% of its total imports. Latin America and the Caribbean today only receive 19.5% of the United States' exports and 15.0% of its imports worldwide.[25] As far as productive investment in our region is concerned, between 1995 and 1997, United States investment exceeded the European Union's by nearly 11 billion dollars (43.015 billion dollars for the U.S. and 32.285 billion for the European Union) while Japanese investment in the region was negligible[26]. These investments were concentrated as follows: 41.5% in Mercosur, 27% in Mexico, and 11.3% in the ACN and were not linked to the intra-industrial process as Japanese investment is in Asia[27].

Although the neo-American model in theory allows for the expansion of Latin American and Caribbean exports due to its tendency towards over-consumption, United States trade flows have, to an important extent, been largely directed northwards (Canada) and westwards (Asia). Moreover, the heavy pressure exerted one way or another on the countries of our region accelerated and deepened the following: the economic adjustment and opening processes: the shift of the centre of gravity to the private sector and the privatisation and reduction of the State, all within a context of a high degree of dependence on international financial flows and highly volatile situations.[28] In a number of important cases, the result was the implementation of abrupt changes; necessary corrections that may have improved the regional macroeconomic situation, but which led to situations of huge vulnerability[29] and produced high social costs.

–The Mirage's Image: the Vision's Coercive Tendency

The conditionality clauses imposed by the trade and finance agents of the developed countries and multilateral agencies (together with situations of national vulnerability) in many cases imply a substantial loss of room for manoeuvre for their Latin American and Caribbean counterparts. Because of these limitations, where external centres are seen as threatening entities and of the region's countries' awareness of their own weaknesses, paralysis tends to set in, and preventive self-restricting steps tend to be taken in the fear of "disciplinary" measures being possibly adopted in reply to our countries' responses to the external debt, the financial crisis or a trade norm or principle, for example. This reduces our capacity to appreciate the "opportunity" aspect that each crisis dialectically represents and the latent capacity we do have to overcome this paralysis by organising our efforts and re-evaluating our possible strong points in terms of the underlying forces of our socio-cultural roots.

VI. The Mirage in Other Lands: Responses in Favour of Development

A brief commentary on the different characteristics of Latin America-the Caribbean and Pacific Asia regarding how they view and handle their problems of international insertion and the influence of the international environment on the course and progress of their development can be used to illustrate the concepts outlined above.

– The Asian Case

One important difference between the countries of both regions is how they see and consequently act in relation to the prevailing economic order. The countries of Pacific Asia accept it under a pragmatic approach which is based on the acknowledgement of the realities of power distribution in the world. This does not mean, however, that they develop a sense of belonging to that order or incorporate it fully into their socio-cultural make up. They use market economics as an instrument; they consider it, in this phase of the evolution of the global system and their development, to be the appropriate option for growth and modernisation. They agree that the government's capacity to act, political stability and development should mutually condition one another.[30] They therefore establish a clear distinction between political and economic objectives. This enables them to define development objectives and strategies (which are agreed to between governments and the main economic agents[31]) more clearly and to obtain enough social support[32] as to to be able to act despite ethnic, religious and political differences.

Acceptance of market economics, therefore, may have represented important political costs and produced complex debates among elites (e.g. economic reform in Vietnam, the move towards "market socialism" in the People's Republic of China, etc.) but it has not meant that the economic changes involved have altered the essential objectives and mainstays of the political regime. Hence, from Singapore, which introduced wholesale free market economics and free trade, to the People's Republic of China and Vietnam, which are doing so gradually and selectively[33], the goal of improving the standard and quality of life of their societies in economic terms should not affect, as those who govern see it, the objectives and nature of the established socio-political and cultural order.

Thus, as numerous studies have pointed out, technology transfers, productive investment and trade and finance operations have to be subjected to restrictive clauses and guidelines that require the inclusion of a percentage of national capital and local management and improvements in the country's export capacity. This independent way of thinking favoured the implementation of development programmes and strategies that were based on endogenous proposals. In short, the point is that in Pacific Asia, it was the "visible hand of the State" and not the invisible hand of the market that in co-ordination with economic agents created the conditions for the changeover from import substitution models to export-oriented ones, directed the subsequent different stages of economic opening and now faces the challenge of implementing drastic changes in response to the financial crisis.

–The Latin American Case

The case of Latin America and the Caribbean reveals a high level of sensitivity to external historical conditioning derived from its relations with both the United States and Europe. This is reflected in the perhaps excessive tendency to locate the origin of our problems and the responsibility for their solution outside the region with the consequent belief that only a thorough restructuring of the international system would be able to improve Latin America's possibilities[34].

This has also contributed to the subordination of politics to economics. The adoption of one development model or another involves the threat (or benefit) of introducing profound changes in the internal distribution of political and economic power. It also goes against the continuity and internal coherence of adopted policies (e.g. different temporary "impulses" in favour of the strengthening of endogenous technological capacity; of human resources training; of bureaucratism and the fight against corruption and unequal income distribution).

Finally, assessments made by important segments of the public and private elites (including the academic sectors) that tended to overemphasise the negative aspects and minimise the achievements of the autonomous modernisation projects that have been attempted since the end of the Second World War[35] (e.g. the discussion of the import substitution period); the increasing sensation that the international context poses a threat, upon which we commented above, and the impact of certain media messages[36] led to the implementation of neoliberal economic policies without due consideration being given to the possibilities offered by the introduction of changes and reforms that could have been undertaken by taking advantage of our own cultural systems' economic and intellectual experience and creative synergy.

VII.Conclusions: the Mirage in Crisis. Notes for a Positive Approach

"When everything is "economics" we come to the end of economics as destiny, to the appearance of economics as culture and the immediate misery of that economic culture[37]".

Three processes that are all linked and interact with one another have formed the main thread of these notes.

a) The analyses and evaluations that provide the basis for the international economic policy decisions made in our countries are restricted to the field of economic science and therefore adhere strictly to its criteria of rationality. Important socio-cultural and political elements, which have extensive influence on the conceptualisation, identification of options and feasibility of the implementation of any strategy and the results to be pursued are not taken into account. The universe of possible, feasible and legitimate paths for decision-making is therefore restricted, and the potential room for manoeuvre and the possibilities of obtaining the collective support of society are thus reduced.

b) The development paradigm that predominates in the international context today exerts significant influence over the political, economic and ideological bases that determine the nature, orientation and content of Latin America's and the Caribbean's responses to the challenges of its external economic agenda. Different developing countries and regions are not affected and do not react in the same way because their socio-cultural and political structures – which have specific diverse features- catalyse and elaborate upon external impacts in different ways.

c) Economic analysis aims to identify policies and measures that are close to the optimum according to the criteria considered most important by the dominant paradigm in each stage of history (in the current stage, efficiency, competitiveness, stability and growth could be considered the most important criteria within the framework of market economics). Political and anthropological analysis, on the other hand, attempts to determine the conditions, agents and processes through which the economic optimums can be reached while bearing in mind social requirements as well. An economic policy analysis turns out to be necessary because it broadens and enriches the realm of thought and not only increases the options for pursuing the desired results, but also brings them closer to meeting the conditions of political feasibility and social legitimacy.

This paper aims to encourage the expansion of time frames –by looking beyond current circumstances– and the range of intellectual and political-social instruments we can use to tackle highly complex processes. The notion of "crisis" with which we began this work could constitute useful analytical instrument. The crisis occupies an intermediate zone between "mutation" or "break" and "continuity"; it implies the continuity of our political-social processes, but not stable equilibrium; an important conflict, but not total conflict. The crisis encourages the use of interdisciplinary approaches as in order to understand it in one sector of reality, other sectors have to be analysed as well[38]. The differences between political, social and economic crises turn out to be ungraspable when we try to understand them separately.

The crisis is linked to the idea of external disorder. In societies it can reveal itself in progressive and regressive movements. Economic progress for example, can correspond to political regressions and viceversa. The disorder produced by a crisis can be considered to be like the consequences of overloading a system and creating situations in which Latin America and the

Caribbean find themselves facing problems they can not solve under the rules and norms that are currently being applied.

This irruption fueled by disorder often leads to paralysis and rigidity; the flexibility of the system is lost, as are its strategic response devices. The crisis therefore arises as the absence of any solution. Nonetheless, crises can also generate a new line of response through their evolutionary transformation and the study of their very complexity[39]. The crisis, therefore, brings with it the possibility for change.

Notas

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3. *Moneta, Carlos "El proceso de globalización, percepciones y desarrollos", in Moneta, Carlos, Quenan, Carlos (eds.),* ***Las reglas del juego. América Latina, Globalización y Regionalismo****, Ed. Corregidor, Buenos Aires, 1995.*

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7. *Emmanuel Todd, for example, provides a lucid and provocative analysis of economic behaviour according to family structure and* ***organisation in***

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10. *Albert, Michel,* ***Capitalisme Contre Capitalisme,*** *Ed. Du Seuil, Paris, 1991.*

11. *Ibid, pages 120-122.*

12. *Todd, Emmanuel,* ***La ilusión económica...,*** *op. cit., chapter III.*

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15. *Ibid, pages 6-9.*

16. *See Frieden, Jeffry, "Invested Interest. The Politics of National Economic Policies in World Global Finance",* ***International Organization*** *and Frankel, Jeffrey, Phillips, Steve and Chinn, Menzie, "Financial and Currency Integration in the European Monetary System", Univ. Of California, Working Paper, 1-3 March, 1992.*

17. *Numerous studies of the Asian financial crisis have been made by the affected countries, research centres and international regional agencies. Among others: Ocampo, José Antonio, "Reforming the international financial architecture: consensus and divergence", ECLAC, Serie temas de coyuntura No.1 (LC/L.1192-P), Santiago, Chile, 1999,; Doc. SELA, "Impacto de la crisis asiática en América Latina, March 1998, SP/DRE/Di No.21 – 98; Doc. SELA, Doc. SELA, "La crisis asiática: riesgos y oportunidades para América Latina", April 1999, SP/Di No.5-99.*

18. *The conclusions reached and analysis made recently during two important events in our region are notable: the Regional High Level Meeting, "Towards a stable and predictable international financial system and its links to social development", External Relations Secretariat of Mexico–ECLAC-UN, Mexico, D.F., 5-6/9/99 and the "II Ibero-American Meeting of Ministers of Economics and Finance", Ministry of Finance and Prices of the Government of Cuba, La Habana, 2-3/9/99.*

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21. *García Canclini, Néstor, "Políticas Culturales: de las identidades nacionales al espacio latinoamericano", in G. Canclini, Néstor and Moneta, Carlos (compilers),* ***Las industrias culturales en...,*** *op. cit., pages 44-45.*

22. *According to many international (and Latin American) analysts, the scheme is a triad consisting of Japan, the United States and the European Union. Other observers –mainly those from the developing world– would also include the People's Republic of China, the Asia-Pacific group and Russia, among others, and thus discern a different power distribution scheme.*

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24. *SELA,* ***La Sociedad civil y el compromiso político de los Estados Unidos para la liberalización comercial: Implicaciones para las negociaciones comerciales,*** *Document SP/CL/XXV/Di No. 10, Caracas, 26-28/10/99, page 16 (Working paper presented by the consultant Craig Van Grasstek).*

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28. *SELA document* ***América latina en la crisis financiera internacional*** *(SP/Di No. 12-99, Caracas, June 1999) –"In addition to the risk premium levels, Latin American countries suffered throughout the financial crisis, especially as of the start of the real crisis, from a reduction in the volume of external financing... For the whole of 1998, Latin American issues reached 38 billion dollars (of a total of 73 billion) compared with 58 billion in 1997 (of a total of 110 billion)" (page 11 of the Spanish version). The annual SELA study of Latin America's external debt and financing...*

(SP/CL/XXV.O Di Nº 5), points out that: - "Latin America´s economic evolution during 1998... reveals a lower net transfer of resources from abroad"... (page 2 of the Spanish version). Finally in its analysis of the economic behaviour of Latin America and the Caribbean between 1998 and 1999 (ECLAC, Documento-Informativo-Síntesis, June 30th, 1999), ECLAC considers that:-..."Given the evidence that crises arise more frequently in an increasingly globalised world economy and in more open economies than those that characterise the region nowadays, it will be necessary in the forthcoming months to assess the instruments used to tackle these crises so as to have a clear idea whether it will be possible to come up with a better response when the next one arises"-... (page 9 of the Spanish version).

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33. *Moneta, Carlos,* ***Vietnam. Doi Moi (Renovación),*** *IRIAP, Grupo Editor Latinoamericano, Buenos Aires, 1995.*

34. *Kan, Alberto,* ***Desarrollo económico: Lecciones...,*** *op. cit., page 19 and among many other works that could be quoted, Solari, Aldo, Franco Rolando and Jutkowitz, Joel,* ***Teoría, acción social y desarrollo en América Latina,*** *Siglo XXI, Mexico, 1976; Dietz, James and Street, James,* ***Latin America´s Economic Development, Institutionalist and Structuralist Perspectives,*** *Lynnie Riener, London, 1987; Calcagno, Eric,* ***El pensamiento económico latinoamericano: estructuralistas, liberales y socialistas,*** *Edic. de Cultura Hispánica, Madrid, 1989; Ominami, Carlos,* ***El Tercer Mundo en la Crisis,*** *Grupo Editor Latinoamericano, Buenos Aires, 1987 and Russell, Roberto,* ***Política Exterior y toma de decisiones en América Latina,*** *Grupo Editor Latinoamericano, Buenos Aires, 1990.*

35. *Ibid.*

36. *For example, the problem of the mass withdrawal of funds by private individuals who then deposit them abroad which has profoundly affected Latin American economies* *in the past few decades is minimal in the Asia-Pacific region. Similarly, several Pacific-Asian countries (e.g. Malaysia, Singapore and the People's Republic of China) have implemented numerous measures to moderate and reduce the effects the operating of transnational communications networks have on national identity (e.g. television).*

37. *Moneta, Carlos,* ***El Espectáculo del Mundo,*** *Nuevo Hacer, Buenos Aires, 1996, based on a text by Jean Baudrillard.*

38. *Starn, Randolph, "Historians and Crisis",* ***Past and Present*** *No. 52, Oxford College, Oxford, August 1971*

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Latin America in the International Financial Crisis
This document, prepared by Egidio Luis Miotti, Carlos Quenan and Nathalie Ricoeur-Nicolai, points out that the international crisis that erupted during mid 1997 is different from previous ones in that even though it began in developing countries it did not originate in Latin America. During the second half of the nineties, and in spite of the fact that their economies continued to register some persistent weaknesses (deficits, uneven development levels) Latin American and Caribbean countries faced a fairly promising future due to the economic adjustments they had undertaken following the debt crisis of the eighties and the Mexican shock and strong international liquidity. Nevertheless, the effects of the Asian crisis soon spread to Latin America affecting first the financial area and later trade and casting an uncertain shadow over the region's future. As a result of the Brazilian crisis, the region has entered into a recession, while foreign financing continues to be inadequate and expensive. Besides reaffirming the region's external vulnerability, the crisis has given rise to new discussions regarding which institutional initiatives and policies are needed to face the volatility of monetary and financial variables resulting from globalization.

América Latina en la crisis financiera internacional
Este documento, elaborado por los doctores Egidio Luis Miotti, Carlos Quenan y Nathalie Ricoeur-Nicolaï a solicitud de la Secretaria Permanente del SELA, destaca que la crisis internacional que se desató a partir de mediados de 1997 presenta cierta originalidad en relación con las anteriores: aún procedente de los países en desarrollo, no se originó en América Latina. A pesar de determinadas debilidades persistentes (déficits públicos, desequilibrios de crecimiento), los ajustes llevados a cabo después de la crisis de la deuda de principios de los años 80, y luego del shock mexicano, así como el contexto de fuerte liquidez internacional, perfilaban un futuro bastante favorable para la zona en la segunda mitad de los años 90. Sin embargo, a través del contagio, primero en el plano financiero, y luego en el comercial, la crisis alcanzó rápidamente América Latina, hasta convertir dicha zona en una importante fuente de incertidumbre. Como consecuencia de la crisis brasileña, se asiste en la actualidad al desarrollo de los efectos recesivos en el plano de la economía real, mientras el financiamiento exterior sigue siendo escaso y caro. Además de confirmar la recurrente vulnerabilidad exterior de la región, la crisis actual ha abierto nuevas discusiones sobre las formas institucionales y las políticas capaces de hacer frente a la volatilidad de las variables monetarias y financieras que resulta del proceso de globalización.

L'Amérique latine dans la crise financière internationale
Élaboré à la demande du Secrétariat permanent du SELA par Egidio Luis Miotti, Carlos Quenan et Nathalie Ricoeur-Nicolaï, ce document souligne que la crise internationale qui s'est déclenchée à partir de la mi-97, présente une certaine originalité par rapport aux crises antérieures: elle n'est pas née en Amérique latine, même si elle est venue d'un pays en développement. Malgré la persistance de certaines faiblesses (déficits publics, déséquilibres dans la croissance), l'avenir semblait plus prometteur dès la seconde moitié des années 90, grâce notamment aux ajustements menés au terme de la crise de la dette des années 80, du choc mexicain, grâce aussi à la grande liquidité disponible sur les marchés internationaux. Néanmoins, par contagion financière d'abord, commerciale ensuite, la crise s'est rapidement étendue en Amérique latine, faisant de celle-ci une zone de grande incertitude. À la suite de la crise brésilienne, ce sont les effets récessifs qui se font actuellement sentir dans l'économie réelle, alors que le financement externe reste rare et coûteux. Malgré tout, la crise actuelle n'a pas seulement corroboré la vulnérabilité externe de la région ; elle a aussi ouvert de nouveaux débats sur les formes institutionnelles et les politiques nécessaires pour affronter la volatilité des variables monétaires et financières résultant de la mondialisation.

América Latina na crise financeira internacional
Este documento, elaborado pelos Doutores Egidio Luis Miotti, Carlos Quenan e Nathalie Rocoeur-Nicolai, a solicitação da Secretaria Permanente do SELA, destaca que a crise internacional que começou a meados de 1997, apresenta certa originalidade em relação com as anteriores: no entanto procedente dos países em desenvolvimento, não foi originada na América Latina. A pesar de determinadas debilidades persistentes (déficits públicos, desequilibrios de crescimento), os ajustes levados a cabo depois da crise da dívida de princípios dos anos 80, e depois do shock mexicano, assim como o contexto de forte liqüidez internacional, perfilavam um futuro muito favorável para a zona, na segunda metade dos anos 90. Entretanto, através do contágio, primeiro no plano financeiro, e depois no comercial, a crise alcançou rapidamente à América Latina, até converter a referida zona numa importante fonte de incertidumbre. Como consequência da crise brasileira, asiste-se na atualidade, ao desenvolvimento dos efeitos recesivos no plano da economia real, mentras o financiamento exterior continúa sendo escaso e costoso. Ademais de confirmar a recorrente vulnerabilidade exterior da região, a crise atual tem aberto novas discussões sobre as formas institucionais e as políticas capazes de fazer frente à volatilidade das variáveis monetárias e financeiras que resulta do processo de globalização.

Latin America in the International Financial Crisis

SELA's Permanent Secretariat

I. Latin America, Victim of a Structural, Financial Lack of Confidence

After the respite following the Mexican crisis, Latin America was one of the first areas to benefit from the return of private capital flows to developing countries during the period from the middle of 1996 to the middle of 1997. A primary borrower in an increasingly speculative market, the region faced a paradoxical stiutation. As market quality decreased (drop in the quality of the issuers, increasingly reduced risk premiums), Latin America, which was rather a progressive region, has suffered from a persistent lack of confidence. Nevertheless, in the period prior to the Asian crisis, the principal Latin American issuers (Brazil, Argentina and Mexico), benefited in absolute figures from the reduction in risk premiums, obtaining less onerous financing than in the past. Yet, when the financial crises were unleashed, they were the first to be affected by them and the flight to quality.

1. Reduced Earnings During the "Profitability Race"

From the end of 1995, private flows toward emerging countries resumed to the marked progression that had characterized them in the 1991-1993 period. An increasing percentage of such flows has been used to meet debt requirements (domestic and international). With 46 billion dollars in 1996 and an equivalent amount reached in just the first quarter of 1997, those flows represented more than 20% of total flows prior to the financial crisis. (Table 1)

The primary and secondary international debt markets at that time experienced a considerable expansion, to which was added the equally dynamic development of the restructured debt markets (the Brady bonds market). In turn, those markets became increasingly more speculative. High profitability, with historically low international yield, attracted an increasingly

Table 1
Development of Private Capital Flows 1990-1998
(In billions of dollars)

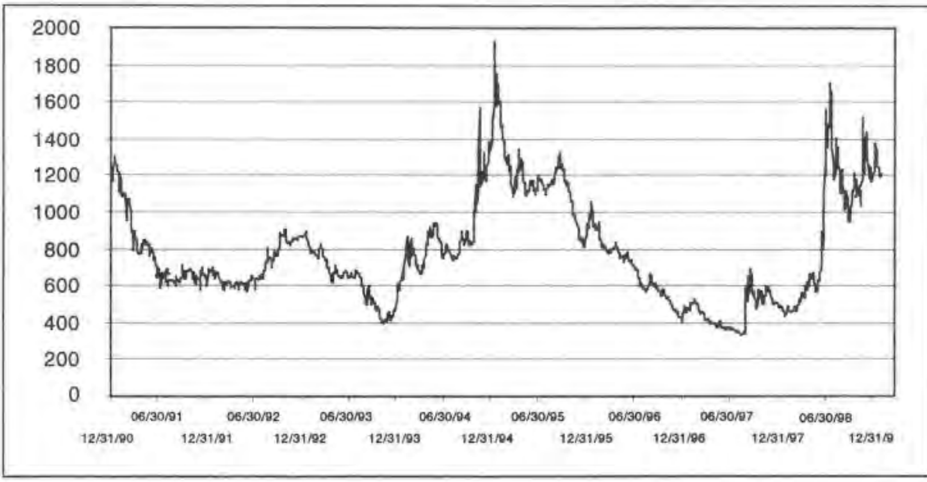
	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total	98.3	116.3	143.9	208.1	206.2	243.1	281.6	300.3	201.5
Public financing	***56.4***	***62.7***	***53.8***	***53.6***	***45.5***	***54.0***	***34.7***	***44.2***	***49.6***
Private financing	***41.9***	***53.6***	***01.0***	***154.6***	***160.6***	***189.1***	***246.9***	***256.0***	***151.9***
Bank loans	3.8	3.4	13.1	2.8	8.9	29.3	34.2	41.1	nd
Obligations	0.1	7.4	8.3	31.8	27.5	23.8	45.7	53.8	nd
Direct Investments	23.7	32.9	45.3	65.6	86.9	101.5	119.0	120.4	111.0
Portfolio investments-shares	3.2	7.2	11.0	45.0	32.6	32.5	45.8	32.5	2.4
Other private financing	11.1	2,7	12.4	9.4	4.7	2.0	2.3	8.3	nd

Sources: World Bank & IIF.

more sustained demand and led to the progressive erosion of risk premiums (Chart 1), to the extension of average terms, and to the development of fixed income securities. Simultaneously, in search of volume, the market opened up to ever more risky issuers, among which were, in the first place, sovereign issuers like Russia, but also numerous banks and emerging companies. In the case of national securities, the risk quality of the issue dropped two positions in general terms (on a 16-level risk scale) when compared with 1993. In absolute terms, Latin America benefited significantly from this process. During this period, its issues accounted for more than 50% of placements; in addition, the countries of the region could resort to longer duration issues. At the same time, interest rates dropped significantly (Graph 2). Latin American issues were so popular in the markets that Argentina, for example, was able to obtain its annual financing through that procedure.

In absolute terms, Latin America benefited significantly from this process. During this period, its issues accounted for more than 50% of placements; in addition, the countries of the region could resort to longer duration issues. At the same time, interest rates dropped significantly (Chart 2). Latin American issues were so popular that Argentina, for example, was able to obtain its annual financing through that procedure.

Chart 1
JP Morgan Index in Spreads* (Base Points)

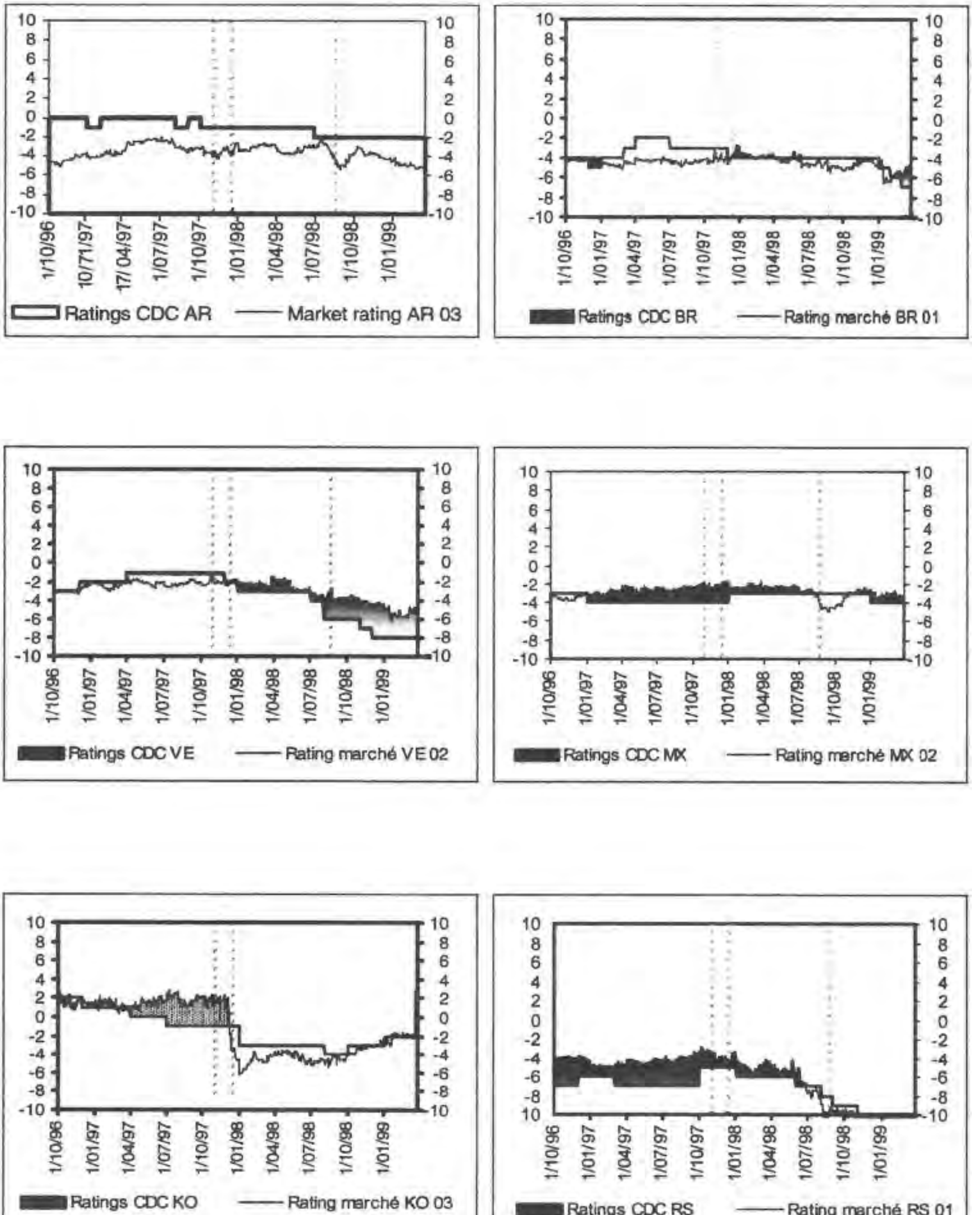


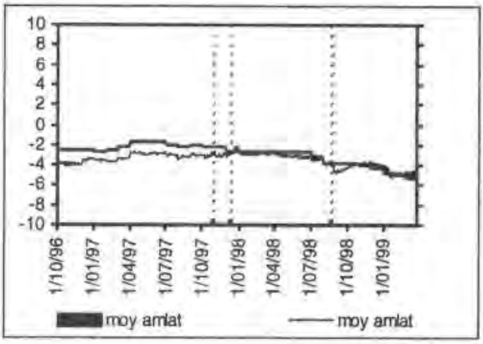
* Excess yield for US Treasury bonds.
Source : Bloomberg.

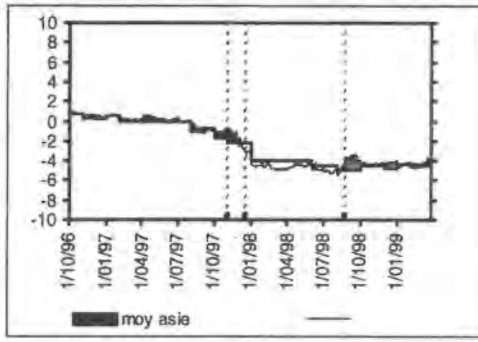
Chart 2
Latin American Euro-obligations Spread (Base Points)

Source: own calculations based on CDC data.

Graph 3
Reliability Indicators





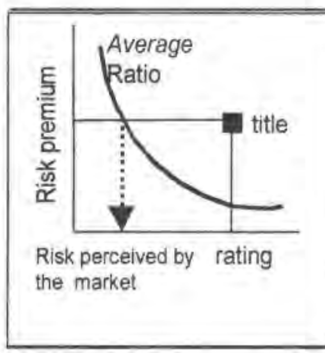


: reference risk level (rating CDC)
: risk perceived by markets (implicit rating deducting risk premiums — See box
: excess market confidence, in comparison with reference rating
: excess market lack of trust, in comparison with reference

Source: CDC calculations.

Box 1

To eliminate risk premiums from the portion attributed to the general market level and retain only the risk level itself, an average ratio is calculated, for each sample day, between the level of the risk premiums and the country-risk rating (CDC rating) on the basis of the sample of securities with imminent maturities. This ratio is presented as an exponential ratio: when risk merits, the risk premium rises more proportionally. With the help of this day-to-day ratio it is possible to transform the premium risk level into an implicit risk level perceived by the market, regardless of market variations. In this way, an indicator is obtained that is directly comparable to country-risk rating (rating CDC).



A more in-depth analysis however shows that the entire area appears to have suffered from an excessive lack of confidence when compared with other issuers.[1] Calculations on a selection of Euro-obligations effectively show that the isk level implicit in the risk premiums used was, overall in Latin America, much higher than the effective risk, calculated on the basis of country-risk indicators (Chart 3 and Box 1).

That excessive lack of confidence, very evident in the case of Brazil and Argentina, has been fed by the significant volume of

Latin America's financing needs. But the excesssive lack of confidence in Latin America also appears to be the result of a traditional view of the risks, dating back to lack of liquidity times and, particularly, the debt crisis of the 80s. Even in the presence of abundant liquidity, international investors (influenced by agency ratings) preferred countries with low indebtedness levels. In the new context, however, countries that were already indebted provided the best advantages. The need to reduce internal demand in order to meet debt reimbursement maturities, imposed restrictive monetary policies. Simultaneously, that external adjustment policy led to exchange policies geared to sustaining competitiveness levels (actual anchoring) or to drastically adjusting the productive sector (increase in productivity and salary adjustment), in the case of nominal anchoring. In all cases, these countries appeared to be the ones best suited to contain their trade deficits and external debt. (Chart 4)

"The excessive lack of confidence in Latin America appears to be the result of a traditional view of the risks, dating back to lack of liquidity times and, particularly, the debt crisis of the 80s."

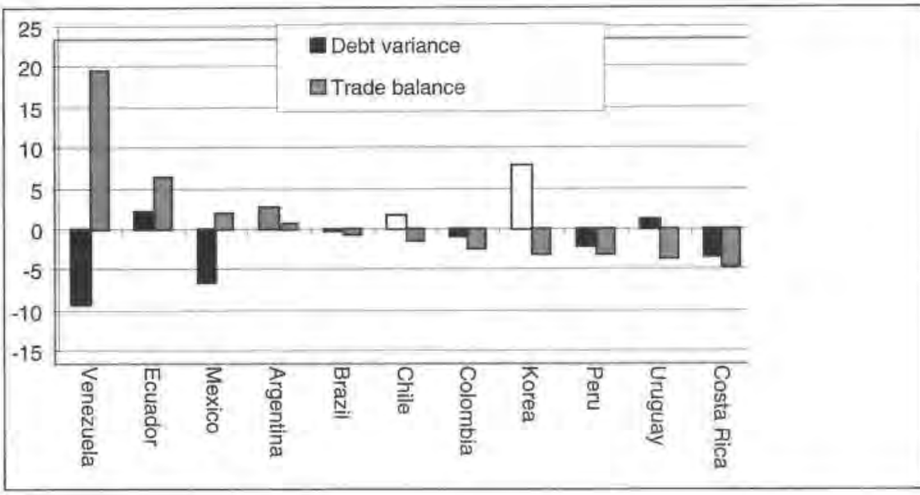
This situation contrasted sharply with the Asian growth systems which, in retrospective, proved to be the most dangerous. In Asian economies, the absence of initial restrictions led to an overheating of the economy, together with expectations of increasingly higher growth. The credit explosion, increase in unproductive investments and loss of control over capital income resulted in higher trade deficits and an increase in indebtedness (particularly in the private sector) that led to the crisis.

2. The Effects of the Financial Contagion

The financial crises that erupted in Thailand, in July 1997 (which led to the Hong Kong crack of October 1997 and the Korean crisis), and later in Russia, in August 1998, caused a similar brutal turnaround in confidence by investors. Both translated into a rupture in external financing flows and inability to honor short-term commitments (lack of liquidity crisis). Loss of confidence was proportional to the previous lack of foresight, leading to a phenomenon of overreaction. That phenomenon was quickly corrected after the Asian crisis, but appeared again in spectacular proportions in the case of the Russian crisis.[2] (Chart 1)

Moreover, both crises caused a contagious phenomenon that affected emerging securities as a whole. This phenomenon may be partially explained by the panic that spurred investors to take refuge in safer securities, not as subject to unfavorable risk valuations (*flight to quality*). But it is fundamentally the result of an international strategy aimed at compensating losses with the

Chart 4
Growth of External Debt 1997/1996 (in GDP Points) and Trade Balances in 1996
(% of GDP)



Source: EIU.

sale of assets, offering at that moment, the best yields. In both cases, Latin America was severely affected.

Since they represented an important part of the liability stocks (Euro and Brady) and since they had benefited from high yields during previous months, Latin American securities were naturally the first to be relinquished. Given that, in addition, they were viewed with a structural mistrust and classified poorly on the emerging risks scale (agency ratings were not too favorable), these, more than others, suffered from the *flight to quality* phenomenon.

During the most acute phase of the Asian crisis (end of October and beginning of November 1997), spreads of sovereign securities of Latin American countries, with less than 10-year maturities showed an increase of 130 base points (thus reaching 300 base points above U.S. Treasury bonds). On the other hand, securities with maturities exceeding ten years experienced an increase of 240 base points in their risk premiums. (Chart 2) The countries most affected were Ecuador, with quite high premium levels before the crisis, and Argentina and Brazil, which faced very high external debt servicing payments. (Chart 2)

Since the evolution of liquidity conditions and international interest rates was not unfavorable the Euro-obligation market slowly reopened between January and July 1998 and spreads decreased moderately. But the Russian crisis marked the beginning of a new phase. In effect, the vertiginous drop of the ruble and the moratorium on Russia's public debt payments (August 1998), the threat of a generalized contagion, with possibilities of deteriorating into successful speculative attacks against Latin American currencies, all became a reality. Meanwhile, the economies of the region had effectively worsened because of the poor evolution of the international environment and its foreign trade (see later sections in this paper). Bewildered, markets and some observers grew concerned about Venezuela, weakened as it was by the drop in oil prices (which seemed to draw it nearer to the Russian example) and by the

Table 2
Latin America : Sovereign Euro-obligations Spreads
Impact of the Asian and Russian Crises
Average of securities with less than 10-year maturities (in bp)

	22.10.97	Peak of the crisis Asian crisis	22.07.98	Peak of the crisis Russian crisis	08.01.99
Argentina	164.2	428.7	198.7	1352.9	447.8
Brasil	148.7	590.4	237.7	1788.5	537.8
Colombia	111.2	138.7	176.1	773.1	453.0
Costa Rica			209.0	360.8	299.5
Ecuador	296.3	491.5	412.1	2617.6	1022.9
México	143.6	309.4	186.8	954.9	303.6
Panamá	169.1	425.2	232.6	778.7	477.0
Trinidad & Tobago	228.3	250.5	192.8	412.7	417.1
Uruguay	128.7	151.2	95.3	318.7	433.8
Venezuela	167.7	260.4	279.6	647.8	612.9

Peak of the Asian crisis: average spread higher or verified between 28/10/97 and 18/11/97.
Peak of the Russian crisis: average spread higher or verified between 01/09/98 and 21/10/97.

Source: own calculations on the basis of Datastream data.

lack of political visibility, and Argentina and its *currency board*, although the latter was less vulnerable than in 1995, the year in which it was subjected to strong pressure by the «tequila effect». Moreover, in early September, when Colombia decided to expand the fluctuation band for the peso in relation to the dollar, some thought that this was the beginning of mass devaluations in Latin America. However, the overreaction of the markets was aimed above all at Brazil, perceived to be the weak link in the South American chain. Thus, Brazil experienced an attack on its currency the "real".

Within a period of few days, spreads in the sovereign securities of Latin American countries, securities with less than 10-year maturities, rose almost 750 base points to more than one thousand base points above U.S. Treasury bonds. As a result, the spreads of the short and medium-term bonds reached a level similar to that achieved by securities with maturities exceeding ten years, which increased their risk premium by 575 base points. (Chart 2)

Reflecting investors' risk perception, Ecuador –affected by the mistrust of markets at a time when growing internal macroeconomic imbalances were converging with the open political crisis in 1997– Brazil and Argentina recorded the highest spreads when the Russian crisis exploded. (Table 2) Colombia, Mexico and Venezuela also experienced strong hikes in their external financing costs.

The convergence of a series of internal factors in the Latin American region (particularly the firm but costly political defense of the "real" by Brazilian authorities, as well as the results of elections in that country, along with the announcement of an agreement with the IMF), and external factors (declarations of the G7, drop in U.S. interest rates) explains the moderate drop in spreads in October–November 1998. However, risk premiums stabilized at a much higher level than that reached before the Asian crisis.

Latin American risk premiums experienced an important rise during these two episodes. The analysis of confidence indicators shows that the rise was comparatively higher than for all the other emerging securities, particularly when the Russian crisis exploded. Only Venezuela escaped this phenomenon: the effective degradation of the risk far outstripped the perceived degradation. (Chart 3)

Besides risk premium levels, throughout the financial crisis and particularly as of the Russian crisis, Latin American countries experienced a reduction in the volume of external financing. In effect, during the first three quarters of 1997, Latin American countries went ahead with gross issues on the Euro-obligations' market, amounting to more than 50 billion dollars. On the other hand, issues during the last quarter, did not even reach 4 billion dollars (Chart 5). Interrupted by the Russian crisis, recovery during the first half of 1998 was limited. Throughout 1998, Latin American issues reached 38 billion dollars (of a total of 73 billion), as compared with 58 billion in 1997 (of a total of 110 billion). Although they continue to be sizable, their volume, as a relative portion, has dropped significantly.

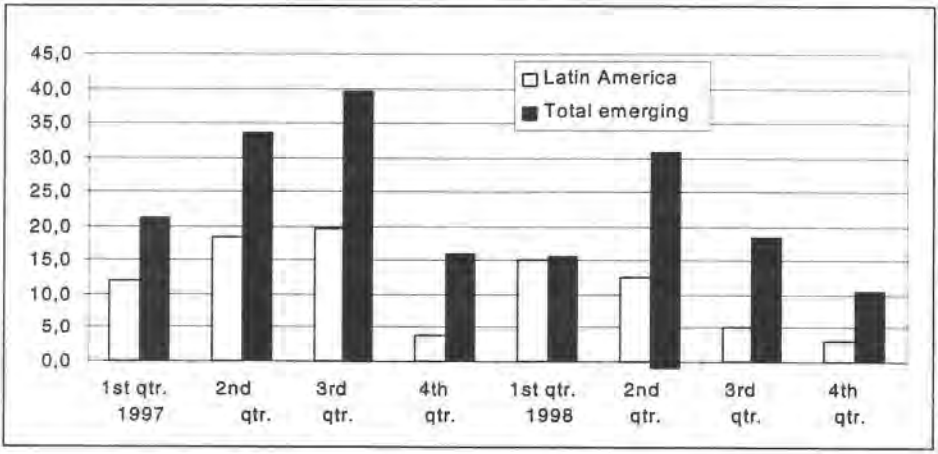
Most assuredly, Latin American countries have experienced the self-realizing phenomenon of lack of confidence. Extraneous to the immediate causes of the Asian and Russian crisis and rather protected from the perverse effects of excess liquidity, they have seen their volume and financing conditions deteriorate, justifying the lack of confidence that penalized them.

"Throught the financial crisis and particularly as of the Russian crisis, Latin American countries experienced a reduction in the volume of external financing."

II. Trade Impact of the Financial Crisis

Any international financial crisis can spread through trade. This is due both to the recessive impact generated on trade

Chart 5
Obligatory International Emerging Issues
(billions of dollars)



Source: IFF.

volume, as well as to downward pressures on the prices of exported products.[3] Although the degree of Latin America's commercial liberalization may be weak compared with other developing regions, it cannot be denied that over the past ten years the region has undergone a rapid opening up process. This process has taken place as a result of trade reforms such as the dismantling of non-tariff barriers and overall and unilateral lowering of customs duties. Thus, Latin America's degree of liberalization, measured by export ratios/GDP, went from 10% in 1980 to 22% in 1997, and from 15% to 26% if measured by the imports/GDP ratio, although this global evolution may mask significant differences in levels among the countries of the region.[4] In this framework, an international financial crisis with its recessive effects on world growth, has had a greater negative impact than in the past.

Undeniably, Latin America has made progress in its export diversification efforts, but the region continues to rely heavily on the production of natural resource-intensive goods. Therefore, drops in the prices of raw materials have significantly buffeted Latin American economies.

Because the financial crisis is characterized by expansive movements in real exchange rates –strong depreciations– the competitiveness of the countries in the region has been affected. This is all the more so due to the fact that certain Latin American economies traded with regions directly affected by the crisis.

1. The Asian Crisis and a Slowdown in World Growth

The direct impact of the Asian crisis (to which we might add the Japanese recession) on the world economy has led to a reduction by half in international trade's growth rate. (Table 3) In that context, in 1998, the growth of Latin American exports, by volume, has slowed down by 4 percentage points when compared with the dynamism recorded in 1997.

That phenomenon in particular may be explained by the strong drop in Asian imports (including Japan) that principally affected Chile, Peru, Brazil, Ecuador, Uruguay and Argentina, a relatively important percentage of whose exports was aimed at Asian countries. (Table 4).

The strongest impact was felt by Chile: the more than 13% drop in total imports may be explained by the drop in exports to Asia. (Table 5) Peru follows and, to a lesser degree, Brazil and Argentina.

2. Asian Competition in Third Markets: the Effects of Devaluation

The wide reach of Asian devaluations has raised the fearful spectrum of a setback in Latin American exports to third countries (including their own intra-regional trade). In effect, the share of total Latin American exports subject to Asian competition would be some 33%.[5] This total rises to 35% in the case of intra-regional exports, and to almost 38% for exports to OECD markets. (Table 6)

"The direct impact of the Asian crisis on the world economy has led to a reduction by half of international trade's growth rate."

A priori, Mexico is the Latin American economy most affected by Asian competition, followed by Uruguay, Brazil and Colombia. However, this is mostly potential competition, since the trade restructuring caused by Asian macro-devaluations is not automatic. In fact, four phenomena may prevent this possibility: the existence of trade agreements (of the multifiber type, bilateral preferences and others); the existence of regional agreements (particularly Nafta, Mercosur and the Andean Community); the differentiation of products and existence of installation or expansion of trade circuits costs. In practice, the range of Asian installation costs' reductions, generated by devaluations, leads us to expect a significant impact, except perhaps in the case of Mexico.

The evolution of bilateral exchange rates between Latin America and Asia one year after the Asian crisis also affected competitive balances. (Table 7)

Once more, the loss of competitiveness has not been immediate, but represents an important enough change in relative prices that could lead to a restructuring of trade in the medium term.

3. Terms of Trade: a Strong Drop in the Price of Raw Materials

The recession in Asian countries and slowdown in the growth of global trade have caused a notable drop in the price of raw materials, particularly oil (already weakened by the significant stocks and overproduction by non-OPEC countries), copper, soybeans, fish and wood. The evolution of the price index of raw materials clearly shows that after a prolonged upswing that began in early 1993 and particularly as of the Asian crisis, prices plummeted. On December 31, 1999, the index reached its lowest figures for the decade. (Chart 6)

A similar evolution may be observed in the case of oil and copper prices, two important products insofar as production specialization of Latin American countries is concerned (oil for

Table 3
Dynamism of World Trade 1997/1998
(growth rate in volume %)

	1997	1998	Difference
World Trade	**9,50**	**5,30**	**-4,20**
	Imports		
Industrialized countries	**8,80**	**5,80**	**-3,00**
United States	14,70	11,80	-2,90
European Union	7,90	7,30	-0,60
Japan	1,70	-7,50	-9,20
Developing countries	8,80	2,80	-6,00
East Asia	3,50	-5,20	-8,70
Latin America	***16,10***	***7,80***	***-8,30***
Pour mémoire			
Asian countries in crisis (*)	3,00	-17,00	-20,00
	Exports		
Industrialized countries	10,10	5,30	-4,80
United States	10,70	4,70	-6,00
European Union	9,60	6,30	-3,30
Japan	9,80	6,40	-3,40
Developing economies	9,80	6,40	-3,40
East Asia	12,70	9,40	-3,30
Latin America	***11,10***	***7,10***	***-4,00***
Pour mémoire			
Asian countries in crisis (*)	7,90	15,30	7,40

Asian countries in crisis (*): Indonesia, South Korea, Malaysia, Philippines and Thailand.

Source: World Bank, 1998.

Venezuela, Mexico, Ecuador, Colombia and Argentina and copper for Chile, Bolivia and Peru). In the case of copper, the December 1998 price is the lowest for the century. (Chart 7)

As a result of this situation, in 1998 a strong deterioration was observed in the terms of trade. Excluding Chile, oil-producing countries are the ones that have sustained the greatest losses: in one year, Venezuela has seen its trade ratio fall by more than 20%, Colombia by 9% and Ecuador by more than 8%. (Chart 8)

ANALYSIS

The negative impact of the fall in the prices of raw materials has been more important for the large economies of the region, excluding Brazil.

Table 4
Asian countries' Share in Latin American Exports
(1996 %)

	Japan	China	Southeast Asia	Total
		a) very important trade		
Chile	16,40	2,40	14,10	32,90
Peru	6,60	7,20	9,20	23,00
Brazil	6,40	2,30	6,80	15,50
Ecuador	2,80	1,40	7,00	11,20
Uruguay	1,00	4,90	5,30	11,20
Argentina	2,20	2,60	5,10	9,90
		b) important trade		
Colombia	3,30	0,10	0,80	4,20
Honduras	2,70	0,00	1,50	4,20
Costa Rica	1,10	0,00	1,60	2,70
Guatemala	2,10	0,00	0,50	2,60
Mexico	1,50	0,00	1,10	2,60
Paraguay	0,10	0,00	2,40	2,50
		c) weak trade		
Panama	0,90	0,00	0,60	1,50
El Salvador	0,90	0,00	0,30	1,20
Venezuela	0,60	0,00	0,30	0,90
Bolivia	0,30	0,00	0,20	0,50
Nicaragua	0,10	0,00	0,30	0,40
Latin America	3,60	1,10	3,70	8,40

Source: taken from DATA INTAL data (IDB).

Table 5
Impact of the Asian Crisis and Repercussion on Exports of Principal Latin American Countries

	Growth of Trade with		Impact on
	Asia	the World	total exports
Chile	-34,30	-13,20	-12,10
Peru	-54,90	-26,10	-7,70
Brazil	-28,50	-0,60	-4,40
Argentina	-13,00	6,00	-2,50

Source: IDB (1999).

Table 6
Portion of Latin American Exports Exposed to Asian Competition
(%, based on the 1995 trade structure)

	To Latin America	To the OECD	To the World
Mexico	53,70	57,50	55,60
Uruguay	39,50	32,50	30,80
Brazil	46,50	31,70	28,90
Colombia	44,90	15,90	22,60
Argentina	23,80	15,40	16,50
Peru	14,70	14,50	12,00
Chile	25,20	4,20	7,30
Venezuela	17,10	9,90	6,80
Ecuador	19,30	2,60	6,10
Latin America	34,50	37,90	32,90

Source: based on IDB data, 1999.

4. Deterioration of Global Trade Performance

The fall in raw materials' prices and a slowdown in the growth of international trade volumes resulted in a decrease in export income for most Latin American countries.

"*The fall in raw materials' prices and a slowdown in the growth of international trade volumes resulted in a decrease in export income for most Latin American countries.*"

Table 7
Latin America: Bilateral Trade Rates vis-à-vis Asian Economies
(Variation in actual trade between June 1997 and August 1998, in %)

	Hong Kong	Indonesia	South Korea	Malaysia	Phillipines	Singapore	Thailand
Argentina	2,00	-62,90	-27,90	-37,40	-33,30	-19,90	-32,10
Brazil	8,70	-68,30	-22,70	-32,90	-27,20	-12,60	-27,50
Chile	9,80	-60,00	-22,40	-32,60	-28,20	-13,80	-26,90
Colombia	7,00	-70,30	-29,40	-31,00	-26,10	-13,40	-30,60
Mexico	2,60	-62,60	-27,50	-37,00	-32,90	-19,40	-31,70
Peru	6,00	-61,40	-25,10	-34,90	-30,70	-16,70	-29,40
Venezuela	-16,10	-69,50	-40,70	-48,50	-45,10	-34,10	-44,10

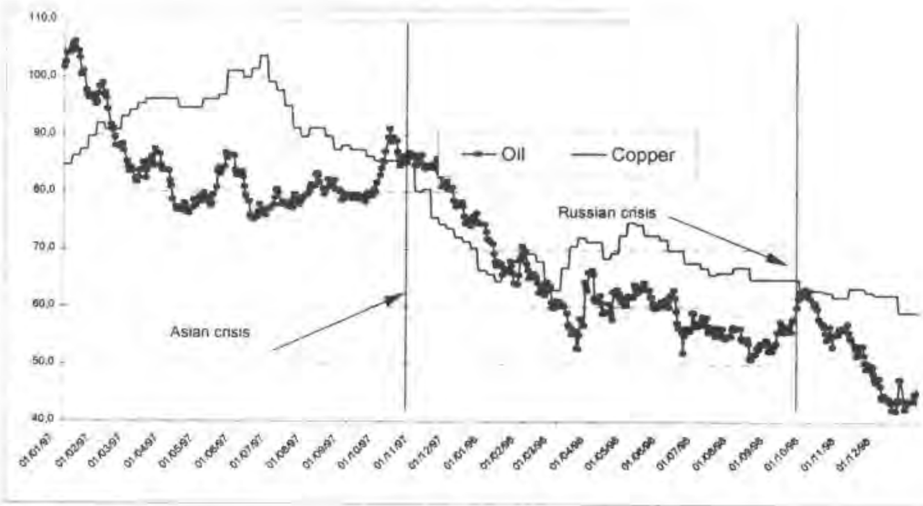
The minus sign indicates real devaluation of an Asian currency vis-à-vis a Latin American currency.

Source: IDB (1999), Table 9.

Chart 6
Evolution of the CRP index of the Price of Raw Materials 1990-1998
(Base index 1990=100)

Source: DATASTREAM.

Chart 7
Evolution of Oil and Copper Prices
(Base index 1990=100)



Source: DATASTREAM.

Thus, except for Mexico, which registered by an upward trend in its external sales despite a decrease in its oil income (that represents less than 10% of total Mexican exports), all the countries studied were affected. The most noteworthy cases were Colombia, Chile, Peru and Venezuela. (Chart 8)

Beyond short-term variations, Colombia is characterized by the stagnation of its exports since early 1997. In the case of Chile, the upward trend in its external income was interrupted in 1996 by the strong impact of the plunge in the price of copper and the erosion in the Asian demand.

The drop in exports is even more apparent in the cases of Peru and Venezuela. With respect to the first country, the fall that began in mid-1997 accelerated thereafter due to its depedence on trade with Asia. As for Venezuela, the fall that began as of 1997 is mainly due to the plunge in international oil prices.

Overall, the different national situations reflect the stagnation of export income as of October 1997 and the consequent downgrading of the global trade balance (Chart 9). The imports of the countries considered could not have continued with the same upward trend recorded since 1996. In effect, the strong deceleration in Latin American growth has broken the trend in

Table 8
1998 Terms of Trade and Their Impact on GDP

	Country rating according to losses/gains resulting from variations in the terms of trade, % of GDP	Variances of the terms of trade (1998) (%)
Losses	Venezuela	-22,80
	Chile	-10,50
	Ecuador	-8,40
	Panama	-1,80
	Peru	-8,80
	Colombia	-6,30
	México	-2,60
	Latin America	**-4,10**
	Paraguay	-4,80
	Bolivia	-4,50
	Argentina	-4,50
	Brasil	0,00
Gains	Haiti	2,80
	El Salvador	2,50
	Uruguay	4,80
	Guatemala	5,30
	Republica Dominicana	0,90
	Costa Rica	3,90
	Honduras	7,50
	Nicaragua	6,40

Source: IDB (1999), graph 16.

the evolution of imports, which marks the beginning of a decrease in the trade imbalance, apparent as of December 1998.

In a context of uncertainty regarding external financing conditions for 1999, the sustained growth in the trade deficit was an important cause for concern as the inadequate foreign trade results aggravated the current account deficit, which went from 58 000 billion dollars in 1997 to 80 500 million dollars in 1998 (that is, 3% and somewhat more than 4% of GDP for the region, respectively[6]).

III. From Exogenous Shocks to the Brazilian Crisis: Towards the Recession

Faced with the growing international crisis, the countries of Latin America have had no alternative but to implement restrictive monetary and fiscal policies to limit imbalances in public finance and current balance of payments, and prevent, in many cases, the abrupt depreciation of interest rates and a return of inflationary tensions. As a result, growth has slowed. With the breakout of the Brazilian crisis the region as a whole entered a recession.

Chart 8
Latin America: External Trade

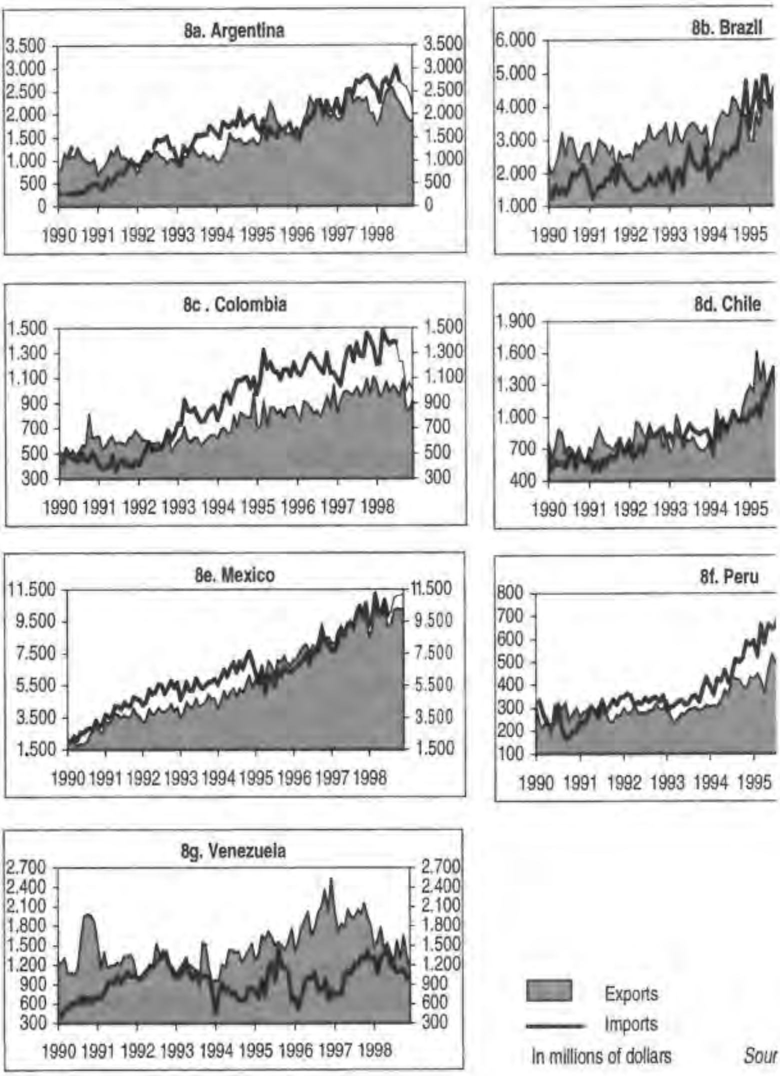
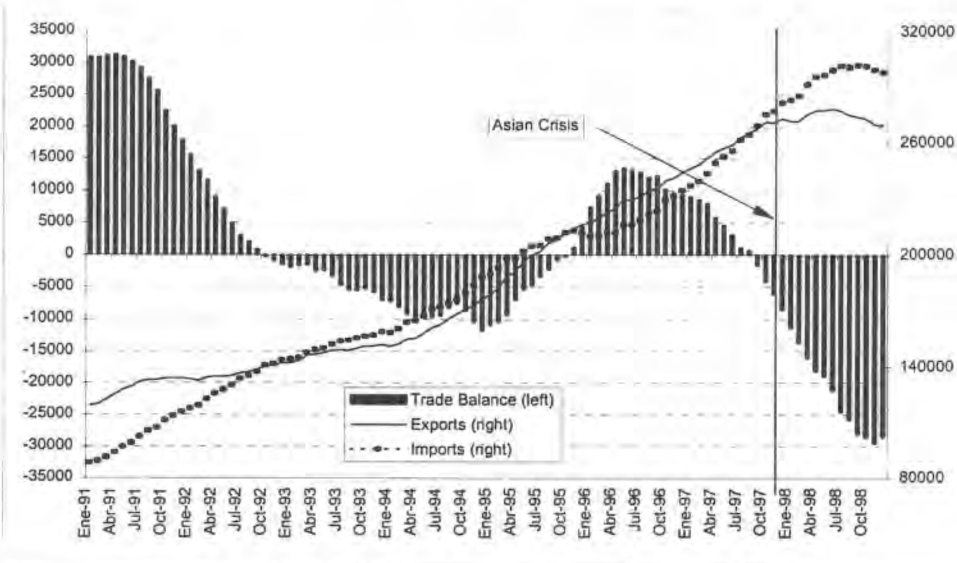


Chart 9
Latin America: Global Trade Performance
(Accumulated data for 12 months, in millions of dollars)



Source: DATASTREAM.

1. Austerity Policies Become a General Trend...

Latin American countries began implementing austere budget policies during the last quarter of 1997. Brazil was the first to put these policies into practice after being hit by speculative attacks set off by the Hong Kong crisis (the Hong Kong crisis being another episode of the international crisis). Brazil's policy, namely the "pacote" of November 10, 1997 (essentially based on lowering expenses in an effort to bring about a drop of more than two points in the fiscal deficit), was unable to reach its objectives. (Table 9).

In order to limit deficits, a second wave of fiscal adjustment measures were introduced by countries whose fiscal income was affected by the drop in raw materials exports.[7] As a result of this Mexico, whose oil industry generates almost 40% of its fiscal income, decided to launch three austerity programmes in 1998. The effort made to reduce expenses focused on public investments, especially the transport and telecommunications sectors. On the other hand, fiscal demands on the national oil company (Pemex) reached 114% of its income.

Table 9
Budget Balance of the Latin American Countries
(% of GDP)

	1995	1996	1997	1998e
Argentina	-0,3	-1,8	-1,4	-1,2
Brazil	-5,0	-3,9	-6,0	-8,5
Chile	2,6	2,3	1,9	0,9
Colombia	-0,6	-2,0	-3,1	-4,9
Ecuador	-1,5	-2,6	-2,0	-5,9
Mexico	-0,2	-0,1	-0,7	-1,5
Peru	-1,6	2,2	0,9	-0,2
Venezuela	-6,9	7,6	2,3	-5,4

Source: National sources and CDC estimates.

Venezuela followed suit implementing three adjustment programmes in 1998. These programmes were based on a downward adjustment of the forecasted average prices for oil, changes in the dollar/bolivar parity, increased withholdings on the national oil industry's income (PDVSA), and above all, cutbacks in public spending.

Ecuador suffered severely from the effects of El Niño (the infrastructure and agricultural sector were the hardest hit). Moreover, Ecuador's public deficit increased as a result of dropping oil prices, even after having eliminated many government subsidies.

Only one country of the region, namely Chile, showed a fiscal surplus throughout the 90s. Nonetheless, the international crisis also bore an impact there. Income from the copper industry was dipping and income generated through taxes was also falling. It was then that the government decided to take measures to insure the health of public finance. By turning to the funds set aside in the copper stabilization fund set up in the mid-80s (264 million dollars were destined to this fund) and implementing budget cutbacks in the amount of 685 million dollars in 1998, Chile managed to achieve a fiscal surplus of 1% of GDP (1.9% in 1997).

At a later date, yet other countries of the region were forced to implement stricter fiscal measures. Peru cut back moderately on capital spending and current spending due to the drop in exports that accompanied the decline in Asian demand, the lower prices of metals and the decrease in its export supply of agricultural and fish products because of El Niño. In Colombia, the newly elected government (mid-1998) announced it intended, in 1999, to bring the fiscal deficit down to the equivalent of 2-3% of GDP by implementing fiscal reforms. This would include broadening the tax basis of the VAT. Finally, the government of Argentina decided to strengthen austerity by implementing fiscal reforms extending the VAT to more areas.

By August 1998, the worsening international financial crisis led to tighter monetary policies aimed at deterring a brutal depreciation in foreign exchange. Brazil had already significantly increased its domestic interest rates (4th quarter of 1997); Colombia did the same between February and July 1998. But when the Russian crisis exploded, monetary policy, in general, became more stringent. The marked increases that followed in real interest rates put the banking systems of Argentina, Chile, Mexico, and foremost, Venezuela and Brazil, to an arduous test (currently many of these countries are undergoing a process of reform which began after the crisis of 94-95; Argentina, Brazil, Mexico, and Venezuela belong to this latter category, among others). (See Tables 10 and 11).

In Brazil, where investors place the least of their trust, the hike in domestic interest rates has caused great tension between government authorities and the market itself.

2. ...Accentuated by the Crisis in Brazil

In effect, from the time the Russian crisis broke out, the only way to repel the speculative attack launched on the *real* was for the central bank to significantly increase its base rate. This was done in two steps, hiking the rate from 19.75% to 49.75%, and taking a loss in international reserves of almost 30 billion dollars between the end of July (when reserves were about 70 billion) and the end of October 1998 (41 billion). The international scenario pivoted around Brazil's situation at that point: the plummeting *real* took a deep downward plunge following the rubble's hard fall. These conditions could lead to full contagion of the crisis by Latin America, along with a downturn in the positioning of international banks (particularly, North American banks) that acted as creditors to the region. This in turn could rebound, weakening the dollar just when doubts existed as to whether the North American economy was still on a growing streak. This clearly explains the reassuring declarations made

Table 10 Latin America: Short-Term Interest Rates (Thirty-day Rate) Impact of the Asian and Russian crisis Annual Rate (Loans in National Currency)

	22/10/97	Peak Asian crisis	22/07/98	Peak Russian crisis	08/01/99	Peak Brazilian crisis	13/04/99	Rate
Argentina	7,92	15,67	8,00	19,00	10,72	15,77	8,61	Thirty-day loans (pesos)
Brazil	27,72	71,94	20,50	42,07	29,04	32,43	38,56	CDI
Colombia	22,95	24,02	36,92	36,93	32,80	33,77	24,06	Deposits (pesos)
Chile	16,20	19,80	13,20	36,00	12,24	12,96	12,72	Thirty-day deposits (pesos)
Ecuador	39,65	40,77	51,95	58,50	62,74	63,54	60,38	Loans (sucres)
Mexico	17,26	21,17	19,99	47,86	29,29	33,41	20,47	CETES 28 days
Peru	30,66	30,65	30,62	36,66	36,07	36,82	37,38	Loans (soles)
Venezuela	30,22	29,89	66,00	78,00	52,45	53,05	45,70	Thirty-day loans (bolivars)

Peak of Asian crisis: highest average rate between 28/10/97 and 18/11/97.
Peak of Russian crisis: highest average rate between 01/09/98 and 21/10/97.
Peak Brazilian crisis : highest average rate between 13/01/99 and 25/01/99.

Source: Figures calculated using information provided by Datastream.

Table 11 Monthly Inflation Rate (IPC, %)

	1997	1998	1999e
Argentina	0,30	0,70	0,20
Brazil	4,30	2,50	20,00
Colombia	17,80	16,70	15,80
Chile	6,00	4,70	4,30
Ecuador	30,70	43,40	39,00
Mexico	15,70	18,60	15,00
Peru	6,50	6,00	6,20
Venezuela	37,60	30,10	30,50

e: estimation.
Source : Datastream et IIF.

by the G7 and the IMF and the lowering of interest rates in the US. At the same time, the stability of the real, the cornerstone of the anti-inflationary economic policy adopted in 1994, would win Cardoso another term as President.

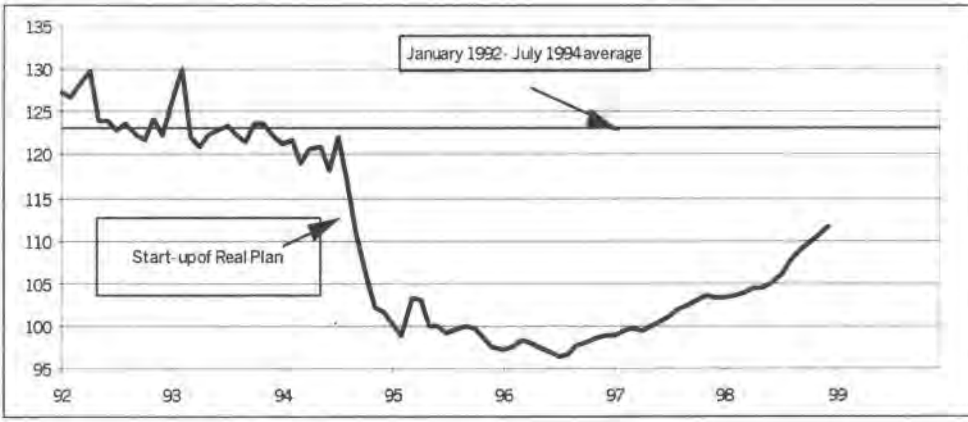
Thus, Brazil's currency managed to hold up until the presidential, legislative and governors' elections of October 4 and 25, 1998. As a result, the strategy to uphold the exchange rate regime aimed at gradually absorbing actual appreciation (the actual devaluation of the exchange rate was higher than the inflation rate) that was supposed to bear fruit by year end 1999 (Chart 10) needed the support of an ambitious austerity plan that would pave the way for an agreement with the IMF and solid international financial support. President Cardoso, reelected for a new mandate, launched a three-year programme, which first needed congressional approval. This programme, aimed at cleaning up public finance, was based on the commitment assumed in two communiqués issued jointly with the IMF and made public in October.

The plan had to take on the feat of dealing with the Achilles heel of Brazil's public finance: the deficit. Within a three-year span, the plan would cut back expenses by 84 billion dollars, lowering expenditures by 23 billion in 1999 alone, thus lowering the unbalanced budget from 8% to 4.5% of GDP. The objective was to achieve a primary surplus (prior payment of interest) in 1999, while assuming the cost this would have on growth (-1% in 1999). In comparison with the programme of 10 November 1997, the new plan was more realistic because it centered more on increased income than on decreased spending. The drop in expenditures through direct budget cuts accounted for less than a third of the adjustment efforts for the 1999-2001 period.

The plan's announcement was followed by the agreement with the IMF. The terms of this "preventive" agreement, signed the 13th of November, would provide Brazil access to international financial support. This financing would total 41 billion dollars broken down as follows: IMF (18 billion), World Bank and Inter-American Development Bank (9 billion), and the large industrialized countries (14.5 billion). Most of the latter figure would be provided by the USA (5 billion) and the countries of the European Union (7 billion). Brazil received the first part of this money (9 billion) in December.

The new plan's announcement and the IMF agreement's signing did not reinstate an atmosphere of credibility nor did it dissipate the fear of a successful speculative attack. Negotiations between the Executive and Congress and new State Governors were drawn out more than would have been desired.

Chart 10
Evolution of Brazil's Real Exchange Rate
(Before devaluation)



Source: Laurent, Miotti and Quenan, 1999.

In effect, Parliament's opposition throughout the month of December to the implementation of a tax on Social Security retirement funds and pensions reinforced the feeling of mistrust among investors who only perceived the Brazilian authorities' lack of competence in enforcing the austerity plan. This brought the process of lowering domestic interest rates to a halt.

The decision to lower interest rates was key for three reasons. In the first place, exorbitant real rates seriously impaired economic activity making productive investment's reactivation practically impossible (investment was modest from the 80s onward). Secondly, these low rates splintered the banking system; while private sector loans did not soften their downward plunge from 1997 on, doubtful and bad credit continued rising. Finally, and most important, these rates increased the burden on the financial expenditures budget of the domestic public debt. The lowering of the various domestic interest rates was one of the indispensable conditions to prevent increases in financial expenses that would altogether cancel out the savings achieved under the new austerity plan.

As a matter of fact, domestic public debt (estimated at 250 billion dollars at the end of 1998), did not seem excessive when compared to GDP (almost 35%, in other words approximately 45% of the total public debt if one includes the foreign public debt of nearly 85 billion dollars). Further, the holders of Brazilian domestic debt papers are for the most part residents of Brazil (Russia's case differed in that non-residents held over 25% of that country's public debt). Beyond the matter of debt accountability, the problem concerned rollover conditions, all the more because the debt was becoming increasingly variable, indexed on the basis of short-term interest rates (75% at the end of 1998, as opposed to 35% at the end of 1997). On the other hand, the maturity terms were becoming shorter, with important installments due the first quarter of 1999. (Chart 11)

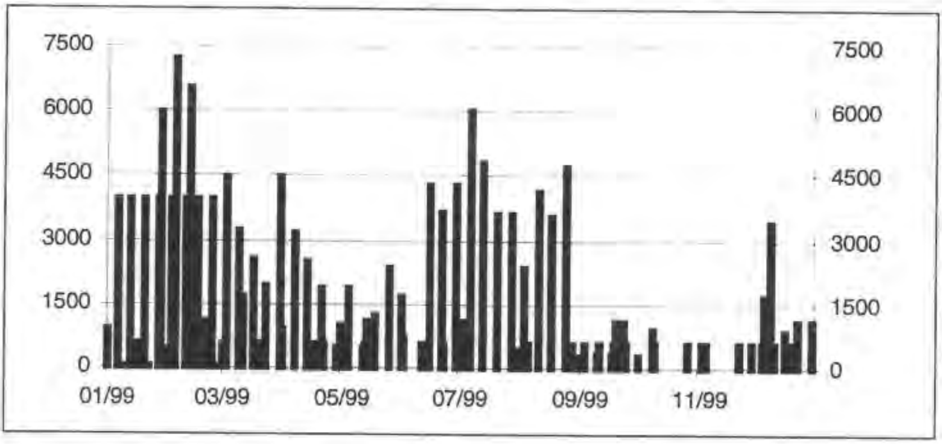
"*Latin American countries for the most part will have lower growth rates in 1999 than they did in 1998 and the region will probably fall into a recession (-1/-2%).*"

Market instability peaked in early January 1999. It was then that several important Brazilian states (particularly Minas Gerais) announced their decision to not pay their debt service with the Central government. Faced with increasingly depressed market conditions and the pressure from industrial lobbyists pressing for new guidelines that would allow for a downward movement in interest rates, the government finally gave in. On 13 January, when authorities decided to broaden the *real*'s fluctuation band, the speculative attack took on an accentuated note. As a result, the *real* quickly surpassed the established margins forcing the government to announce the currency's flotation.

The outbreak of the Brazilian crisis has emphasized a tendency toward a recession throughout Latin America. Although Latin America stood up well during all the financial turbulence originated by the Asian and Russian crises, the diminishing level of external financing along with its higher cost, the unhealthy repercussions on trade along with restrictive budget and monetary policy have translated into a slowdown in 1998's economic activity (2.1% as opposed to 5.3% in 1997). In 1999, economic difficulties continued as a result of the recession in Brazil (affecting that country's neighbors), mediocre growth in global trade, and the continued high cost of external financing (Table 12). Therefore, Latin American countries for the most part will have lower growth rates in 1999 than they did in 1998 (Chart 12) and the region will probably fall into a recession (-1 / -2%).

Despite congressional approval of measures previously rejected in December 1998 (such as the tax on financial transactions) and the calmer atmosphere resulting from the disbursement of a new tranche of the international aid plan, Brazil continues to be the country with the most difficult predicament, even after all the progress it has made. The plunging *real* is now under control (Brazil's currency dropped to more than two *reals* per dollar in March 1999 when it had been worth 1.20 *reals* per dollar before 13 January), the new agreement with the IMF provides for strengthened austerity measures and the speeding

Chart 11
Domestic Public Debt Reimbursement Terms



Source: Laurent, Miotti y Quenan, 1999.

up of privatization to generate a primary surplus of 3.1% of GDP, which is greater than established under the October 1998 plan. Likewise, an attempt to keep the tendency towards inflation at bay using an extremely restrictive monetary policy (Selic-type for the monetary market, which went from 39% to 45% on 4 March, ended up going back to 42.5%, and then to 29.5%). From the viewpoint of the new plan, economic activity in 1999 is expected to drop significantly (-3% / -4%), with inflation ranging from 10% to 20% and the real stabilizing around 1.70 per U.S. dollar.

The good results in controlling inflation (2.6% for the first quarter according to the IBGE government index), the easing up of domestic political tension, the return of foreign investments, and the prospects stemming from the privatization programme requested by the IMF have led to a wave of market optimism. These factors have even made some authorities predict that the recession will not be as strong as expected. However, it might be too soon to determine the outcome. On the one hand, the new fiscal adjustment will meet its expectations if interest rates remain high (as these raise the cost of the domestic public debt, which continues to affect the State's accounts). At the same time, during the third quarter significant commitments must be met as regards the maturity schedule. Further, private external debt maturities can accentuate pressure on the foreign exchange rate, causing new difficulties. Finally, the anti-inflation programme, aimed at keeping the possibility of having to use indexing out of the picture, is based on a strict salary policy that is under pressure from trade unions and sectors of the opposition.

Argentina is the country most directly affected by the Brazilian crisis, which bears a particularly hard impact on industrial exports, feeds unfavourable expectations that have resulted in the drop in private investment and accentuates public finance problems. However, the preventive foreign debt policy, despite its cost, coupled with the strength that the financial system has shown until now and the recent renegotiations of the IMF Agreement lead us to think that the currency board is not threatened.

Venezuela will continue suffering from the slowdown in activity which began in 1998. The effects of the drop in oil prices (despite the recent comeback), high interest rates and the need to decrease budget imbalances are at the center of its current recession. Ecuador, affected by a severe banking crisis that in turn has played a role in deteriorating the economic and political crisis, will go into a severe recession.

Table 12
Latin America : Spreads of Sovereign Euro-obligations
Impact of the Brazilian Crisis
Average of papers with maturities of less than 5 years (in gdp)

	08.01.99	Peak brazilian crisis	02.03.99
Argentina	447.8	767.8	521.5
Brazil	537.8	1267.7	735.5
Colombia	453.0	552.9	441.3
Costa Rica	299.5	376.1	350.4
Ecuador	1022.9	1382.4	2181.2
Mexico	303.6	522.6	336.7
Panama	477.0	603.4	405.0
Trinidad & Tobago	417.1	426.1	442.8
Uruguay	433.8	457.4	439.2
Venezuela	612.9	1049.2	814.5

Peak Brazilian crisis: highest average spread between 13/01/99 and 25/01/99.

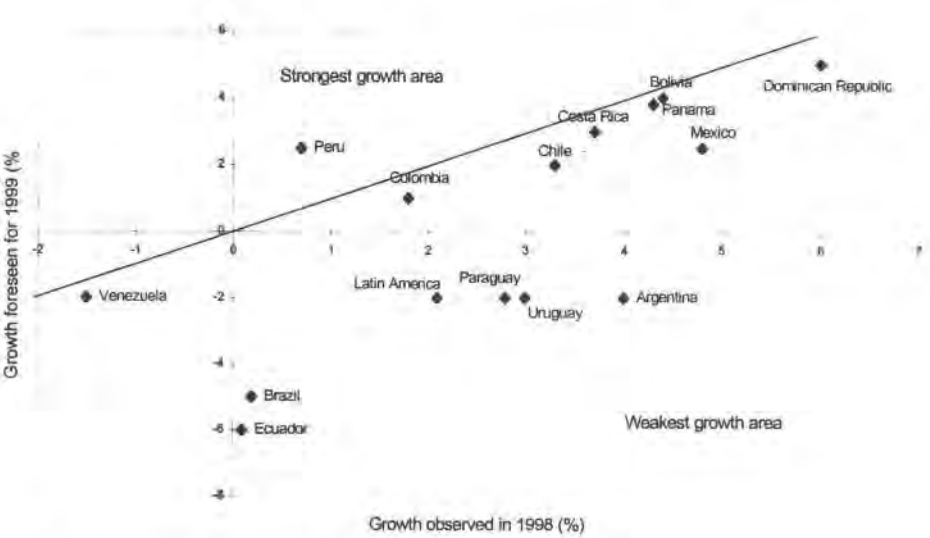
Source : calculations based on data taken from Datastream.

Of all the countries that could expect to see some moderate growth, only Peru is on the way to recovery. Peru, which succumbed to the full force of El Niño and the Asian crisis in 1998, is now on its way to a healthy recovery. Two countries, however, that will undergo new signs of slowdown are Colombia, currently following the tracks set for budget adjustments, and Chile which despite being the region's strongest economy, is suffering the shocks of unfavourable trade: Asian crisis, dropping copper prices, and now Mercosur's decreasing demand. In this context, Mexico, benefiting from the sustained dynamics of the United States, is a priori the least affected. It will nonetheless experience a slowdown in growth due to restrictive policies to keep fiscal and foreign deficits under control.

IV. Conclusions

Latin America was unable to keep out of the reach of the international financial crisis even though it had no direct link to its beginnings. Actively participating in the financial globalization process with programmes for liberalization and opening up

Chart 12
Generalized Setbacks in Growth in 1999



Source: national data and own estimates.

implemented in the mid-80s, the countries of this region have undoubtedly taken advantage of the opportunities made available by this process. Particularly, private agents have benefited from the enlarged access to international financial flows thus increasing production capacity.

Participation in the game of globalization entails risks. The instability that goes hand in hand with deregulated financial markets increases the volatility of nominal variables and can transform a minor incident into a crisis of global magnitude. It is just this sort of systemic risk that occurred as a result of the Thai bhat crisis. The exogenous shock's propagation through financial and trade channels ends the first act of the Latin American crisis (Box 2).

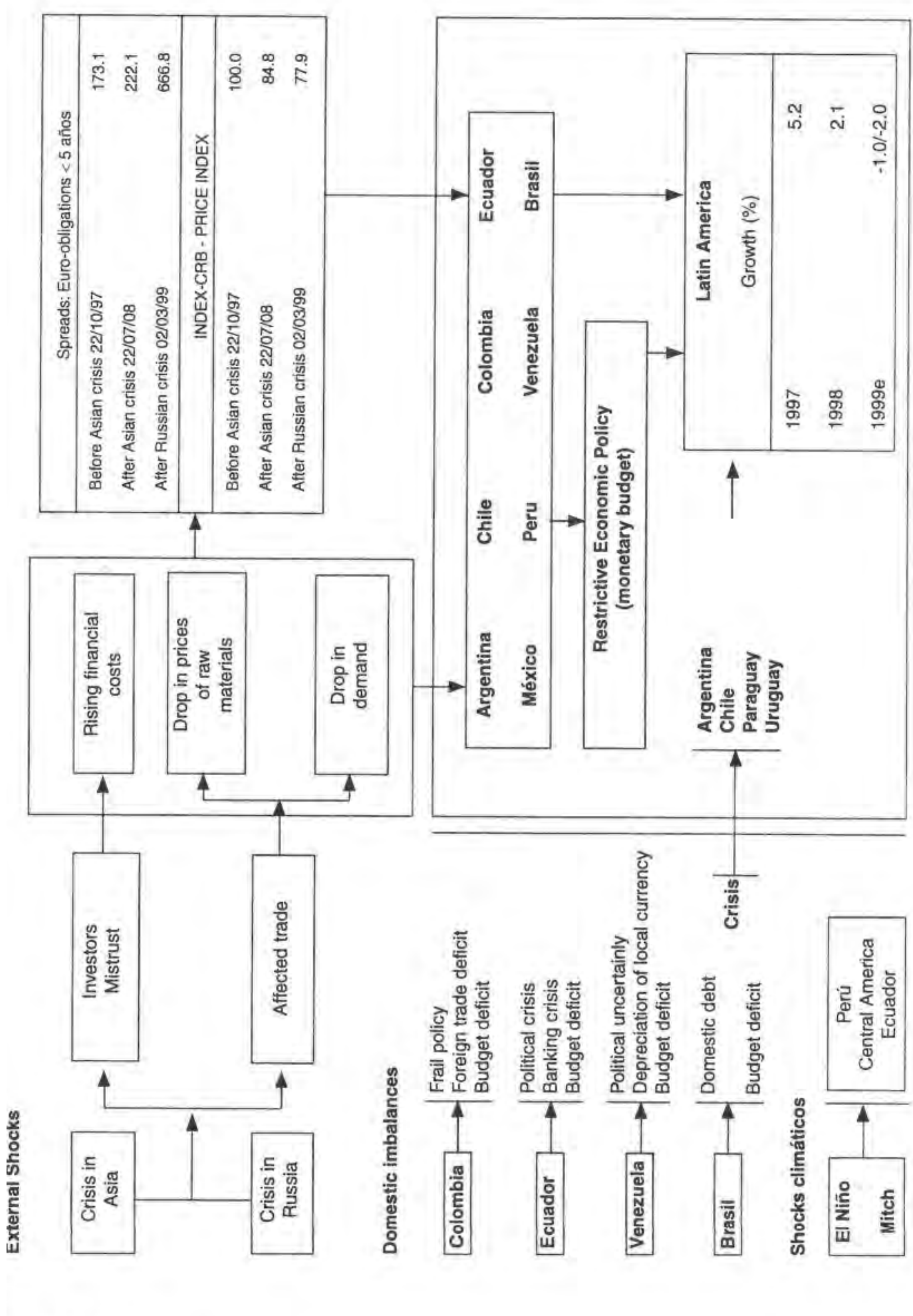
“The instability that goes hand in hand with deregulated financial markets increases the volatility of nominal variables and can transform a minor incident into a crisis of global magnitude.”

The external dimension of the crisis, making foreign financing both costly and scarce while trade balances feel the effects of a dropping demand and world prices, will continue to rage as long as economies are of a fragile structure: heavy burden of the external debt, marked specialization of base products. Structural weaknesses inherited by Latin America from its past insertion modality put it at a high risk level. These structural disadvantages only served to increase market distrust.

At the same time, because the external dimension of the crisis requires the implementation of restrictive monetary and budget policy, internal macroeconomic or financial frailties are combined with that external sphere. This combination has led to virulent effects in the case of some Latin American countries characterized by unbalanced budgets, explosive internal debts, financial systems convalescing from the 1995 crisis, currency exchange regimes lacking in credibility, and at times, even political uncertainties. Countries considered the weakest were seriously destabilized: Colombia, Ecuador, Venezuela, and above all, Brazil. With the crisis in Brazil, the epicenter of the international crisis finally shifted to Latin America. Although at present its financial effects have been curtailed, the impact has had a significantly negative impact on growth, particularly through trade in MERCOSUR.

As with other crucial issues, the crisis of Latin America has paved the way for new discussions (Box 3).

Without exhaustive reference to numerous reflections and proposals made by the main official authorities and academics, it is obvious that recent debates increasingly refer to institutional and systemic factors. Unlike the Mexican crisis of 1994, the Asian crisis generated ample discussion on the IMF's role and intervention modalities. The Russian crisis, whose potent contagion power has been surprising, increased the speed with


External Shocks
Crisis in Asia
Crisis in Russia
Investors Mistrust
Affected trade
Rising financial costs
Drop in prices of raw materials
Drop in demand
Spreads: Euro-obligations < 5 años
Before Asian crisis 22/10/97 173.1
After Asian crisis 22/07/08 222.1
After Russian crisis 02/03/99 666.8
INDEX-CRB - PRICE INDEX
Before Asian crisis 22/10/97 100.0
After Asian crisis 22/07/08 84.8
After Russian crisis 02/03/99 77.9
Argentina
Chile
Colombia
Ecuador
México
Peru
Venezuela
Brasil
Restrictive Economic Policy (monetary budget)
Latin America
Growth (%)
1997 5.2
1998 2.1
1999e -1.0/-2.0
Argentina
Chile
Paraguay
Uruguay
Domestic imbalances
Colombia
Frail policy
Foreign trade deficit
Budget deficit
Ecuador
Political crisis
Banking crisis
Budget deficit
Venezuela
Political uncertainly
Depreciation of local currency
Budget deficit
Brasil
Domestic debt
Crisis
Budget deficit
Shocks climáticos
El Niño
Mitch
Perú
Central America
Ecuador

Box 3
Lessons Learned from Globalization

Crisis		Identified problems	Advances in discussions
1994-1995	**Mexican**	Current account Banking fragility Short-term debt	Monitoring of external deficits Responsibility of liberalization
1997	**Asian**	Banking system	Control and monitoring of national systems
		Short-term debt	Control of short-term capital
		Currency exchange exchange regime	Discontinued use of fixed currency
		Internal sources of imbalance	Controlled currency exchange
		Regional contagion	Moral risk, final recourse lender
		ROLE OF IMF	
1998	**Russian**	All the above	
		Domino effect and systemic crisis	Frailty of developed bankin systems
		Role played by financial markets	Burden of leverage effects (hedge funds): taxes
		Risk of global deflation	New international financial architecture
1999	**Brazilian**	Currency exchange regime	Dollarization, currency board, ... International monetary system

which means were sought out to prevent and battle international financial instability in the event of such a scenario. The proposal for a "new international financial architecture" should be constructed particularly on the basis of strengthened monitoring of institutions involved in international financial flows with the application of accounting rules and regulations, of enhanced prudential control mechanisms that govern national financial systems and greater transparency of the financial situation of States and private operators. However, to the extent that the advances made by this new international financial architecture are modest, the matter of a currency regime that is increasingly adapted to a highly volatile environment linked to the free movement of capital, is proposed in fact at the level of each nation or for each regional group, independently of the debate under way on the international rules of the game.

The Brazilian crisis has therefore sparked serious discussion on currency exchange systems. The proposal for dollarization in Brazil should therefore be interpreted in a context that goes beyond the statement made by the Argentinean authorities when the real began its swift downward descent.

The poor results obtained by fixed, quasi fixed and floating regimes as compared to the benefits that these in theory are meant to achieve support the thesis which a number of analysts sustain for the adoption of a supranational currency in Latin America thus eliminating the risks of currency exchange: this currency could be the dollar providing that issues concerning the issuance of currency (coining), the final lender, and the government structure of the monetary authority are resolved.[8] This proposal is based, among others, on the high dollarization level that already exists in many countries of Latin America.[9]

Other analysts, considering that dollarization probably could not be implemented without first reaching an agreement with the United States, and that it is not convenient because it would mean giving up one's own monetary sovereign entirely, are more inclined towards implementing, in specific cases, a currency board system like that of Argentina[10]. Since this would mean a fixed currency exchange and restrictions in terms of issuance of currency, this type of regime in effect can be perceived as advantageous from a credibility standpoint. However, the economic and political conditions for its implementation and operation are not met by many of these countries[11].

> "*The debate on currency exchange systems reminds us that even the best of regimes is influenced by national conditions.*"

At the same time, Chile's experience, whose currency exchange regime is deemed «intermediate» with an adjustable fluctuation band based on circumstances and a referential rate of currency exchange vis-a-vis a currency basket, demonstrates that a country's capacity to cope with international financial instability is also determined by other variables: sturdiness of the banking system, public finance's health conditions.

As a matter of fact, the debate on currency exchange systems, a principal point of discussion stirred up by the international crisis,[12] reminds us that even the best of regimes is influenced by national conditions. At the same time, nonetheless, this controversy in itself suggests the monetary dimension of the international financial crisis. In this respect, the debate reveals a legitimate concern: the advances made in building a «new international financial architecture» must be complemented with the start-up of a process for the reform of the international monetary system. But this process, that needs to include the definition of institutional and operative criteria for the international last-resort lender, has not been able to make its way into the political plane.[13]

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Data base: **Datastream, EIU, IIF and national sources**.

Notes

1. *For a detailed presentation of the methodology used to measure excess lack of confidence, see Ricoeur-Nicolaï, 1998.*

2. *Regarding the effect of the contagion unleashed by the Asian and Russian crises and the impact on Latin America, see: ECLAC, 1998a: Laurent, 1998; Miotti and Quenan, 1998; Perry and Lederman, 1998.*

3. *For a systematic study of the commercial impact on Latin America of the current international financial, see IDB, 1999.*

4. *ECLAC, 1998b.*

5. The methodology used to obtain these results appears in IDB, 1998.

6. *ECLAC, 1988c.*

7. See table 11 for inflation rates.

8. *Hausmann, Gavin, Pages-Serra, Stein, 1999.*

9. *Particularly Argentina, Bolivia, Nicaragua, Peru, Paraguay and Uruguay (see Baliño, Bennett and Borensztein, IMF, 1999.*

10. *This is, for example, the proposal made by the former Minister of the Economy of Argentina, D. Cavallo, for the case of Brazil (see Cavallo, 1999).*

11. *The currency board in particular supposes having very strict budget discipline, and does not allow or seriously limits monetary authorities from intervening as last resource lenders; hence, this calls for the implementation of specific mechanisms capable of ensuring the stability of the banking system in the framework of a broad set of economic and institutional reforms (Eichengreen, 1999).*

12. *Ocampo, 1999.*

13. *Aglietta, (1998).*

Crisis = Opportunity

During the 1990's Latin American countries registered an increase in capital flows similar to that of the 1070's. However, while in the 1970's capital flows were aimed mainly at medium term bank loans, today they target stocks, bonds and deposits which are notoriously volatile. At the beginning this new inflow of capital created positive macroeconomic effects, allowing the region's GDP to grow beyond the increase in production. Later, however, it caused pernicious effects as the region's economy became more vulnerable to future negative external shocks. Mexico and Chile are two different examples of how countries in the region dealt with the sudden flow of foreign capital during the period analyzed in this article. According to the author, several political lessons can be derived from the financial crisis. In his opinion, this has opened up a new opportunity to significantly improve the design of the international financial system and to review the internal policies needed to achieve a sustainable macroeconomic balance and increase growth.

Crisis = Oportunidad

Durante los años 90 los países de América Latina experimentaron un incremento en el flujo de capital similar al de los 70, con la diferencia de que en la década actual ha habido una elevada oferta de inversiones en acciones, bonos y depósitos caracterizados por su liquidez y volatilidad, mientras que el anterior se concentró fundamentalmente en créditos bancarios a mediano plazo. Esta nueva entrada de capitales ha generado efectos macroeconómicos que en un principio fueron positivos, al permitir un aumento del PBI de la región más allá de la expansión del límite de producción; pero posteriormente adversos, porque hicieron que la economía interna fuera más vulnerable a los futuros impactos negativos externos. México y Chile son dos ejemplos, divergentes, de cómo se enfrentó la abrupta entrada de capitales a la región en la época analizada en el presente artículo. Según su autor, hay algunas lecciones desde el punto de vista polítco que pueden extraerse de la crisis financiera, pues, en su opinión, esta ofrece una nueva oportunidad para mejorar significativamente el diseño del sistema financiero internacional, y retomar el enfoque a nivel interno para lograr los equilibrios macroeconómicos sustentables y elevar su contribución al crecimiento.

La crise: une opportunité

Dans les années 90, les pays de l'Amérique latine ont connu une hausse des flux de capitaux semblable à celle des années 70. La différence réside dans l'offre actuelle élevée d'investissements en actions, titres et dépôts, qui se caractérisent par leur liquidité et leur volatilité, alors que, durant la décennie 70, les placements se dirigeaient essentiellement vers les crédits bancaires à moyen terme. Dans un premier temps, les effets macroéconomiques de cette entrée massive de capitaux ont été positifs, puisque le PIB de la région a pu croître au-delà de l'expansion de la production. Toutefois, dans un deuxième temps, ces effets se sont pervertis, rendant l'économie intérieure plus vulnérable aux impacts négatifs externes qui vinrent plus tard. Les exemples, divergents, du Mexique et du Chili illustrent la manière dont a été reçue l'entrée brutale de capitaux dans la région, durant la période analysée dans l'article. De l'avis de l'auteur, on peut tirer certaines leçons politiques de cette crise financière, qui offre ainsi une occasion nouvelle d'améliorer considérablement l'architecture du système financier international et de revenir sur une approche plus intérieure, afin d'atteindre des équilibres macroéconomiques durables et d'en augmenter la contribution à la croissance.

Crise = Oportunidade

Durante os anos 90, os países da América Latina experimentaram um incremento no fluxo de capital similar ao dos anos 70, com a diferença de que na década atual tem havido uma elevada oferta de inversões em ações, bônos e depósitos caraterizados pela sua liqüidez e volatilidade, entretanto, que o anterior concentrou-se fundamentalmente em créditos bancários a mediano prazo. Esta nova entrada de capitais tem gerado efeitos macroeconômicos que num princípio foram positivos, ao permitir um aumento do PBI da região, mais longe da expansão do limite de produção; mas posteriormente adversos, porque fizeram que a economia interna fosse mais vulnerável aos futuros impactos negativos externos. México e o Chile são dos exemplos divergentes, da forma como enfrentou-se a abrupta entrada de capitais à região na época analizada no presente artigo. Segundo seu autor, tem algumas leições desde o ponto de vista político que podem-se extrair da crise financeira, pois, na sua opinião, esta oferece uma nova oportunidade para melhorar significativamente o desenho do sistema financeiro internacional, e retomar o enfoque a nível interno para lograr os equilíbrios macroeconômicos sustentáveis e elevar sua contribuição ao crescimento.

Crisis = Opportunity

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ANALYSIS

Introduction

Latin American countries (LACs) have been strongly affected by the changes that have occurred in capital flows over the last quarter of a century. During the 1970s, a large supply of funds was made available to the region; then, during the 1980s, there was a generalized severe shortage of financing, and the region became a net exporter of funds. Between 1991 and 1994, it received a large capital surge again, only to experience another sharp reduction focused in Mexico and Argentina, and a generalized drop of portfolio flows in late 1994 and early 1995. The so-called tequila crisis was followed by a renewed access in 1996-97. In 1998-99, Latin America has been experiencing a new shortage of external financing, aggravated by a worsening of the terms of trade. The crisis centered in Asian countries has now given rise to of a new recessive macroeconomic adjustment in the region. It appears impossible to hide the significant instability of financial markets.

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On all those occasions, the changes that were first expansive and then contractionary, began in the international markets and had a strong impact on national economies. Up to 1996, the successful emerging economies of Asia appeared to be immune to the instability associated with capital surges. The recent events have shown that is no longer so. Some of the causes are common with those of Latin America. The new crisis provides a renewed opportunity to significantly improve the architecture of the international financial system (ECLAC, 1999), and to reform the domestic approach so as to achieve sustainable macroeconomic equilibria and to enhance its contribution to growth.

I. Capital Flows to Latin America

Net capital inflows to Latin America averaged nearly 5% of GDP in 1991-94 and 1996-97. During both periods the current account deficit rose sharply and exchange rates increased (see

ECLAC, 1995); naturally, imports grew more rapidly than exports, and external liabilities rose steadily. Indeed, soon all these variables reflected a growing macroeconomic imbalance.[1] In many cases they were anchored to one dominant "balance", that of a falling CPI tied to an increase in real exchange rates and climbing external deficits. Those recipient countries which had larger current account deficits heavily financed with short-term liabilities and exhibiting stronger exchange rates, tended to become increasingly more vulnerable to external creditors. Creditors, given the high exposure of financial assets placed in the region, subsequently became more sensitive to any "bad news".

The dramatic increase in the flow of international financial resources in recent years has been more diversified during the current decade than it was during the 1970s. But the situation is potentially more unstable, inasmuch as the trend has been to move from medium-term bank credits to investments in liquid stocks, bonds and deposits. A very high percentage of this supply of financing is of a short-term and liquid nature. Paradoxically, there has been a diversification toward volatility in the 1990s; the relative improvement after the "tequila crisis", with a rising share of Foreign Direct Investment (FDI), still included a significant proportion of volatile flows. Latin America was a receptive destination, and offered the expectation of high rates of return.

Why the high rates of return? Naturally the rate should tend to be higher in the "productive" sectors of capital-scarce regions, like Latin America. Several factors contributed to this situation. Initially, prices of equity stocks and real estate were highly depressed. That allowed a 300% average rate of return (in current US dollars) in the stock markets of Latin America between late 1990 and September 1994. After a sharp drop around the tequila crisis which affected all Latin American stock markets, between March 1995 and June 1997 average prices nearly duplicated, due directly to portfolio inflows. Domestic interest rates were high as well, reflecting the external restrictions prevailing in 1990 and the tight monetary policy in place (plus the nature of financial reforms implemented; see Ffrench-Davis, 1999). Finally, in a non-exhaustive list, the renewed supply of external financing generated a gradual exchange-rate appreciation that also encouraged short-term or liquid inflows (see tables in Ffrench-Davis, 1999, ch. 10).

The yearly current account deficits rose persistently. By 1994 Mexico and the region had accumulated 4 years of large flows of external liabilities. While in 1991 the actual stock of assets of the new investors in Latin America was evidently below the "desired" stock, in 1994 it was notably large. We had entered a vulnerability zone, with the economy growingly sensitive to bad political or economic news. The longer and deeper the permanence in that zone, the harder to get away without a crisis.

During the 1990s, capital inflows contributed to a recovery of economic activity, after the recession that had prevailed throught 1990 in most LACs. Argentina and Perú were two outstanding cases of underutilization of capacity; Chile and Mexico were the exceptions in the other corner.

Annual GDP growth rose from 1.2% in the 1980s, to 4.1% between 1991 and 1994 and to 2.9% in 1995-98 (table 1). This growth was meager, however. On the one hand, the comparison with the previous golden age is shocking. In 1950-80, Latin America had averaged a GDP growth of 5.5% per annum; and domestic investment had risen fast. Subsequently, in the 1980s the investment ratio fell sharply by 7 points of GDP, with only a mild recovery in the 1990s. In fact, investment grew much less during this decade than did capital inflows. Thus, a significant part of the external flows financed increased consumption and consequently crowded-out domestic savings (Ffrench-Davis and Reisen, 1998).

Actually, the new supply of financial flows initially had a

Table 1
Gross Domestic Product, 1970-98
(Annual growth rates, %)

	1970-80	1981-90	1991-94	1995	1996	1997	1998
Argentina	2,8	-0,7	8,2	-5,0	3,6	8,4	4,2
Brasil	8,6	1,6	2,8	4,2	2,8	3,0	0,2
Chile	2,5	3,0	7,9	10,1	7,3	6,9	3,4
Colombia	5,4	3,7	4,3	6,2	2,2	3,2	0,6
México	6,7	1,9	3,7	-6,6	5,3	7,3	4,8
Perú	3,9	-1,2	5,3	7,7	2,4	7,7	0,7
Uruguay	3,0	0,0	5,2	-2,1	5,3	5,1	4,5
América Latina (19)	5,6	1,2	4,1	0,4	3,5	5,3	2,3

Source: Calculations based on official figures for 19 countries processed by ECLAC; figures expressed in 1980 US$ for 1970-80, in 1990 US$ for 1980-97 and in 1995 US$ for 1998.

positive effect on Latin America. Thanks to a larger utilization of installed capacity, GDP increased beyond the expansion of production: about one third of the 4% annual GDP growth rate in 1991-94 reflected an increased use of installed capacity. The phenomenon was particularly intense in countries such as Argentina and Peru. Subsequently, the strong recovery of Argentina and Mexico in 1996-97 rested to a significant degree on the underutilization created in 1995. And, again, recovery was short-lived, giving way to slower growth since mid-1998, and open recession in Argentina in 1999.

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The renewed access to external capital challenged the stability and sustainability of macroeconomic equilibria. Indeed, the affluence of capital had an adverse effect on the evolution of exchange rates,[2] the money supply and domestic credit, the accumulation of external liabilities (mostly with short-term maturities), and thus made the economy more vulnerable to future negative external shocks.

What happens? Why debtors don't stop capital inflows before a crisis?

In the majority of cases, authorities allowed the capital surges to move into their domestic economies. Most of them thought they should do nothing or could do nothing, or preferred to "benefit a little longer" from the anchoring of the domestic CPI to international inflation.

In general, observers tended to agree that disequilibria had been created. For voluntary flows to take place both debtors and creditors must agree on it. Then, why did creditors not act in due time to curb flows? The specific nature of the main agents on the creditor side is crucial. The conflictive segment of flows, that was predominant in both surges and busts, naturally works over the short term.

When creditors discover an emerging market, they start out with non-existent exposure. Then they generate a series of consecutive flows which accumulate in rapidly increasing stocks. As said, the creditors' sensitivity with regard to bad news increases remarkably with the level of stocks placed in a country (or region), and with the degree of debtors' dependence on additional flows (current account deficit plus refinancing of maturing liabilities). Additionally, the most relevant feature is that after a significant increase in asset prices and exchange-rates, accompanied with rising stocks of external liabilities, the probability of reversal of expectations grows steeply.

The accumulation of stocks and a subsequent reversal of flows can be considered to be a "rational" behavior, given the nature of predominant agents. Investors with short horizons are not concerned whether the foundations (over a long term) are weakened by capital surges while they continue to bring inflows. What is relevant for them is that the crucial indicators –real estate prices, stocks, exchange rates– can continue providing profits in the near term; thus, they will continue pouring money until expectations of near reversal start to built.

The most relevant issue is that myopic agents specialized in microfinance have begun to determine the macroeconomic situation and to design policies. The outcome, unsurprisingly, turns out to be unsustainable macroeconomic imbalances, "wrong" prices, and an environment not conducive to productive investment. Then what appears to be "irrational" is that the domestic macroeconomy has become increasingly influenced by experts in microfinance. Macroeconomic authorities must face their responsibility and insure that macroeconomic balances both sustainable and suitable for growth are achieved. That requires that they avoid entering vulnerability zones during economic booms-cum-capital surges.

III. The Contrasting Cases of Mexico and Chile in 1990-95

It is important to design economic policies that will attract resources and also ensure that they flow in a fashion and quantities that are sustainable and directed more towards long-term investment than to consumption.

1. Mexico's Case

The Mexican crisis which exploded in 1994 is a good example of the harm that can be caused when a country absorbs an excessive volume of capital flows, giving way to a large stock of external liabilities, especially when the composition of such financing makes it volatile. Producers and consumers adjusted to a level of overall expenditures that was much higher than the potential GDP, and after a while the amounts involved became unsustainable. Recessive adjustment inevitably followed. In 1995 Mexico experienced a 6.6% drop in GDP and a nearly 30% drop in capital formation. These were closely associated, first, to a persistent revaluation of the exchange rate and a growing current account deficit and, later, to a sharp cutback in financing on the part of creditors. The country was forced into a highly recessive adjustment and a huge devaluation, despite the large package of international support it received in 1995 (Lustig, 1997; Ros, 1999).

As said, the seeds of the crisis date back to the period 1992-94, when there was a massive capital inflow, mostly short term. Aggregate demand grew rapidly, leaving far behind the potential GDP; it leaned increasingly towards tradable goods, especially encouraged by the strengthening of the exchange rate. Thus, in those years, there was a maladjustment that would most likely have to be reversed in the future. What is extremely important is that such disequilibrium was encouraged by capital inflows. Since the public sector was balanced, the disequilibrium occurred in the private sector.

In 1995, the Argentine economy was seriously affected by the contagion. Although this did not lead to a currency crisis with a sharp exchange rate devaluation, as many had feared in 1995, Argentinean GDP fell by 5% and investment diminished by 16%. The overall growth rate of Latin America went down sharply, to a figure below the population increase, while the regional investment ratio also fell substantially. During 1995, in diverse countries, negative flows were observed in several segments of the supply of funds (especially bonds, deposits and stock markets). Average growth in Latin America was negative in the four quarters included between March 1995 and 1996.
Subsequently, the flow of funds was reactivated once again, exceeding US$80 billion in 1997. The resulting economic reactivation was particularly significant that year. However, some of the same problems apparent in the 1991-94 recovery reappeared in 1996-97, and actually claimed their due in 1998-99. Nevertheless, the consequences were moderated by the following variables. First, the new financial boom period was short-lived; it lasted only a couple of years. Second, there was a tendency to increase the share of FDI flows, which are most steadfast than flows to the stock market or short-term credits. Third, owing to a sharp reduction in 1995 of the current account deficits (and a significant exchange rate depreciation, particularly in the case of Mexico), a high deficit was recorded only in one year (1997). Fourth, taking into consideration the banking crisis of Mexico and Argentina, following the "tequilazo", these and other countries introduced reforms to their financial systems which strengthened the regulation and supervision of their banking systems.

Consequently, the 1998 adjustment took place in economies with a more moderate stock of volatile liabilities than in 1995, with healthier banking portfolios, and with less overheated economies. However, in all, the Asian crisis caught Latin America after most of the region's countries had strengthened their exchange-rates and their current account deficit had risen sharply. The same old story was being repeated, at a time when the international scenario was hit by a recession, worse terms of trade, declining trade flows and access to finance, and rising spreads.

2. Reducing Vulnerability in Chile

Chile's performance was opposite that of Mexico in 1995-96, in spite of numerous similarities during the years prior to 1994. Both the Mexican crisis and Chile's strength were built up over time. Towards the end of the 1980s, both countries had already opened up their trade considerably, their budgets had improved substantially, privatization was well under way, annual inflation was around 20%, and the two countries had similar domestic savings rates. The reason why Chile performed better in 1995 is that, faced with an abundance of external funds in 1990-94, it deliberately followed a cautious policy (Agosin and Ffrench-Davis, 1999; Stiglitz, 1998). Instead of taking and spending all the large supply of external resources available, which would have led to a significant appreciation of the peso and to a rising current account deficit, it chose to discourage short-term capital inflows. In 1991 a tax was imposed and substantial non-interest-bearing reserves for external credit were required; the reserves requirement was subsequently extended to deposits in foreign currencies and investment in second hand stocks, while primary issues and venture FDI capital were exempted;[3] FDI had to be held in Chile for one year at least; the financial system was subject to relatively strict regulations, including a selective supervision of assets and required provisioning, as well as restrictions and drastic penalties on operations with related parties. The set of measures adopted effectively discouraged speculative capital inflows (Agosin, 1998; Agosin and Ffrench-Davis, 1999).

As a consequence, by late 1994, Chile had a moderate external deficit, high international reserves, a modest and manageable short-term debt, a domestic savings rate that was rising instead of falling (the latter being the case in Mexico and Argentina), a level of domestic investment that since 1993 has been the highest recorded in history and the exchange rate in 1990-94 was comparatively closer to equilibrium than that of most of the countries of the continent, as reflected by a moderate current account deficit.

The measures adopted were effective in achieving their targets for most of the 1990s. However, in 1996-97 this policy mix and the intensity with which it was applied remained unchanged, in spite of a new vigorous surge in capital flows to most countries in the region, but particularly to Chile, a country immune to the tequila contagion. This surge should have been met with increased restrictions on rising inflows. Since these are a market-based mechanism that alters the relative prices of capital flows, what happened was that capital inflows ended up paying the cost of the reserve requirements, with no evidence of significant evasion.

The fact is that, in general, the policies were rather unchanged in face of a stronger capital surge during 1996-97. As a consequence, despite heavy intervention in the foreign exchange markets, the Central Bank was unable to prevent a sharp rise in the exchange-rate and the current account deficit. Nonetheless, the benefits of the active regulations implemented in previous years had left large international reserves, a low stock of foreign liabilities and a small share of volatile flows. Unfortunately, those strengths were partially undermined by the excessive rise in the exchange-rate and the high external deficit recorded in 1997.

IV. Policy Lessons

Optimism regarding Latin America returned to the international financial markets in 1996-97. The current net capital inflow climbed to pre-crisis levels. Composition improved, with a larger share of FDI. GDP decline in various LACs was reversed. In fact, a dynamic growth for the region as a whole was observed since mid-1996 until mid 1998.

GDP recovery in Argentina and Mexico was particularly vigorous, although after the sharp decline in both countries due to the Tequila Effect in 1995, there was a large gap between effective GDP and productive capacity. This allowed for a significant reactivation which led to a complacent view of the effects of crises and of countries' capacity to recover. Nevertheless, in both countries only by 1997 did per capita GDP reach the levels achieved in 1994, while average wages were still lower in 1998, with Mexico 22% lower than in 1994. Costs for the real economy and equity are large and long-lasting.

It should be noted that since the GDP increase comprised a larger recovery share, effective GDP was once again close to the production level. However, such level moved upward slowly, because productive investment was still low, while real exchange rates were once again on the rise. Consequently, as long as productive investment did not increase substantially, that rate of growth was not sustainable. In effect, at the beginning of 1998 it was estimated that the 5.3% growth of 1997 would be moderate, around 4%. With the intensification of the Asian crisis and its contagious effects on finance and trade, effective growth contracted to 2.3% in 1998 and is expected to close near below zero in 1999. Thus, the region is experiencing a new significant adjustment. The following lessons can be derived from recent experiences.

1. Level, Composition and Sustainable Uses of Capital Flows

It is important to ensure that the volume of inflows is consistent with the absorptive capacity of the host country. Absorption must, of course, refer to use in productive investment. The composition of flows has relevant incidence in three dimensions. First, FDI (excluded purchases of existing assets) goes directly to capital formation, as well as long term loans to importers of capital goods. Second, volatile flows tend to impact more directly the foreign exchange and stock markets. Third, the capital surges or deviations from the trend tend to leak toward consumption, because of the faster capacity of consumers to respond as compared to irreversible productive investment. There is growing evidence that the greater the instability of flows (or deviation from the trend), the lesser the share directed to productive investment.

Opening up the capital account indiscriminately can be very detrimental to productive development and to the welfare of the majority of people and firms, inasmuch as externalities and other imperfections of international capital markets give rise to frequent cycles of abundance and shortage of external financing (Rodrik, 1998; Wyplosz, 1998). Effective, efficient regulation is possible. Chile proved this from 1991 onwards.

The recent experience of emerging economies has shown dramatically that allowing the market, dominated by short-sighted agents, to determine the volume and composition of capital flows can have a very high cost for the recipient country. This is why the use of regulations on capital inflows should not be neglected *a priori*. On the contrary, the microeconomic costs associated with the use of such instruments should be balanced against the social benefits in terms of macroeconomic stability, investment and growth (Williamson, 1993; Zahler, 1998).

2. Avoiding Outlier Prices and Ratios

Governments must ensure that capital flows do not generate atypical (outlier) prices or significant distortions of basic macroeconomic indicators, such as interest and exchange rates, aggregate demand, the composition of expenditures in terms of consumption and investment, and the production of tradables.

Capital surges should not be used for achieving an extreme objective related to a single domestic economic variable, such as to anchor inflation, by appreciating the real exchange rate. This tends to throw other major variables off balance. It is risky to remain bound to a fixed nominal rate, and worst to fully dollarize except if the economy is in an optimum currency area with the US. Is there any country in the region that fits this description? The methods for regulating the exchange rate can be extremely diverse, several of them involve some form of a crawling-band, with some type of intra-marginal intervention.

3. Consistent Sequencing

It is generally agreed that across-the–board opening-up of the capital account has been premature and should have been postponed, moving only in a selective way, until a long term process in which other major reforms had been consolidated and new equilibrium prices had been established. The lesson to be learned from this experience is that during structural adjustment, with open capital accounts (especially when international financing is abundant) capital flows can increase too fast and have destabilizing macroeconomic and sectoral effects (Williamson, 1993; Wyplosz, 1998).

In the first place, in Latin America many countries adopted deep trade reforms in the 1990s together with increases in the exchange-rate. Second, if productive investment capacity reacts slowly and/or with a lag and domestic financial markets remain incomplete and poorly supervised, additional external resources cannot be absorbed efficiently in the domestic economy, and thus they threaten the future stability of the flows themselves. In the third place, fiscal parameters need to be consolidated, since in the absence of a sound tax base and flexible fiscal mechanisms the authorities will have to depend excessively on monetary policy to regulate aggregate demand. Finally, since part of the aggregate demand generated by capital flows is inevitably spent on non-tradable goods, when actual demand comes close to the production frontier, the relative price of non-tradables tends to rise. This in turn is reflected in a higher current-account deficit. A real revaluation of the currency can obviously distort the allocation of resources and investment, seriously weakening the structural mid-term objective of penetrating external markets with new exports (ECLAC, 1995; Ffrench-Davis, 1999, ch. III).

4. Flexible Selective Regulation

It is not wise to make an inflexible commitment to indiscriminately keeping the capital account open, particularly in light of the crucial importance of macroeconomic stability, along with the disproportionate volume of the international capital markets compared with the small size of LACs markets, and the serious shortcomings of both markets. As long as market movements depend to a significant extent on short-term transactions and domestic securities markets remain shallow, there will be a risk of great instability in this new modality of linkages with the international economy. In fact, Mexico's, Korea's and Thailand's recent critical experiences attest to the wisdom of discouraging both large financial inflows and the accumulation of short-term external liabilities.

Understanding better the working of domestic and international financial markets is at the core of the future of the world economy. More pragmatism and systematic efforts should be undertaken.

Notes

1. The presence of significant disequilibria, in a framework of repeated statements regarding the need to maintain macroeconomic equilibria, reveals either a too narrow definition or an inadequate understanding of how to achieve those equilibria in order to make them sustainable and consistent with development. See Ffrench-Davis (1999, ch. VI).

2. It should be recalled that several LACs were implementing sharp liberalization of import regimes pari passu *with exchange-rate appreciation. See Ffrench-Davis (1999, ch. III) and ECLAC (1995, ch. V).*

3. The rate of the reserve requirement, that had to be kept at the Central Bank for one full year, was reduced from 30% to 10% by the end of June 1998 and to zero in September, in order to accommodate to the new shortage of external financing *associated to the Asian crisis. Authorities, including President Frei and the President of the Central Bank, have reiterated that the policy tool is available for the next capital surge.*

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Small Countries and the New World Financial Architecture

This article reviews the developments that led to the new role global financial markets are playing today, the economic crises and their contagious effects and analyzes some of the main issues concerning the management of recent crises. It concludes by formulating a number of suggestions regarding needed reforms and the role countries of the South should play to insure their implementation. In this regard, the article points out that the relevant financial authorities must participate, perhaps through separate committees or sub-committees, in all future FTAA or Post Lome IV Agreement discussions on financial cooperation and crisis prevention and management. Moreover, it suggests that their agendas should include discussions on special treatment measures for smaller and more vulnerable countries. Such negotiations could provide an alternative forum in which to discuss the future global financial architecture.

Los países pequeños y la nueva arquitectura financiera mundial

El siguiente artículo presenta, en primer lugar, los antecedentes contextuales del nuevo papel de los mercados financieros globales, las crisis y el contagio. Luego aborda algunos de los temas principales del manejo de las crisis recientes. Finalmente formula sugerencias en torno a reformas que serían convenientes y al papel que los países del Sur deberían asumir para lograr esas reformas. Sobre este particular señala que en todas las negociaciones futuras del ALCA o del Acuerdo Post-Lomé IV, debe preverse una discusión directa entre las autoridades financieras relevantes, quizás mediante comités separados o subcomités, sobre la cooperación financiera, la prevención y el manejo de crisis; y propone que en sus agendas exista un espacio para tratar arreglos especiales en favor de los países más pequeños y más vulnerables. Plantea también que esas negociaciones pudieran ofrecer, como un útil producto derivado, un buen foro alternativo para adelantar puntos importantes acerca de la futura arquitectura financiera global.

Petits pays et nouvelle architecture financière mondiale

Cet article présente, tout d'abord, les antécédents contextuels du nouveau rôle des marchés financiers mondiaux, la crise et la contagion. Sont ensuite abordés certains thèmes portant sur la gestion des crises récentes. Finalement, des suggestions sont avancées sur les réformes qui s'imposent et le rôle que les pays du Sud devraient assumer pour les mener à bien. Sur ce point, l'auteur ajoute que, dans toute les négociations futures dans le cadre de la ZLEA ou de l'Accord post-Lomé IV, une discussion directe doit être prévue entre les autorités financières correspondantes, éventuellement en comités séparés ou en sous-comités, portant sur la coopération financière, ainsi que sur la prévention et la gestion des crises. Il est également suggéré que les ordres du jour prévoient la possibilité de concéder des arrangements spéciaux aux pays plus petits et plus vulnérables. Enfin, de telles négociations pourraient constituer, par extension, un forum idéal pour avancer certaines idées quant à la future architecture financière mondiale.

Os países pequenos e a nova arquitetura financeira mundial

O seguinte artigo apresenta, em primeiro lugar, os antecedentes contextuais do novo papel dos mercados financeiros globais, as crises e o contágio. Logo aborda alguns dos temas principais do manejo das crises recentes. Finalmente, formula sugestões em torno a reformas que seriam convenientes, e ao papel que os países do Sul deveriam assumir para lograr essas reformas. Sobre esse particular assinala, que em todas as negociações futuras do ALCA ou do Acordo Post-Lomé IV, deve-se prever uma discussão direta entre as autoridades financeiras, a prevenção e o manejo da crise, e propõe que em suas agendas exista um espaço para tratar acordos especiais em favor dos países mais pequenos, e mais vulneráveis. Manifesta ademais, que essas negociações pudessem oferecer, como um útil produto derivado, um bom foro alternativo para adiantar pontos importantes acerca da futura arquitetura financeira global.

Small Countries and the New World Financial Architecture

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Introduction

Financial instability, banking system failures, exchange rate crises and consequent real macroeconomic disruption have increasingly been seen as a major (and in many cases, new) threat to the development prospects of poor countries. Highest priority has in recent years been reassigned by international development institutions from advice on project evaluation and "development strategy" (which, in any case, often remains controversial) towards macroeconomic and financial sector policy reforms. There no longer seems much doubt that the strength, stability and effectiveness of savings-investment systems; the broad appropriateness of exchange rate policies; a reasonable degree of macroeconomic stability; and public confidence in government and the legal system are likely to be far more important to the development of the poorest countries than any amount either of external assistance or of fine-tuning of (often controversial) trade policies or other domestic economic, political or social policies.

Moreover, the potential problems created by contagion of financial distress are now seen as threatening to whole regions, and indeed well beyond. In August 1998, Latin America as a whole was suddenly shut out of global capital markets because of events in Russia. South Africa's future is highly vulnerable to current developments in Brazil. While most discussion of these issues has focused on the problems of the "emerging" and "transitional" economies, and often on their systemic implications, the analogous problems of smaller developing countries have been relatively neglected. In future discussions of the FTAA and post-Lomé IV arrangements they can no longer be avoided.

These "new" financial issues have by now assumed such regional, and even potential global, importance that any negotiation of longer-term development or trade cooperation cannot be credible without full provision for cooperation in financial crisis prevention and management within a *fully integrated* trade–financial cooperation package. It is no longer plausible for some intergovernmental agencies to address purely trade issues (sometimes even trade in financial services) in one forum while totally different ones (often considerably more powerful) "sort out" the financial issues separately in another. Nor can these "financial cooperation" issues any longer be understood, as they once were, as basically the business of the official development assistance agencies. As private capital surges and crises grow in frequency and in importance, Treasuries and Central Banks must be directly involved in negotiations of the FTAA and post-Lomé type. (In some national capitals a degree of inter-agency cooperation and information exchange on these issues is achieved; in most there is still very little. Some Treasuries and/or Central Banks have argued, for a variety of reasons, that their activities must remain independent.)

This paper will argue that in *all* future FTAA or post-Lomé IV Agreement negotiations, there *must* be provision for direct discussion among the relevant financial authorities, perhaps in separate committees or subcommittees, of financial cooperation, crisis prevention and management; and on their agendas there must be room for the provision of special arrangements for the smallest and most vulnerable countries. It will argue that these negotiations may offer, as a useful byproduct, a useful alternative forum for the pressing of important points about future global financial architecture at the same time that concrete and practical proposals for future FTAA and post-Lomé IV Agreements are negotiated. It begins with some contextual background on the new role of global financial markets, crises and contagion. It then addresses some of the major issues in recent crisis management. Finally, in Part 4, it makes suggestions as to appropriate reforms and approaches to crisis prevention and management in the context of forthcoming FTAA and post-Lomé IV negotiations. For the reader who is short of time, Part 4 contains the main recommendations. It is a short paper; there is therefore no summary or conclusion.

I. The New Role of Global Financial Markets, Crises and Contagion in the Developing Countries

The East Asian crisis has brought dramatic attention to the implications of the vastly increased flows of private international capital throughout the world, not least to many developing countries, and, in particular, their potential to generate major difficulties not only for developing countries but for global macroeconomic management. It is now widely understood that financial crises can inflict severe social and economic damage upon countries even when the governments of these crisis-stricken countries have been managing their budgets prudently and have had little prior indication of deficient macroeconomic conditions or economic mismanagement. "Contagion effects" in other countries are now recognized as potentially severe.

It is well-known that financial markets, indeed all asset markets, are qualitatively different in their functioning and behaviour from the "text-book" markets for goods and services in which policymakers all are so well schooled. Because of the importance of information in asset markets, and its imperfect and asymmetric availability, participants in financial markets respond to "signals" in sometimes herd-like and apparently perverse fashion. The available information is always subject to interpretation by these market participants and interpretations can and do alter at short notice. It follows that asset markets can settle at multiple equilibrium points in consequence of participants' alternative interpretations of available information about the future. These markets are therefore highly vulnerable to fluctuations in "animal spirits" and, as in the recent East Asian case, to self-fulfilling losses of confidence. "Bubbles" in asset prices and crises are inherent in financial markets. No amount of increased information, transparency or supervision can prevent recurrent "runs", panics and crises in stock and bond markets, property markets or currency markets. National central banks and financial supervisory agencies have been expressly created to protect the social interest in these circumstances and to seek to prevent or suppress their possible negative consequences in the real economy and society.

"Contagion across countries and markets is inevitable. No country can be totally immune."

Of course, the global economy is undergoverned in these (and many other) dimensions. It has only the bare rudiments of a central bank or the requisite financial regulatory authorities – in the IMF, BIS, IOSCO and various less formalized arrangements. Yet it is now clear that there are significant economic and financial spillovers across national borders. Contagion across countries and markets is inevitable. No country can be totally immune. The best that policymakers may be able to achieve is some reduction in the frequency of crises and greater preparation for the modification of their consequences, including their potentially contagious effects.

International economic and financial contagion takes many forms. Direct links between financial institutions are the most obvious source of financial contagion. There is a long and sorry history of sequential domino-like consequences, even for apparently sound and significant financial institutions, flowing from what initially seemed fairly minor disturbances in smaller financial institutions. When loans and investments begin to turn sour, financial institutions have fiduciary and often legal obligations to call in their loans, increase their liquidity and reserves, raise risk premia on their credits, and exercise greater restraint in their credit and investment allocations. Financial institutions frequently have faced margin calls and liquidity pressures in one country that have forced them to sell perfectly sound assets, in a quasi-distress manner, in another.

In the new world of informatics –with instantaneously teleconnected, round-the-clock financial markets and often highly leveraged international investments– and absent adequate international supervisory or lender-of-last-resort facilities, such *direct* international financial contagion can spread extraordinarily quickly. Indeed the sophistication of current derivatives markets and the degree of (still poorly understood) linkages among international financial institutions and markets appear to have reached a stage well beyond the capacities of even the strongest financial supervisory authorities fully to understand; their risk aversion in the face of such informational and analytical constraints led to the debacle of the Fed's "organized rescue" of the LTCM, a modest-sized but evidently highly leveraged and well-linked New York-based hedge fund. Many fear that current international financial markets, so technically advanced and so undersupervised, may already be *inherently* extremely fragile and highly volatile.

Perhaps a more familiar form of (international) contagion takes the form of psychological effects –the herd-like behaviour (already referred to) typical of asset markets with limited information, in which market actions themselves constitute an important informational signals upon which the less well-informed base their own activity, thereby forcing even the well-informed to take such reactions into account in their own decisions. As noted above, bubbles and "busts" are typical of asset markets. Such contagion may, at times, be based upon perceived similarities in policies, economic structures, or real links between countries and hence it may be focused on particular geographic regions, e.g. East Asia, or Latin America, or particular types of economies, or particular types of asset, e.g. real estate, or stock markets.

There are also, of course, reasons for expecting old-fashioned "real" contagion effects through the existence of direct trade and other current account or international production links and/or the prospect of intensified international competitiveness in third markets, competitive devaluations and the like. And it should go without saying that these different forms of contagion can all feed upon one another.

It is also important to note that there may also be severe *indirect* contagion effects for some small countries that appear otherwise totally unlinked to foreign financial markets or indeed only weakly linked to the world economy at all, and that appear to be managing their own economies prudently and promoting development effectively. Financial crises, wherever they occur, unfortunately, but inevitably, breed negative real effects with some "general equilibrium" consequences –on real investment, trade flows, commodity prices, etc.– even when their own financial markets do not seem to be much affected. Most African and Caribbean countries suffered more from the effects of the Asian crisis on their primary export prices than they did from direct effects through financial markets.

"*Most African and Caribbean countries suffered more from the effects of the Asian crisis on their primary export prices than they did from direct effects through financial markets.*"

Sometimes forgotten, however, in the continuing debate over the causes and implications of the East Asian financial crises are the ramifications of the new international financial scene for a large number of smaller, amd often already highly vulnerable (to other exogenous shocks), developing countries in other parts of the world. It is not widely known that many of these countries have *already* experienced surges of capital flows, both inward and outward, of dimensions (relative to the size of their own economies) *just* as great as those recently experienced in East Asia. Because of their small absolute size and their more limited implications for the global economy, such events in smaller countries receive much less press. The problems created, for them, by volatile private international capital flow are just as great, however, and arguably even greater, in smaller, potentially more volatile, less flexible and "less consequential" countries as (than) they are in countries with "deeper" financial markets and the potential to generate systemic consequences. The changing character of international finance; new experience of the herd-like behaviour of international financial flows and international contagion; and new sensitivity to the potential severity of their negative consequences all make it imperative to open focused discussion on mechanisms that could be deployed to prevent unnecessary damage from surges in private international capital flows to the smaller, more vulnerable and more fragile countries.

II. Issues in Crisis Management

At least four major issues have figured prominently in the management of the East Asian crisis, are likely to arise in future crises, and should be among those for which there should be explicit forward planning in future FTAA or post-Lomé IV agreements.

1. The distribution of the burden of adjustment as between residents of the crisis-affected countries and external creditors

> "*If the crisis was at least as much a matter of short-term liquidity difficulties and panic as of economic mismanagement or structural flaws, the timely provision of significant further external credit could easily have overcome the need for draconian adjustment measures.*"

Crisis response has typically taken the form of the immediate application of austerity measures to the borrowers and, more generally, the residents of the crisis-stricken countries. This involves real adjustment downward in economic activity –real GNP, employment and investment. In the case of the five most-affected East Asian countries, a turnaround in the current account balance of roughly 11% of GDP was accomplished between 1996 and 1997– involving an enormous real (downward) adjustment.

If, as most observers now believe, the crisis was at least as much a matter of short-term liquidity difficulties and panic as of economic mismanagement or structural flaws, the timely provision of significant further external credit could easily have overcome the need for such draconian adjustment measures. Rather than permitting external private creditors to "take off", by failing to roll their short-term credits over, the financial "system" should have encouraged them, or even forced them, to maintain their previous exposures. Just as a bank should close its doors temporarily during a liquidity crisis, to prevent further runs on the bank, external creditors should be prevented from leaving precipitately thereby creating an unnecessary economic collapse. Instead of bailing them out, international financial institutions should have bailed these private creditors "in" by demanding, as a condition for their assistance, that private creditors impose a standstill on their exposure and restructure their short-term credits over a longer term. (In some circumstances, the official "rescuers" might reasonably demand *expanded* private credits –more equitable burden-sharing– as a condition of official assistance.) The official response to such crises should involve the early "pushing" of *both* sides to the credit relationship, the creditors as well as the debtors, rather than only imposing tough measures upon the latter. If it is truly a liquidity crisis, the creditors will suffer no long-term harm from such official pressures, which are simply overcoming a collective action problem.

If the problem really is one of solvency, in which there will be a problem in future debtor payments, the sooner that the creditors "take a hit" and begin the initiation of a debt workout, the better. In these circumstances, official action will again be needed to stop the creditors from each running for a "piece of the action" immediately. Official coordination and compulsion will be needed for orderly debt workout in cases of insolvency as well as of liquidity crisis.

Such a balanced approach to the distribution of the real adjustment burden implies that the IMF and other official institutions involved in the response to a financial crisis will be encouraging a moratorium on external payments at a fairly early stage and will be lending into arrears. There is a precedent, of course, in the 1980s debt crisis for IMF lending into commercial arrears. Article VIII of the IMF specifically authorizes the restriction of normal debt servicing in support of stabilization objectives. Early and significant official measures to ensure equity and balance in the burden of adjustment to crisis can reduce both the real costs at present borne by crisis-stricken countries and the real costs of financial crises to the relevent region, other countries and to the entire global system. There is no reason why the FTAA and post-Lomé IV agreements should not seek explicitly to put formal force behind such improved arrangements (see below).

2. Appropriate domestic macroeconomic policy and, in particular, the distribution of the burden of domestic adjustment in the crisis-stricken country

Whatever the degree of real restraint that is still required, after better balance between external creditors and the debtor country is achieved, there remain important domestic policy choices in the debtor country. A key objective should always be the protection of the most vulnerable to domestic macroeconomic restraint –the poorest and those most affected by cutbacks. Pursuit of this objective is likely to involve either a reordering of the government budget, or increased tax revenues to finance the necessary expenditures, or a degree of fiscal loosening.

More broadly, there is the matter of the appropriate fiscal–monetary policy mix, given the required degree of macroeconomic policy restraint. Current IMF and "orthodox" approaches emphasize the role of monetary restraint and sharp increases in interest rates to restore confidence in the currency. Sharp interest rate increases failed, however, to restore confidence in the recent East Asian experience. Rather, they seemed to be taken by investors as a signal of the extreme seriousness of underlying problems. Confidence was certainly *not* furthered by declarations by the IMF and others that the problems of the affected countries were deep and structural rather than of a short-term (liquidity) nature. Interest rate increases, of course, generate enormous negative side effects in the form of increased bankruptcies and reduced asset values, whatever their signalling effects upon operators in currency markets. So, of course, do plummeting currency values. Reasonable people may differ as to the details of the appropriate monetary and fiscal policy response to crisis; but there is little doubt that the monetary measures taken in the recent East Asian crises failed in their primary intent.

Other policy measures, associated with IMF conditionality, were and are also at issue:

- **Inappropriate issue linkage.** External sources of support should not intrude into policy spheres unrelated to the financial crisis, as they have done in Korea and Indonesia. Longer-term development policy relating to the role of the State, governance questions, competition policy, openness to foreign direct investment, and trade protectionism should not be conditions attached to external finance intended to address financial crisis situations, particularly when they appear to stem from temporary (liquidity) problems.
- **Timing of reforms.** Major structural reforms should, in any case, not be introduced at the height of a financial crisis. Widespread bank closures, with only limited provision for depositor protection, constitute, at such a time, a major further blow to confidence. Most fundamental reforms take considerable time and should be introduced with due caution. Certainly, the worst time for the introduction of structural reforms in the financial sector is in the midst of a financial crisis.
- **Capital account policies.** Since most now assign some responsibility for the crisis to premature financial liberalization and, in particular, liberalization of the external capital account, the conditioning of finance upon the *further* liberalization of the capital account was surely inappropriate. At the very least, it was extremely controversial! Most would describe it as foolhardy.

There exists a strong case for developing liquidity and crisis management systems that are based upon institutions more attuned to the realities of the particular countries in need of assistance. These could be based upon regional familiarity, similarities in economic circumstances (e.g. size or economic structure), linguistic links, or other legitimate likely bases for informed and objective peer review. The degree of overseas and distant (in every sense) concentration of power and influence over financial crisis management has arguably become counter productive and, in any case, politically unsustainable.

3. Size and nature of external financial support

It is clear from the Mexican, East Asian, Russian and Brazilian experiences that the size of the external financial inputs required for the resolution of financial crises in some developing countries may be very large. It is far from obvious that the IMF will have anywhere near the resources to supply the necessary amounts in the future. In all of these recent experiences, it was necessary for it to find a variety of other complementary sources of official finance.

No less important, however, is the manner in which such finance is to be supplied. In order to address a liquidity crisis it is necessary to insert liquidity, i.e. finance that is available at very short notice, in large amounts, and virtually unconditionally. Finance that is supplied only on the basis of negotiated conditions and which is released only on the basis of compliance with them, through successive tranches, may be very helpful in the resolution of the crisis. In some circumstances, it may be sufficient. But it is *not* liquidity. Future liquidity crises should be met with liquidity responses, and all countries should be treated equally in this respect. It is striking that the amounts quickly supplied to Mexico during its crisis far exceeded the amounts only slowly being made available to the East Asian countries and Russia in response to their crises. Only a fraction of the financial package put together for East Asia has so far been disbursed. There have been no special relaxations of previously agreed quota-based limits on assistance for small countries.

4. National treatment for foreign financial firms

In times of financial crisis, there is likely to be a flight to large foreign financial institutions within the crisis-affected countries, whatever other directions the flight may take. In these circumstances, the "national treatment" required under the terms of the financial services agreement within the WTO may be quite inappropriate. It may be sensible and should be legitimate for the national authorities to devote particular attention to the problems of domestic financial institutions which are usually smaller and less internationalized than those that are foreign-owned. While there is some recognition of this potential problem in the WTO agreement on financial services, it is somewhat ambiguous in its formulation and will have to be tested through particular cases. It is important to prepare for such cases in advance. It will be important to seek (appropriate, i.e. cautious) clarification on this issue in any new North–South agreement that purportedly seeks to go "beyond the WTO". Similar *caveats* obviously apply to other attempts to go "beyond" existing WTO or other standards, e.g. in respect of foreign investment (see below).

III. Crisis Prevention and Damage Control: Issues in FTAA and Post-Lomé IV Negotiations

In developed market economies, steps have been taken to reduce the frequency and size of financial crises, and to limit the damage they are likely to cause. Appropriate institutions have been created –central banks, banking and financial supervisors, deposit insurance, etc.– and rules, incentive systems and resources have been deployed in their support. Yet the increasingly globalized international economy does not yet have much of a comparable character. Nor do regional or subregional groupings. Surely more can be done while the world continues to grope its way to a more effective system of global economic governance. Let me highlight some of the issues that arise in this connection, and could receive attention in forthcoming less-than-global negotiations.

1. Discouragement of short-term private capital flows and appropriate agreements on capital account regimes

In the aftermath of the East Asian crisis there has been greatly increased interest in the problem of volatile short-term private capital flows. Most discussion now revolves around the question of *how* to reduce surges in short-term capital flow rather than, as before, *whether* to. The current debate about the appropriate international capital account regimes for countries at different stages of financial development is a healthy one.

It is important that the developing countries quickly develop a coherent response to the OECD push for universal across-the-board capital account liberalization –a push which is found within the IMF, as it discusses its new purposes and jurisdiction in the capital account; in the WTO, as it completes its negotiations on financial services and discusses the initiation of discussions on foreign direct investment; and in the OECD, as it continues its work on a multilateral agreement on investment. Developing countries have yet to put together their own consistent and coherent approaches to capital account issues, and they need to do so as a matter of urgency. For the present, their emphasis, in the IMF and elsewhere, on caution and order in capital account liberalization is entirely appropriate; but there must be more active (as opposed to purely defensive) attention devoted expressly to these issues (and to the turf struggles between the IMF, BIS, WTO and "MAI" that surround them). Why should they not present their own proposals?

A common popular misperception about the problem of financial surges, crises and the uses of capital controls is that they all have to do with capital outflows. In fact, the most difficult issues for developing country macroeconomic managers promoting stability relate to the volatility of private capital flows *in both directions* –both inward and outward. Those developing countries that have most successfully addressed the macroeconomic management problems created by volatile capital flows are those that have most cautiously "managed" private capital *inflows* –typically with a judicious mix of real currency appreciation, fiscal retrenchment and direct or indirect resort to capital controls, notably taxes or controls over capital imports. Fundamental to such success is therefore *full retention of national autonomy in the management of the capital account*, including transactions which may be formally categorized as "foreign direct investment". Herein obviously lies an area of potential fundamental policy conflict between financial interests in the Northern countries and the interests of macroeconomic policymakers in the South. It will be critically important *not* to leave negotiations on trade in financial services or foreign direct investment exclusively in the hands of trade and/or investment agencies, most of whom have little appreciation of the potential macroeconomic management implications of their potential trade or investment agreements.

"The most difficult issues for developiong country macroeconomic managers promoting stability relate to the volatility of private capital flows in both directions."

Developing country negotiators should be particularly wary of agreements that appear to relate primarily to foreign direct investment but then define "investment" so broadly as to encompass portfolio flows and other forms of foreign-owned capital, as in the aborted Multilateral Agreement on Investment in the OECD. Foreign direct investment can be highly volatile too (as the East Asians quickly learned, to their cost, in their recent crisis). It can readily be translated into liquid capital, e.g. by borrowing from domestic institutions on the security of foreign-owned physical capital, for the purpose of achieving rapid capital outflow when crises strike. Foreign direct investment should therefore be subject to the same general rules as other forms of (portfolio) investment with regard to rights to repatriation.

To repeat, it is *not* simply the (liberal) trade components of the proposed large-scale integrated North–South economic cooperation agreements that will influence the long-term development of the poorer countries, though they may continue to receive the bulk of popular attention. Capital surges –in either direction– are not necessarily associated with trade liberalization; but their developmental consequences can be enormous, even catastrophic. It follows that arguably the *key* provisions of these agreements will be those relating to the rights and obligations of private savers and investors; the soundness of the institutions for their support; and the stability of macroeconomic conditions, not least, appropriate and stable real exchange rates. These provisions will have to incorporate full autonomy for local policymakers to manage their capital accounts and their domestic financial systems in the interest of their own macroeconomic stability and development.

Any FTAA or post-Lomé IV agreement that is to be useful to the developing countries facing the new world of international financial market turbulence should therefore include flexible provisions to permit the deployment of capital account measures to discourage short-term inflows and outflows of private capital. They should reflect extreme caution about premature cross-the-board liberalization of member countries' international financial flows. They should make provision, in carefully defined circumstances, for the favouring of domestic banking and other financial institutions over foreign-owned ones in the resolution of financial crises.

Moreover, there is no reason why any such agreements should not write in some specifics as to a required increase in the two-way exchange of information and technical cooperation among central banks and regulatory/supervisory agencies in the financial sector. The degree of direct bilateral cooperation among G-10 or BIS central bankers is much greater than that between any central bankers in the North and their counterparts in the South. Why cannot Northern financial authorities who have been both so demanding and so cooperative with their Southern counterparts in the sphere of money laundering not be equally cooperative and even active in the monitoring and control of short-term capital flows?

2. The financing of external crisis responses

It is clear that the resources of the IMF are quite inadequate to provide sufficient liquidity to address future financial crises of the East Asian kind. The IMF Managing Director has appealed for a significant increase in IMF quotas, but to little effect, and the restrictions placed by the US Congress on its renewed "support" for the IMF threaten the very integrity of this ostensibly "multilateral" institution. In consequence, individual IMF members cannot at present assume the availability of financial support in amounts remotely approaching those required to address their problems during periods of liquidity (or other) crisis.

Strictly speaking, under Article VI (of the IMF Articles of Agreement), the Fund is forbidden to supply resources "to meet a large or sustained outflow of capital". In recent years, however, Fund lawyers have been able to interpret this flexibly so as to permit IMF support in such circumstances and indeed to supply it to some members in amounts considerably greater than those that appear to be authorized under the current formulae for access to IMF resources. So far, these exceptional arrangements have been deployed in circumstances where, as in Mexico, Korea or Russia, the difficulties being addressed are considered to constitute a systemic threat. The IMF's General Arrangements to Borrow (GAB) and their New Arrangements to Borrow (NAB) are authorized, however, only in support of activities which threaten the stability of the overall system; and their activation requires (uniquely) the agreement of the lending countries rather than simply, as one would think it should in a fully multilateral body, that of the entire IMF membership. There is as yet no agreed mechanism for the provision of equivalent support (equivalent in relative dimensions) for smaller countries whose difficulties are unlikely to constitute a threat to the international monetary and financial system. There is therefore a very strong case for the creation, on an urgent basis, of arrangements to supply such support if or when it may be required.

"There is little prospect that smaller and poorer developing countries can acquire sufficient reserves or access to sufficient credit lines to protect them adequately against future financial crises."

There is little prospect that smaller and poorer developing countries can acquire sufficient reserves or access to sufficient credit lines to protect them adequately against future financial crises of the kind that other emerging market economies have been experiencing (or indeed of more traditional kinds). Under current IMF rules and procedures, there are no mechanisms for the provision of sufficiently large emergency credits to enable such countries to overcome comparable liquidity (or other) crisis. The IMF could, of course, develop its role in these countries less as a direct financier than as a "leader" and "signaller" for other sources of finance, notably central banks, private banks and, conceivably, even the BIS.

New forms of regional cooperation, such as were mooted in response to the East Asian crisis but (myopically) discouraged by the US and the IMF, are another obvious new route to pursue. The FTAA and the post-Lomé IV Agreement arrangements could provide mechanisms for the support of *all* members, including those in which crises are unlikely to constitute threats to the global or even regional systems, in circumstances of contagion-induced or otherwise exogenously caused financial crisis. Such arrangements could take the form of special "stabilization funds" or agreements for direct central bank cooperation through swap arrangements or similar devices, to be activated in circumstances that are fully agreed in advance. Such supports could and should offer contingent support well in excess of that provided under the current terms of IMF financing arrangements. The inclusion of such agreements within the FTAA and post-Lomé IV Agreements would help national governmental promises to maintain liberalized external financial arrangements, whether in the current or the capital account, to carry real credibility. Again, if central banks can work so closely in cooperation against money laundering, it is difficult to see why they cannot act similarly in other spheres. These possibilities and the case for them are pursued further in the sections tht follow.

3. Regulation, supervision, transparency – and finance

Both within the developing countries and at the international level, the search is on for new and tightened rules and stronger institutions functioning more effectively in the provision of information, supervision and, where appropriate, regulation. These efforts should be encouraged at the regional level, within the Commonwealth and Francophonie, and wherever common language, institutions or experience make them especially likely to be productive. There is every reason for cooperation and technical assistance in this sphere to be an integral part of any post-Lomé IV or FTAA agreement. While such provisions are to be encouraged their translation into improved practices will take some time. Standards must therefore not be established so inflexibly as to throttle financial development. There are, in any case, limits to the degree to which they can prevent further financial crises.

From this it follows that more needs to be said about the regulation/finance tradeoff in the context of the smaller countries, within a future "integrated" FTAA or post-Lomé IV Agreement. In the larger debates over the future of the international financial architecture the relative weight to be assigned to (i) improved information, supervision and regulation as against (ii) the greatly increased provision of finance when required, is a central element. The sheer magnitude of the amounts that would now be required effectively to influence global markets for most currencies in times of crisis and continued political unwillingness to contemplate a true lender of last resort have left reform advocates with little option but simply to press for improved supervision by national authorities, buttressed by norms established by the BIS, IOSCO or some new World Financial Authority; with, of course, some continuing debate over the efficacy of some forms of controls and/or taxes on capital flows. But, in the case of smaller and poorer countries the relative weight to be assigned to these two basically different policy instruments is not the same as in the conventional argument.

The expertise and experience for the effective supervision of domestic financial systems is considerable. Even financial "booms" of (absolutely) modest dimensions can easily overwhelm (small) local supervisory authorities in small countries that are typically already hard-pressed to meet their normal responsibilities. External technical assistance may be called upon for some relief but it is likely to be slow to respond, inexperienced in the local environment, and, in any case, far from top priority among decisionmakers in supplier countries during periods of overall financial turbulence when they may be most needed.

On the other hand, the emergency liquidity (or restraining influence) required to address the potential problem of surges in private capital flows out of (or into) small poor countries is rarely likely to be absolutely large in size –even in circumstances of considerable small-country crisis coincidence or contagion (although, of course, potentially far greater than currently permissible drawing rights in the IMF). For small poor countries, while obviously continuing to do everything possible to construct sound and well-regulated domestic financial systems, there are therefore sound arguments and real possibilities for building strong financial/liquidity defences for them within subglobal agreements. To do so will help to build confidence in these countries' emerging domestic financial systems. The prospect of moral hazard, either for borrowing countries or for lenders, while not non-existent, should, as always, be guarded against wherever possible; but it can, certainly in its possible absolute size, be taken as of second-order importance. How exactly such extra liquidity can be provided offers many possibilities, including, for instance:

- A small country liquidity fund or facility operated by a regional monetary fund, a single large national monetary authority, the BIS or the IMF;
- a similar small country fast-disbursing fund administered by a regional development bank, a single aid donor, or the World Bank;
- more informal and even *ad hoc* agreements among monetary authorities, arranged either on a bilateral or multilateral basis.

4. The roles of the IMF and World Bank

As argued above, effective response to financial crises in the future will require larger and earlier insertions of liquidity. The IMF may continue to lead in its provision but it is not now equipped to be its sole supplier. Moreover, it is the World Bank and potentially the Regional Development Banks, *not* the IMF, that should play the major role in structural reforms in the financial sector, and in addressing the profound social consequences of financial crises, particularly mismanaged ones. The IMF, the World Bank and the relevant regional development banks and/or new regional or subregional monetary associations must work cooperatively. During the Asian crisis, significant policy disagreements have arisen between IMF and Bank advisors. This is not inherently undesirable or surprising. What *is* undesirable is the effort to suppress such professional disagreements in the interest of the creation of a consistent "Washington" position; and to suppress and downplay legitimate alternative professional analyses emanating from within the crisis-affected region. Both on the basis of likely *comparative advantage*, the principle of *subsidiarity* in the allocation of governance functions, and *political sustainability and credibility*, there is a strong case for greater *decentralization* of financial power and influence –a significant reduction in the roles of the IMF and Bank in development and crisis response in smaller and poorer developing countries. (A parallel case can be made for a significant reduction in the roles of purely Northern credit rating agencies and other financial institutions in the private sector as well.).

What the recent experience further clearly underlines is that the IMF (and the international community) still suffers from the fact that the IMF has no independent evaluation and assessment unit. The recent IMF experiment with external assessment of its ESAF programme, which uncovered significant differences of view as between the IMF staff and the external assessors, illustrates the potential importance and value of such independent assessments. A recently-released report by Jacques Polak and others, done for the Washington-based Center of Concern, also makes a persuasive case for increased IMF transparency and independent evaluations of IMF activities. If the IMF is unable itself to introduce these critical elements of good internal governance, it is even *more* important that *alternative sources of professional analysis* be consciously constructed in the emerging international financial architecture, e.g. at the regional or subregional level, or conceivably for the worldwide "small country" constituency.

IV. Final Thoughts

The FTAA and post-Lomé IV Agreement negotiations provide an important potential forum for the presentation of developing country views on (i) future financial architecture, outside the (considerable) constraints of the IMF/Bank meetings, and (ii) the need to integrate the financial discussions with those of trade issues.

Such integrated approaches will be opposed by the US and the EU, or at least by their Central Banks and Treasuries. Some Southern Central Banks, Treasuries (and even Trade Ministries) may also fear loss of turf and oppose such integration. But eventually it must and it will come. Wouldn't it be good to initiate proposals for it in the South? push its unassailable logic hard? and seek to influence the current IMF/Bank and financial architecture debates on this quite different stage? (while simultaneously conducting parallel activity in the run-up to the UN Conference on Financing for Development and, on an ongoing basis, within the UNCTAD)?

Vulnerability, the Other Side of Economic Liberalization

The recent financial crisis has demonstrated that the economic adjustment policies implemented by Latin American and Caribbean countries have not succeeded in countering the devastating effects of external shocks. As this article points out, the 1997-1998 crisis, with but a few exceptions, affected solely developing economies and the most advanced and successful ones at that, those that had distinguished themselves for having implemented policies aimed at improving their insertion in the world economy. Some countries of the region, such as Chile and Peru, suffered from the fall in their exports to some of their more important markets, such as the Asian countries. However, the decrease in the Asian aggregate demand also affected other countries that did not depend on those markets due to its repercussion on the price of primary products.

Vulnerabilidad, la otra cara de la apertura económica

Si algo demostró la reciente crisis financiera es que las políticas de ajuste económico puestas en práctica por los países de América Latina y el Caribe no han sido suficientes para contrarestar los efectos «devastadores» de los choques externos. Tal como indica este artículo, la crisis de 1997-1998, con muy pocas excepciones, impactó solamente a las economías en desarrollo, y entre estas, a las más avanzadas y exitosas, a las que más se habían distinguido en la ejecución de políticas para lograr una mejor inserción en la economía mundial. Algunos países de la región, como Chile y Perú, fueron afectados directamente por la caída en las ventas de sus productos hacia mercados importantes para sus economías, como los asiáticos. Pero otros que no dependían directamente de esos mercados también fueron alcanzados por la contracción de la demanda agregada asiática sobre el precio de productos básicos.

La vulnérabilité: la face cachée de l'ouverture économique

Ce que la récente crise financière aura mis en avant est bien le fait que les ajustements économiques mis en œuvre par les pays de l'Amérique latine et des Caraïbes n'auront pas suffi pour contrecarrer les effets « dévastateurs » des chocs externes. Comme l'explique cet article, à quelques rares exceptions près, la crise de 1997-98 n'a frappé que les économies en développement, et notamment les plus avancées et efficaces, celles qui s'étaient distinguées dans leurs politiques d'insertion dans l'économie mondiale. Certains pays de la région, comme le Chili et le Pérou, ont été directement affectés par la chute des ventes de leurs produits sur des marchés vitaux pour leur économie, tels les marchés asiatiques. Mais d'autres pays, qui ne dépendaient pas directement de ces marchés, ont été également atteints par les effets de la contraction de la demande globale en Asie sur les prix des produits de base.

Vulnerabilidade, a outra cara da abertura econômica

Se alguma coisa demonstrou a recente crise financeira é que as políticas de ajuste econômico colocadas em prática pelos países da América Latina e o Caribe, não tem sido suficientes para contrarrestar os efeitos "desvastadores" dos choques externos. Tal como indica este artigo, a crise de 1997-1998, com muito poucas excepções, impactou somente às economias em desenvolvimento, e entre estas, às mais avanzadas e exitosas, às que mais haviam-se distinguido na execusão de políticas para lograr uma melhor inserção na economia mundial. Alguns países da região como o Chile e o Peru, foram afetados diretamente pela queda nas vendas de seus produtos aos mercados importantes para suas economias, como os asiáticos. Mais, outros que não dependiam diretamente desses mercados, também foram alcançados pela contração da demanda acrescentada asiática, sobre o preço de produtos básicos.

ANALYSIS

Vulnerability, the Other Side of Economic Liberalization

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Introduction

Referring recently to the financial crisis that began with the devaluation of the Thai currency (baht) in June 1997 and soon became a crisis of the emerging economies, UNCTAD's Secretary General, Ambassador Rubens Ricupero, listed some of its traits. First, the 1997-1998 financial crisis affected, with but very few exceptions, only developing economies and, among them, the most advanced and successful ones, precisely those economies that had deliberately adopted policies aimed at improving their countries' insertion into the world economy. To some extent, the more industrialized economies profited from the fall in the prices of raw materials and manufactured goods. According to International Monetary Fund's estimates, in 1998 all industrialized countries, with the exception of Japan, registered a positive growth rate, between 1.4% (Italy) and 3.9% (USA), compared with the previous year. On the other hand, the newly industrialized countries (NICs) of Asia registered a negative growth rate of -1.5% and a group of four countries (the Philippines, Indonesia, Malasia and Thailand) of – 9.4%.[1]

> "*The financial crisis demonstrated that a good international insertion and a solid economy are nor enough to withstand the devastating effects of external shocks.*"

In reality, as ECLAC has pointed out, the financial crisis demonstrated that a good international insertion and a solid economy are nor enough to withstand the devastating effects of external shocks.[2] What is more, the ensuing financial instability revealed that at the other side of opening up the economy is its potential vulnerability.[3] The upheavals some countries experienced in their economy soon spread to other countries and regions through trade, monetary and financial channels.

In this paper we will analyze the trade channels through which the crisis spread. The spectacular contraction, beginning in the second half of 1997, of previously fast growing East Asian economies strongly affected several markets for goods and services due to those economies' high level of integration to world trade and to the structural characteristics of international transactions in goods. During recent years, all regions of the world had increased their percentage of exports to Asia. Given their significant and growing demand for imports, financed by the inflow of private capitals, the dynamic Asian economies became not only important competitive suppliers of a vast array of products but also, and increasingly, an engine for the world economy.[4] Therefore, those economies' recession directly affected some Latin American countries, such as Chile and Peru, for whom the Asian markets had became an important market for their exports. Moreover, other economies that did not depend directly on those markets were affected by the direct impact the contraction of the Asian countries'aggregate demand had on the price of raw materials.

"The present weakening of world economic growth is the fourth global recession in the last twenty five years."

I. Structural Changes in the International Economy

The strong impact of the financial crisis, its extent and scope, surprised even international financial organizations. Also, the vastness of the crisis underlined the systemic risks globalization entails. Systemic financial crises encompass a number of elements, agents, markets and interactions which make it difficult to adequately predict their intensity, vastness and duration, thus impeding timely market intervention. Moreover, market agents' expectations play a fundamental role in the creation, duration and expansion of the crisis. Under such circumstances, the intervention by financial organizations which should spearhead the assistance efforts for countries experiencing a crisis may, in itself, end up aggravating the situation.

As the International Monetary Fund (IMF) has pointed out, the current decade has been characterized by a high level of instability. The present weakening of world economic growth is the fourth global recession in the last twenty five years.Two global crises occurred during the nineties, causing the world product to grow, on average, at a modest and progressively lower rate during the final three decades of the century. It is estimated that the world product's average growth rate for the current decade will be of 3.1%, below the 3.4% and 4.4% rates achieved during the 1980's and 1970's.[5] Even so, it was basically the newly industrialized countries that contributed to this rate as the industrialized economies only grew by 2.1% during the nineties and 2.3% during the eighties, while developing countries' growth rate for those decades were of 5.4% and 4.2% respectively.[6]

Among the industrialized countries only the USA has registered a fully satisfactory growth rate during the nineties, in spite of the recession it experienced during the first years of the decade. The United States' uninterrupted economic growth since March 1991, with the lowest unemployment rate in the last 28 years and price stability, represents a milestone in that country's economic history. In fact, the US economy has benefitted from the Asian crisis' downward pressure on the price of raw materials –among them oil– and manufactured goods, which considerably lessened inflationary pressures.

On the other side of the spectrum we have the Japanese economy which during the 1990's has registered a mere 1% growth rate, in spite of the significant recovery of 1996, as opposed to the 4% achieved during the eighties. The slow down in Japan's economy, together with the recession other Asian countries were experiencing, caused a contraction in the demand for a great number of raw materials, including oil.

On the other hand, during the current decade, the European Union countries'growth rate remained below 2%, compared to the 2.4% achieved during the 1980's. Nevertheless, their growth rate was not affected by the contraction in the Asian demand due to the role trade plays in the growth of those countries' economic activity.

The economy's low average growth rate was accompanied by a high increase in international transactions, which indicates a closer interdependence between nations and markets. According to the IMF, the average growth rate of world trade has been estimated at 6.1% for the nineties and 4.7% for the eighties, that is, between two and three times the world product's growth rate, even though in 1998 and 1999 trade grew at a slower rate. During both decades, the expansion rate of developing countries' manufacturing exports was two times greater than the aggregate average.[7]

The industrialized countries' low average growth during the nineties did not impede an increase in trade for some developing countries. This demonstrates that the link between both groups of countries has weakened somewhat and that transactions between Asian and Latin American developing countries are playing a greater role.

It should be pointed out that according to Paul Krugman the structure of trade is characterized by what he defines as "a breaking down of the value chain" and other authors as "shared production". In this process, enterprises can divide production among different stages of value adding, which take place in different areas and cause economies based on production activities to be interdependent. According to Krugman (1995), until 1993, that is during the first globalization wave, each consumer good was exported only once. Today, the same good can be accounted for several times in statistical data since it may be produced in one country with inputs from other countries which, in turn, are assembled with sub products from still other countries. Trade statistics cannot clearly distinguish between all these operations[8].

II. The Effects in Latin America

"The modernization process that has taken place in Latin American countries has not succeeded in noticeable changing the region's exports."

In December 1998, taking into account the effects on demand of the adjustment policies in Brazil and Chile; the fall in the prices of the region's exports, particularly oil and cereals; the effects of El Niño in Ecuador, El Salvador and Peru and of hurricane Mitch in Central America (particularly Honduras and Nicaragua), ECLAC revised its previous estimates and calculated that Latin America would grow by close to 2.3%.[9]

In 1998 Latin American and Caribbean exports faced an unfavorable international context that had began to evolve during the second semester of 1997 as a result of the Asian financial crisis. This unfavorable international situation affected the region through three channels: the radical drop in short term international capital flows and the increase in the cost of external financing; sharp falls in the prices of raw materials and the slowing down of world trade's growth rate. The fall in prices was only partially offset by a relative increase in export volumes and, according to ECLAC estimates, the value of the region's exports compared to the previous year decreased for the first time in 12 years.

Ever since the eighties, Latin American governments have been adopting fiscal and monetary austerity measures to control the macroeconomic unbalances caused by the debt crisis. Also, they have implemented policies aimed at opening up and deregulating internal markets, as well as privatization programs, all in an attempt to restructure the system of incentives for the private sector, improve market functioning and contribute to increasing their enterprises' international competitiveness. ECLAC has pointed out in a number of documents that such measures are necessary but insufficient to stimulate the region's sustained economic growth. What is needed is for countries to improve their participation in trade's more dynamic flows, as well as their access to technology, foreign direct investment and long term financing.

The modernization process that has taken place in Latin American countries has not succeeded in noticeably changing the region's exports. On the contrary, the unilateral opening up of the region's economies has strengthened exports based on abundant raw materials and cheap labor.

Most of the region's economies depend on a few products or a few markets (or both) for their export revenues. With the exception of Mexico, all countries export mainly raw materials, while more advanced economies diversify their exports by producing more elaborate industrial goods derived, nonetheless, from those same raw materials. Mexico has succeeded in diversifying its exports by producing higher technology manufactured goods and it has based its export strategy on radically increasing the United States' participation in its trade and investments.

As mentioned above, the spectacular contraction in the Asian demand for goods affected the price of both, mineral and agricultural raw materials. Moreover, oil and copper prices continued their downward tendency. Oil prices fell until the beginning of 1999 and copper prices until June 1999. Latin American countries' great dependency on a still limited number of commodities increases considerably their export sectors' vulnerability vis-à-vis a fall in those exports'prices.

In order for countries to counterbalance the fall in prices with an increase in export volumes, demand must increase. Nevertheless, as mentioned above, before the Asian crisis world exports depended for growth on the economic expansion of the USA, East Asia and, to a lesser extent, Latin America's demand. The economic adjustment programs adopted in Asia and in some countries of the region have caused a sharp fall in those countries'demand, thus leaving the USA as the major factor determining the expansion or contraction of global demand.

Only a few Latin American countries export to Asia in any significant volume. Chile and Peru, which had succeeded in diversifying their export markets by targeting Asian countries, were the countries most affected by the fall in the Asian demand. The Asian markets' participation in Chile's exports had increased gradually from 26% in 1990 to 35% in 1995, retaining the same rate in 1997. These markets also received 19% of Peru's exports in 1990, 27% in 1995 and close to 15% in 1997. In reality, within the region as a whole, the Asian markets' average participation decreased from more than 10% in 1990 to a little over 8% in 1997, due mainly to a reduction in their oil imports from Venezuela and a decrease in Brazil's exports (see Table 1).

However, the fall in the price of raw materials is what caused the strongest impact on the region. Even though the decrease

Table 1
Asia's Participation in Latin American and Caribbean Trade 1990-1997

Country Informant	Imports				Exports			
	1990	1995	1996	1997	1990	1995	1996	1997
Argentina	11.6	12.3	12.0	13.1	10.0	10.2	11.0	10.8
Barbados	10.1	11.9	10.3	12.8	0.4	1.4	0.9	1.1
Bolivia	11.7	16.0	15.9	15.4	0.8	0.8	0.7	0.8
Brazil	10.6	13.9	14.6	15.2	16.7	17.1	16.3	14.5
Chile	13.7	18.0	17.1	17.1	26.3	34.8	34.6	35.0
Colombia	10.3	13.6	10.2	11.9	4.6	5.8	4.3	4.3
Costa Rica	12.0	7.1	7.8	...	2.5	3.5	3.2	3.4
Ecuador	12.9	13.9	10.0	10.8	5.7	10.9	11.9	10.8
El Salvador	5.1	8.9	7.8	6.5	1.2	2.1	1.3	1.2
Guatemala	9.7	7.6	6.7	6.9	4.4	7.6	2.6	2.9
Honduras	10.4	5.7	6.5	5.0	6.8	7.4	4.1	4.3
Jamaica	8.2	10.8	8.7	...	1.0	2.5	2.5	...
México	7.6	10.2	9.5	10.1	6.7	2.5	2.9	2.3
Nicaragua	11.6	9.1	10.8	6.8	9.1	2.6	0.6	0.9
Panama	9.8	10.3	10.8	12.0	0.9	1.4	1.6	1.6
Paraguay	30.2	30.3	20.3	19.6	3.8	7.5	2.5	3.5
Perú	9.5	16.9	15.0	15.0	19.1	26.9	26.1	24.5
Santa Lucía	9.7	9.5	10.3	...	0.0	0.2	0.2	...
Trinidad and Tabago	8.6	9.2	9.5	7.9	1.4	0.6	0.4	0.2
Uruguay	6.7	8.9	8.6	10.0	7.3	11.6	11.2	9.8
Venezuela	6.9	8.4	6.9	7.2	4.3	1.9	0.9	0.7
Latin American and the Caribbean	**9.8**	**12.4**	**11.6**	**12.1**	**10.5**	**9.7**	**8.9**	**8.2**

Source: ECLAC, based on official data.

in the price of exports did not cause a decrease in export volumes and, therefore, did not affect real product, measured in constant prices, it did cause a deterioration of the terms of trade, decreasing the real revenues of the region as a whole. Nevertheless, oil exporting countries were the ones to suffer the most from the deterioration of the terms of trade. For the other raw materials exporting countries the decrease in their export prices was relatively offset by a decrease in the price of oil. Therefore, their terms of trade deteriorated but moderately.

Ever since the beginning of the financial crisis, raw materials prices, with the exception of a reduced number of products, have decreased considerably.

In 1998, the average price of oil fell by 32%, the sharpest fall since 1986, while raw materials'index prices, with the exception of oil, fell by 16%, the sharpest fall since 1975. In Latin America, Venezuela has been the country most severely affected by the decrease in oil prices. Its oil revenues contracted by 30%, causing the 1997 current account surplus equal to 6.8% of GDP to become a 1.6% deficit. Ecuador is slightly less dependent on oil exports (close to 30% of the value of total exports) and Mexico much less so (less than 10%). Nevertheless, the fall in oil prices contributed to a deterioration of their external and fiscal accounts. Other countries, such as Chile and Peru, also had problems with their balance of trade, due to the fall in copper prices.[10]

"Ever since the beginning of the financial crisis, raw materials prices, with the exception of a reduced number of products, have decreased considerably."

Ever since the nineties, the consumption of primary goods in most Asian countries grew at a higher rate than in the rest of the world. For example, between 1992 and 1996, developing Asian countries'consumption accounted for close to 66% of the increase in the use of oil.[11] These countries also play an important role in the international demand for some basic metals and agricultural products (grain, oil and grease). An analysis of the markets for raw materials indicates that the crisis has had a direct impact on the demand for aluminum, tin, zinc, lead, refined copper, nickel, natural rubber, cotton, wool and furs. However, it affected to a less extent the prices of wood, steel, meet, corn and soy products. Oil consumption fell by 3% in Japan and 15% in the Republic of Korea, while that of other raw materials such as copper and aluminum decreased by two digits in both countries as well as in other Asian importing countries, due to a scaling down in their infrastructure investment plans.

Other factors also affected prices. During the last two years the production of some agricultural goods increased considerably: the production of grains, in particular, grew 9.5%, while consumption only increased 5.5%. During the same period, the production of vegetable oils increased almost 9%, reaching a peak in 1997-1998. Sugar production also grew to 7.2% in 1997, while the demand increased only 4.5% during that same year.[12]

According to IMF econometric studies on the relation between national production and the prices of raw materials, the 1997-1998 decrease in the economic activity of Asian countries affected by the crisis and Japan accounts for most of the fall in the price of raw materials, including oil, during those same years. Nevertheless, those prices are also subject to historical factors which reflect the gradual growth in global stocks and a less vigorous increase in demand, which, in turn, reflect the low growth rate of more advanced economies, a change in productive activities toward less natural resources intensive activities and the technological changes that allow enterprises to operate more efficiently.

"Generally, raw materials prices should continue to remain low during 1999, as there should be no important changes in the factors that have determinated their fall during the last years."

Generally, raw materials prices should continue to remain low during 1999, as there should be no important changes in the factors that have determined their fall during the last years. Raw materials prices should rebound after 1999, albeit slowly and depending on the health of the economy. Even with the expected end of the Asian recession in 1999 and the recovery of Japan's economy, historical factors should continue to curb raw materials prices.

III. Final Considerations

During the current decade, Latin America's external trade has been characterized by a net increase of imports compared to exports. This has caused a constant build up of trade and current account deficits. Imports have played an important role in the region's industrial restructuring since imported products and capital goods allowed those countries to technologically update their industrial base. Trade liberalization and the new system of incentives and regulations spurred the restructuring of the industrial sector, particularly in countries' production specialization and a greater use of imported goods in local production, they also affected many industrial sectors whose local enterprises were unable to compete with similar imported goods.

In general, the sharp fall in raw materials prices, together with an increase in the offer and a contraction in the demand, evidenced the vulnerability of Latin American countries' exports. During the last decade, several countries of the region made considerable efforts to diversify their exports, both in terms of products and markets. Nevertheless, as studies demonstrate, only few succeeded in doing so. Countries such as Bolivia, Ecuador, Paraguay and Venezuela continue to be highly vulnerable in their trade, given that their exports are concentrated in just a few products and markets.

However, ironically, the financial crisis affected particularly Latin America's more open, integrated and diversified economies. The economies that are more dependent on the US market were less affected due to those countries' "shared production" with US enterprises through maquila operations and to the growth of the US economy. In 1998 and mid 1999 some Central American and Caribbean economies registered high growth rates. In 1998, the Mexican economy grew by close to 5%, in spite of the fall in oil prices.

"Ironically, the financial crisis affected particularly Latin America's more open, integrated and diversified economies."

The United States is an important market for the region's products, even though in varying degrees depending on the country. The USA receives more than 80% of Mexico's exports, while only 10% of Argentina's. Nevertheless, the leading role the US has played in the expansion of world trade and the unlikelihood that other industrialized countries may replace it in this role, in the medium term, are a cause of great concern since should a sudden decrease in its economic growth occur, it would have far reaching effects on Latin America's and Asia's economic recovery.

Notes

*1. IMF, 1999, **World Economic Outlook**, May, International Monetary Fund, Washington, D.C., Table 1.1., p.2.*

*2. ECLAC, 1999, **Panorama de la Inserción de América Latina y el Caribe**, 1998 Edition (LC/G.2038-P), Santiago, March. United Nations publication, sales No.: S.99.II.G.3, p.27.*

*3. United Nations, 1998, **World Economic and Social Report** (E/1998/50/ST/ESA/261), New York, United Nations publication, sales No.: S.98.II.C.1.*

*4. UNCTAD, 1998, **Trade and Development Report**, 1998, vol.1 (UNCTAD/TDR1998 (vol.1), Geneva, August 7, p.32.*

*5. IMF, 1999, **World Economic Outlook**, May, International Monetary Fund, Washington, D.C., p.27.*

6. IMF, 1999, table 2, p.140.

7. IMF, 1999, tables 22-24, pp.167-170.

*8. Krugman, 1995, **Growing World Trade:Causes and Consequences**, Brookings Papers on Economic Activity, no.1, p.334.*

*9. ECLAC, 1998, **Balance Preliminar de las Economias de America Latina y el Caribe, 1998**, (LC/*

G.2051-P), Santiago, December. United Nations publication, sales No.: S.98.II.G.15, p.2.

10. *IMF, 1999, p.57.*

11. *Between 1992 and 1996 the oil consumption of the Republic of Korea, together with that of other Asian less developed countries (Philippines, Indonesia, Malaysia and Thailand) as a percentage of total world consumption increased from 5% to 6.5% (IMF,1999,* **Economic and Financial Reports. World Economic Outlook***, Washington, D.C., p.125).*

12. *World Bank, 1998,* **Commodity Markets and the Developing Countries***, World Bank Business Quarterly, Washington, D.C., August.*

The "Samba" Effect in MERCOSUR

The crisis that affected Brazil's economy from the end of 1998 to the beginning of 1999 placed MERCOSUR in the most difficult situation since its creation in 1991. According to the author, the developments that took place in the region and their aftermath demonstrate in specific examples the prevailing theoretical wisdom regarding the extreme importance of insuring consistent macroeconomic policies and economic and financial stability in the countries parties to an integration agreement. Nevertheless, we can learn from past experience new ways to face with "greater wisdom" the next stages of MERCOSUR.

El efecto "samba" en el MERCOSUR

La crisis que sufrió la economía brasileña entre finales de 1998 y principios de 1999 colocó al MERCOSUR en la situación más difícil desde su nacimiento en 1991. Los acontecimientos vividos en esa región y los que se han desarrollado posteriormente son, de acuerdo a la autora de este artículo, ejemplos concretos de las afirmaciones teóricas previas en relación a la importancia extrema que revisten la consistencia de las políticas macroeconómicas y su ejecución, y la estabilidad económico-financiera en los países vinculados por un acuerdo de integración. Sin embargo, la experiencia vivida permite formular algunas reflexiones que permitirán enfrentar con "mayor sabiduría" las próximas etapas del MERCOSUR.

L'effet "samba" sur le Mercosur

La crise qui s'est abattue sur l'économie brésilienne entre la fin de 1998 et le début de 1999 a placé le Mercosur dans la situation la plus difficile depuis sa création en 1991. Au dire de l'auteure de cet article, les événements survenus alors dans la région, et ceux qui ont suivi, illustrent concrètement les affirmations théoriques déjà formulées quant à l'énorme importance, pour des pays liés par un accord d'intégration, de concevoir et d'appliquer les politiques macroéconomiques de manière cohérente et d'atteindre la stabilité économique financière. Toutefois, il est possible de tirer de cette expérience certaines réflexions qui permettront d'attaquer les prochaines étapes du Mercosur avec plus de "sagesse".

O efeito "samba" no MERCOSUL

A crise que sofreu a economia brasileira entre o final do ano 1998 e princípios de 1999, colocou o MERCOSUL na situação mais difícil desde seu nascimento em 1991. Os acontecimentos vividos nessa região e os que tem-se desenvolvido posteriormente, são de acordo à autora deste artigo, exemplos concretos das afirmações teóricas prévias em relação à importância extrema que revistem a consistência das políticas macroeconômicas e sua execução, e a estabilidade economico-financeira nos países vinculados por um acordo de integração. Não obstante, a experiência vivida permite formular algumas reflexões que permitirão enfrentar com "maior sabiduria" as próximas etapas do MERCOSUL.

The "Samba" Effect in MERCOSUR

➾ **Eva Holz**
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ANALYSIS

Introduction

At the end of 1998 the Government of President Fernando Enrique Cardoso adopted a number of deficit reduction measures to which markets reacted with little enthusiasm, having expected stronger action. Shortly after that, during the first days of January 1999, and due to the Federal Government's decision to reduce its allocations to states as a way of forcing them into balancing their accounts, the Governor of the State of Minas Gerais, Itamar Franco, announced his intention to request a 90 days moratorium on all of that state's payments.

Governor Itamar Franco's decision caused major waves in the financial world, unleashing capital flights. On January 13, the government expanded the real exchange rate band and two days later (January 15), Brazil's Central Bank withdrew from the foreign exchange market.

By March 5, the real had devalued by 85%, the prices of several products had increased, shortages began to appear, there was talk of freezing oil prices and negotiations began for salary adjustments. President Cardozo's governments adopted a number of specific measures, some of which had previously been submitted to Congress for approval, among them the following were aimed at reducing the deficit: the provisional increase of the "checks tax"(Financial Movements Provisional Contribution Tax); the increase in federal employees' social security payments and the establishment of contributions for public sector's retirees.

At the same time, Brazil negotiated a new agreement with the International Monetary Fund which envisioned, among other measures, a 15% annual inflation rate and the reduction of the fiscal deficit though the elimination of several export subsidies.

President Cardoso announced, as well, that the central government would work with the State of Minas Gerais to deal with its foreign debt problem and agreed to meet with other governors dissatisfied with the central government's decision to decrease state allocations.

I. Brazil's Modification of its Foreign Exchange System: What Does it Mean?

The devaluation of its currency, which is a natural result of Brazil's modification of its foreign exchange system, did not solve that country's critical economic and financial situation. It was merely an acknowledgement by the government of the failure of its deficit reduction plan which was aimed, ultimately, at correcting macroeconomic unbalances. Faced with a radical fall in its foreign exchange reserves, which had been falling steadily ever since the Russian crisis, Brazil's Central Bank decreed the free floating of the real. The loss of reserves –which already mirrored the market's lack of confidence– became critical with the State of Minas Gerais'debt moratorium announcement. Such declaration brought to the light the political problems President Cardoso's Government faced –and still faces– to adopt the deficit reduction adjustment measures agreed upon with the IMF. Thus, the perception arose within the market that Brazil's possibilities to correct its major macroeconomic difficulties were extremely uncertain.

"The real's devaluation was merely an acknowledgement by the government of the failure of its deficit reduction plan which was aimed, ultimately, at correcting macroeconomic unbalances."

Brazil's economic difficulties are the result of severe fiscal unbalances and of a lax monetary policy. Neither can be modified by just altering the foreign exchange system.

In the old foreign exchange system, the foreign exchange market adjusted through the fluctuation (loss) of Brazil's Central Bank reserves. In the new system the market adjusts through fluctuations in the foreign exchange rates, rather than through variations in the level of international reserves. Thus, the magnitude of the devaluation will depend on the extent of the fiscal adjustment undertaken and on the government's credibility among investors, since a lack of confidence also contributes to higher foreign exchange rates.

It is yet too early to predict the short tem outcome of Brazil's economic and fiscal stabilization policies. Once again, such outcome will depend not just on the implementation of a stable set of economic policies, but also on the political system's acceptance of the stabilization policies that will be needed.

II. Repercussions Within the Region

Brazil's current difficulties are transferred to its neighbors through two channels. The first is trade, as evidenced by the changes that have already taken place in Brazil's exports and imports in goods and services to and from neighboring countries. The second is capital movements, to and from Brazil, within the balance of payments.

1. Foreign Trade

Exports to Brazil, particularly from neighboring countries, decreased or slowed down during the first months of 1999.

For example, almost one third of Argentina's total annual exports of automobiles, family consumer goods, foodstuffs, agricultural and animal products such as oil, cereals, fuel, lubricant oil, etc., are to Brazil. Because of the changing value of Brazil's currency, which makes it hard for Brazilian importers to estimate their total cost, most ongoing trade operations were suspended. At a later stage, exports decreased due to the fact that they were not able to compete in price with local products and to a fall in Brazil's internal demand caused by the difficult situation experienced by consumers.

Similarly, third countries' producers found it difficult to compete with Brazilian goods. Thus trade with neighboring countries was also affected by an increase in imports from Brazil, which hurt those local products unable to compete with Brazil's lower prices.

"Trade with neighboring countries was also affected by an increase in imports from Brazil."

Both developments resulted in a decrease in the region's demand for goods and services, which caused a fall in production and prices, thus unleashing a recession.

2. Capital Flows

Capital flows were affected to the extent that investors perceived the region's situation as critical, since this caused a decrease of resources in the capital market.

At the microeconomic level, this negative perception derived from expected decreases in the demand for goods and services and, at the macroeconomic level, from the probable decrease in fiscal revenues which would make it difficult for the region's governments to balance their budgets and honor their commitments. To this we could add the uncertainty regarding the stability of foreign exchange systems and the devaluation tendency within MERCOSUR countries, particularly Argentina.

3. Governments' Answer

The region's countries' immediate reaction to Brazil's devaluation was to defend their foreign exchange systems , assuring that they would not be modified. Such assurances were meant to assuage the concerns expressed by each country's economic agents and by international organizations and investors.

In the case or Argentina the government's defense of the peso's conversion plan went so far as considering the possibility of totally transforming the economy into a dollar economy. This defensive position, clearly expressed by Argentina's authorities, timidly considered by some private sector experts in Uruguay and Paraguay and forcefully rejected by Brazil's technocrats, was adopted in order to dispel all doubts regarding the future of each country's foreign exchange policy since any uncertainty would affect the confidence of internal and external economic agents.

"The productive sectors of the region's countries feel that the measures adopted are not sufficient to offset their products' loss of competitiveness."

Together with their decision to maintain their foreign exchange systems, and in order to improve the competitiveness of their country's products, the governments of the region have cut down their annual expenditures and investment plans (as in the case of Uruguay); sped up the progressive reduction of employers' contributions to retirement funds in several productive sectors (Argentina) and, in general, adopted a more prudent and restrained public expenditures policy for 1999.

They have also implemented some financial mechanisms, such as the one adopted for Uruguay's export sector and for the purchase of low priced vehicles in Argentina.

This type of measures are aimed primarily at insuring economic stability and, secondarily, at improving the competitiveness of locally produced goods and services. By curbing public expenditures, the potential expansion of the fiscal deficit, which could cause a contraction of the economy and therefore a reduction in tax revenues, is avoided. These policies also strengthen indirectly the balance of payments'capital flows since macroeconomic stability is fundamental to insure investors'confidence. Moreover, they have not generated a debate nor caused upheavals within the countries that have adopted them.

4. The Productive Agents

Nevertheless, the productive sectors of the region's countries feel that the measures adopted are not sufficient to offset their products' loss of competitiveness. Most of their demands and complaints to their governments are in this regard. Moreover, the type of microeconomic measures and the policies they are claiming for to protect local production from Brazil's more competitive goods and services are casting an ominous shadow on the future of MERCOSUR.

Also, some sectors within the region's governments, worried about the future of local producers, are supporting this type of requests.

A survey of some of the complaints and demands voiced by industrial and productive sectors within the region illustrates the extreme concern of the population for the current situation. Moreover, these demands are being voiced in spite of the fact that some of MERCOSUR countries'public and private sectors have met on several occasions with Brazilian authorities to analyze the situation of their productive sectors and to formally and informally exchange suggestions on the measures to be adopted .

One of the most common demands that is being voiced is that governments should request Brazil to review its exports incentives policy and its reimbursement of sales taxes on products aimed at MERCOSUR. At the same time, pressure is mounting within each country of the region to limit border trade by stopping the massive flow of Brazil's goods through their borders. Argentina and, partially, Uruguay have already began to adopt this type of measure.

Also, pressure is mounting in Argentina and Uruguay to review the implementation of escape clauses or other types of WTO approved mechanisms that may stop the massive flow of Brazilian goods into neighboring countries. Those sectors that have been most affected by the change in the competitiveness of the region's products are clamoring for the adoption of non tariff, individual, ad-hoc trade barriers. The unfortunately very real possibility of companies'shut downs and unemployment will rapidly build support for this type of measures.

Other demands that are being voiced refer to the adoption of several types of subsidies for those sectors most heavily affected by Brazil's measures. All such requests are in clear violation of WTO rules.

Brazil's media, on the other hand, has 'counter attacked' by pointing to the systematic increase in the balance of trade deficit within MERCOSUR between 1992 and 1997. They point to the well documented increase of Argentina's exports to Brazil (from US$1.67 to US$7.7 billion), admitting, though, that Brazil's exports to Argentina have a greater aggregate value than that country's exports to Brazil.

Within this context, the future of MERCOSUR is often questioned in Brazil and Argentina in light of the dramatic changes that have taken place in Brazil and their impact on the region. Finally, on a more constructive note, both the Argentinean and Uruguayan governments have pointed out that they will double

"The future of MERCOSUR is often questioned in Brazil and Argentina in light of the dramatic changes that have taken place in Brazil and their Impact on the region."

their efforts and collaborate with their private sectors to increase their exports to new markets outside MERCOSUR.

III. MERCOSUR's Near Future

1. In General Terms

There is no doubt that MERCOSUR is experiencing its worst crisis since its creation. The mechanisms that will be used to correct the impact of the new price relations between its members will be fundamental for the future of this integration agreement.

With a GDP of approximately $500 thousand million, Brazil has considerable influence over MERCOSUR's trade. Argentina's production equals 43% of that of Brazil and Uruguay's and Paraguay's joint outputs are barely 5% of Brazil's output. Because of this, Brazil's macroeconomic stability is of fundamental relevance to the region. It affects regional trade –which increases considerably when there is stability–, as has been the case since the adoption of the Real Plan. This, together with a price level relatively higher than that of its trade partners led to a sustained increase in the region's trade, to the detriment of Brazil's balance of trade deficit, which also registered a surge.

In 1993, Brazil 's trade registered a $13. 3 billion surplus, while in 1998 the trade deficit reached over $6 billion. During that same period, Uruguay's and Argentina's exports to Brazil increased 150% and 188% respectively (including goods that are hard to place in other markets and are covered by special export regimes within MERCOSUR).

As these numbers indicate, it is difficult to ascertain to what extent is the trade increase within the region due to the Real Plan, MERCOSUR's trade preferences or a combination of both. The first due to the over valuation of Brazil's currency and the ensuing increase in its products' prices. The second due to the different treatment granted products depending on whether they are from within or outside MERCOSUR. Brazil's crisis has considerably altered the first such component.

The higher prices of Brazil's products, which curtailed their access to the other countries of the region and stimulated imports within Brazil, have suffered a reversal. Today, the prices of Brazilian goods represent a competitive advantage compared to those of other countries. This has created an unexpected and complex situation for the future of MERCOSUR. As mentioned above, much will depend on the type of mechanisms that are adopted to lessen or offset the impact caused by the abrupt change in relative prices within MERCOSUR.

As highlighted by the press, the future of MERCOSUR's integration appears somber and, at the very least, uncertain in all countries of the region. The reason for this is twofold. In the first place, it is very difficult and even not convenient to continue with an integration process that encompasses countries with very different macroeconomic policies, especially when one of them –whose economy represents more than half the total product of MERCOSUR members countries– is experiencing great instability and a macroeconomic crisis. In the second place, there is the possibility that in order to protect some sectors, some or several of the countries members of the Asunción Treaty may decide to adopt mechanisms or non tariff barriers that are not compatible with MECOSUR or WTO regulations.

"The adoption of adequate macroeconomic policies in coordination with the other countries members of MERCOSUR is the pillar that will insure the continuation of this integration agreement."

As for Brazil's macroeconomic policies and the stabilization of its economic and financial situation, it appears that the policies adopted so far are headed in the right direction. There is no doubt that the adoption of adequate macroeconomic policies in coordination with the other countries members of MERCOSUR is the pillar that will insure the continuation of this integration agreement. Discipline on the part of all countries is a key element. Any adjustment such as the one that took place in Brazil offsets the transition mechanisms that have been carefully planned for the more sensitive sectors in all four of MERCOSUR member countries.

On the other hand, regarding the possible unilateral adoption by some MERCOSUR members of policies that may contradict this agreement's rules, it is significant and highly positive that, to date, none have done so. On the contrary, pressure is mounting in Brazil to adopt MERCOSUR and WTO approved measures and to allow other MERCOSUR countries to do the same.

Finally, we can state that the measures adopted by the other MERCOSUR countries denote maturity and ponderation and are consistent with the special needs of economies that are involved in an integration process. Such measures reveal MERCOSUR's member countries' committment to the Agreement.

2. In Specific Terms.

We will review here several measures that Brazil could adopt to lessen the impact of its policies on the other MERCOSUR countries and which are compatible with this organization's rules.

Should the other MERCOSUR countries' imports from Brazil increase significantly and should there be a consensus regarding the need to mitigate such situation, one of the first things that could be done is to adopt some measures in accordance with MERCOSUR and WTO regulations.

MERCOSUR, however, has not envisioned any type of defense mechanism to counterbalance situations such as the one Brazil and the region are experiencing today. Thus, given the lack of specific regulations within MERCOSUR, the alternative would be to turn to WTO approved safeguard measures. It is doubtful, however, that such mechanisms may be applied to MERCOSUR members since in a case such as this that agreement's rules should prevail. On the other hand, the strict application of safeguard measures requires the implementation of a number of regulations and since this could take some time, the damage be worse.

Another legitimate possibility, which could turn out to be more effective, practical and swift, would be to obtain Brazil's consent to the temporary application of a defense mechanism against the enormous flow of Brazil's goods into the markets of its MERCOSUR partners. For example, a tariff could be levied equal to a fraction of the real's devaluation. Even though this measure would address only part of the difficulties faced by the other MERCOSUR countries, and only on a temporal basis, it would, at least, pre empty the need for other legitimate measures that could have a destructive impact on relations between MERCOSUR countries.

Be that as it may, recently Brazil began to consider some of the complaints from its MERCOSUR partners. In this regard, it decided to eliminate its subsidies to Brazilian exporters –in response to Argentina's claim– and to make its exports financing system more flexible- in response to Uruguay's request. The Brazilian government has also announced that it will study the effects of further export tax returns and that it will implement an automatic licensing system –licenses will be granted within 24 hours- for the importation of goods, thus eliminating non tariff barriers on imports from other MERCOSUR countries. Finally, the Brazilian government has proposed the establishment of a technical commission to follow up on trade flows and to evaluate the effects on the different countries of the different measures that may be adopted.

IV. Final Considerations

1. Following the successive Asian, Russian and Brazilian crisis the first reflection that comes to mind refers to the cost-benefit relation of integration and the globalization of financial markets. Are the benefits enough to justify the harsh costs and risks societies are facing? In our opinion, the liberalization of the flow of goods, services and capitals results in an increase in trade –and thus in product– and greater efficiency in the global allocation of resources and capitals, which contributes to the well being and better quality of life of societies living within the framework of integration. As regards integration and financial globalization, we must keep in mind that a freer access to available external savings is what has enabled, at least partially, many Asian and Latin American countries to build a modern industry and a dynamic economy, while acknowledging the dangers of relying on very short term capital.

These positive aspects are still apparent today, in spite of a greater awareness of the risks and costs they entail and which we must learn to understand fully in order to avoid them or at least lessen them.

2. One common trait of the Asian, Russian and Brazilian crises –which were caused in part by different factors– is that they began and deepened because of a lack of consistency in macroeconomic policy over a period of time, enduring unsustainable structural deficits coupled with a significant and often short term external debt and other similar mechanisms aimed at financing the deficit without correcting its causes. When markets' confidence regarding the sustainability of economic policies falters, a crisis erupts.

This demonstrates that in order for integration processes to be viable, the macroeconomic polices of all the countries members of such an arrangement must be aimed at insuring a sustainable deficit, debt and growth level in each of them. Moreover, within a framework of free circulation of capitals and financial globalization, the consistency and coherence of each country's macroeconomic policies is one of the fundamental pillars needed to insure the confidence of international markets and free access to international investment and credit.

3. The situation we are currently experiencing within MERCOSUR points once again to the need to closely coordinate the definition and implementation of the macroeconomic variables that affect all countries members of an integration agreement. Monetary, foreign exchange, inflation policies; the situation and evolution of the balance of payments; the close monitoring of

“*The situation we are currently experiencing within MERCOSUR points once again to the need to closely coordinate the definition and implementation of the macroeconomic variables that affect all countries members of an integration agreement.*”

these and other major economic variables, are some of the issues that concern each and every country. Thus, all stages of macroeconomic policies, from their initial definition to the follow up of their evolution, must be closely monitored in a joint and coordinated manner by all the governments, in the understanding that an unbalance in any of the economy's major variables within any of their countries will affect the others with ever increasing strength, and all the more if progress has been made in the free circulation of goods and services within the region. The sudden adjustment of one country's foreign exchange policy causes an unforeseen and misarranged fluctuation in the relative prices of the other MERCOSUR members' goods and services. A variation in any other major economic variable would cause a similar effect. For example, in a free circulation of services type of arrangement, one country's unemployment will be balanced by the migration of labor to another country within the integration agreement that enjoys a better relative employment situation, thus the latter country's unemployment level will increase as the first country's unemployment level decreases.

4. In order to prevent distortions in the macroeconomic policies of the region, countries must intensify their coordination and commit themselves to the implementation and follow up of such policies. Each country is responsible not only for the good management of its country's economic variables but also for insuring that such policies do not hamper the development of the economies of the other countries members of the integration agreement. Continued access to and the flow of international credit and investments throughout the region also depends on this.

5. Moreover, in the coordination that may develop between the countries of MERCOSUR to prevent distortions and difficulties in the implementation of economic policies by any of its members, the following variables must be taken into account internally:

–The information, both regarding the public and the private sector, exchanged between countries must increase, as it influences the implementation and coordination of policies and contributes to a better functioning of financial markets. Transparency must also increase. Information must be exchanged particularly regarding each country's international reserves, foreign debt –particularly short term debt– and capital flows. Better quality and more fluid information regarding economic policies and the evolution of economic and financial indicators allow countries to evaluate risks with greater accuracy, thus it is extremely important that countries coordinate their actions. At the same time, better quality information affects the adoption of more precise and adequate economic policies since it facilitates their analysis and discussion by the other countries members of the integration agreement.

–International accounting, auditing , insolvency regime standards must be applied with greater discipline. These standards will contribute to the development of healthier trade practices and will allow for a better differentiation of debtors by financial markets. We must remember that the strengthening of each MERCOSUR country's internal systems is aimed, in part, at attracting international credit markets which, as investors and lenders, will closely monitor all improvements and modifications that may take place within this group of emerging countries. On the other hand, the intensification of these standards will allow for better understanding of the policies each country adopts and, thus, more credibility.

–The strengthening of internal financial systems –including monitoring mechanisms– is indispensable to offset the weaknesses of the respective systems. On the one hand, it is necessary to contribute to the development of an adequate banking system, with good liquidity and management of exchange rate risk, by developing effective internal monitoring systems that may balance risks and profitability. This also requires a free and transparent flow of information, adequate regulations and prudent supervision, direct inspections or auditing and swift action should any institution's position be weakened or inadequate measures be adopted. The strengthening of the system of payments and of legal systems regulating the execution of contracts and situations of insolvency is also required. Likewise, it is important to be informed on the activities of institutional investors, particularly their operations involving very high leverage financing, and on their exposure. Internal financial systems are important because of their close effect on macroeconomic variables and because any difficulty they may experience may affect the other countries of the region and even the rest of the world through systems of payment and inter bank credits and deposits.

Note

The information, data and declarations included in this article are based on articles published in La Gazeta Mercantil (Brazil) and Ambito Financiero (Argentina) and in the weekly publication Búsqueda (Uruguay) during the period from January 8 to March 4, 1999.

Korea and Latin America: End of a Honeymoon?
After Japan, Korea is the East Asian country that has made the greatest trade and investment efforts to cement its relations with Latin America and the Caribbean during the current decade. Between 1990 and 1998, attracted by the trade liberalization and integration policies implemented by countries of the region and spurred by its need to expand its investments beyond its geographical area, Korea invested more than $2,000 million in Latin America and the Caribbean. However, the 1997 crisis, which in Asia affected Korea the last, put an end to its plans to become a strong presence in our region. What motivated Korea's recent and aggressive forays into Latin America's economies? How does the financial crisis affect Korea's economic relations with Latin America? What strategies can be adopted in the future regarding relations between Korea and our region, given that both are being affected by a decrease in international funds? These are the questions this article explores.

¿El fin de la luna de miel entre Corea y Latinoamérica?
Después de Japón, Corea ha sido el país del este asiático que más esfuerzos ha hecho, en términos comerciales y de inversión, para consolidar sus relaciones con América Latina y el Caribe en la presente década. Entre 1990 y 1998 Corea invirtió poco más de 2.000 millones de dólares en nuestra región, atraído por las políticas de apertura comerciales e integración puestas en práctica, y por su necesidad de buscar zonas estratégicas de inversión distintas a las de su propia geografía. Pero el estallido de la crisis del 97 acabó con sus planes de crear una «fortaleza» coreana en latinoamérica. ¿Qué motivó la reciente y agresiva penetración coreana a los mercados latinoamericanos?. ¿Qué significa la crisis financiera de Corea para sus relaciones económicas con América Latina?. ¿Qué tipo de estrategias se tienen como opciones para sus relaciones en el futuro próximo, en vista de que ambas partes están viviendo la etapa de depresión financiera internacional?. Estas y otras interrogantes son objeto de análisis del presente artículo.

Corée et Amérique latine: la fin de la lune de miel?
Après le Japon, la Corée est le pays d'Asie qui a, dans cette décennie, déployé le plus d'efforts, en termes de commerce et d'investissements, pour consolider ses relations avec l'Amérique latine et les Caraïbes. Ainsi, entre 1990 et 1998, ce pays a investi un peu plus de deux milliards de dollars dans la région, attiré par les politiques d'ouverture commerciale et d'intégration mises en œuvre. Ces mouvements répondaient aussi au besoin de la Corée de trouver des zones stratégiques d'investissement en-dehors de sa propre région géographique. Toutefois, la crise de 1997 a mis un terme aux prétentions coréennes de créer une « forteresse » en Amérique latine. Qu'est-ce qui a motivé le récent mouvement agressif de pénétration des marchés latino-américains par la Corée ? Quelles sont les implications de la crise financière coréenne pour ses relations économiques avec l'Amérique latine ? Dans le court terme, quelles stratégies de relations avec la région reste-t-il à ce pays, étant donné que les deux parties vivent encore les effets de la dépression financière internationale ? Autant de questions que cet article tente d'élucider.

O fim da lua de mel entre a Coréia e América Latina?
Depois do Japão, Coréia tem sido o país do leste asiático que mais esforços tem realizado, em termos comerciais e de investimento, para consolidar suas relações com a América Latina e o Caribe na presente década. Entre 1990 e 1998 a Coréia investiu pouco mais de 2000 milhões de dólares na nossa região, atraído pelas políticas de abertura comerciais e integração postas em prática, e por sua necessidade de procurar zonas estratégicas de inversão, distintas às de sua própria geografia. Mas o estalido da crise do 97 acabou com seus planos de criar uma "fortaleza" coreana na América Latina. Que motivou a recente e agressiva penetração coreana aos mercados latino-americanos? Que significa a crise financeira da Coréia para suas relações econômicas com a América Latina? Que tipo de estratégias tem-se como opções para suas relações no futuro próximo, devido a que ambas partes estão vivendo a etapa de depresão financeira internacional? Essas e outras perguntas são objeto de analise do presente artigo.

Korea and Latin America: End of a Honeymoon?

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Introduction

The Asia-Pacific became a new important horizon for trade after Latin America began to liberalize its economy in the late 1980s. High-growth Asia-Pacific nations, as export markets and capital sources, could contribute to the Latin American goal of diversifying international economic relations away from an excessive dependence on the United States. and Europe. In this sense, the hard-to-define term "Asia-Pacific" has been used to mean Pacific-shore Asia or East and Southeast Asia, although it generally include North America, Pacific South America, and Oceania.

Japan has been Latin America's undisputed Asian trade and investment partner owing to its economic importance in the post-war world. Korea (South Korea), Taiwan, Singapore and Hong Kong, the so-called Asian Newly Industrializing Economies (NIEs) with their fast economic growth, have joined the category. China and other Southeast Asian nations including Thailand, Indonesia, and Malaysia, have recently also become important partners for Latin America and the Caribbean. During the 1990's Korea has been the most prominent runner-up to Japan in consolidating economic relations with the region in terms of trade and investment. Not only statistically, but also institutionally, Korean relations with the region have been strengthened.

However, the 1997 Asian financial crisis, to which Korea became the last country to succumb, devastated its momentum in establishing a stronghold in Latin America. The crisis paralyzed Korean conglomerates or *chaebols*, with their large debts, and forced them to reduce the debts by stopping operations and liquidating assets. Government relations also suffered a stalemate, lacking official attention from top decision-makers, during the period of restructuring and economic reform which has taken place under the close scrutiny of the International Monetary

Fund (IMF) and the U.S. Stronger relations with Latin America have also suffered a setback as a result of the international financial crisis finally affecting Latin America's emerging markets, and finally by Brazil's economic recession. Meanwhile, in a seemingly paradoxical development, Korea pursues free trade with Chile, the first negotiation of this kind between an Asian and Latin American country.

The purpose of this paper is to explore the recent developments in Korean-Latin American economic relations and their future prospects: What motivated the recent aggressive Korean penetration into Latin American markets? What does the Korean financial crisis mean for Korean-Latin American economic relations? What kind of strategies are there as options for their relations in the near future, given that both are undergoing the bust part of the international financial cycle?

I. Korea's Presence in Latin America in the 1990s

By the second half of the 1980s, Korean-Latin American relations were dominated by the "three traditional pillars": anti-communist ideology, international emigration, and limited commercial relations.[1] Korea's international political concerns had been based on anti-North Korea policies and relations with its four influential neighbors: the Soviet Union (Russia), China, Japan and the U.S. At the international economic level, Korea had been concerned with relations with its major trading partners, the U.S. and Japan. Hence, Korea's relations with Latin America were very limited. They followed the general trend of Asian-Latin American relations in that both region's economies were quite protective of their industries and competed with each other.

In the mid-1980s, Korea began to become substantially involved in Latin America and the Caribbean for both international and domestic reasons: the 1984 U.S. preferential trade policy for Central and Caribbean countries in 1986; the Korean current-account surplus, and the subsequent liberalization of overseas direct investment.[2] Taking advantage of the Reagan Administration's Caribbean Basin Initiative (CBI), Korean exporters invested in Central American and Caribbean countries as springboards into the U.S. market. Even the early 1990s investments in Mexico were made in the *maquiladora* (in-bond) industries as another way to enter the U.S. market; they were not targeted at the local market even though the Mexican economy was booming.

It was in the 1990s that Korea's economic relations with Latin

Table 1
Korea's Trade with Latin America
(Unit: US$ million, %)

	Exports			Imports			Total trade			Balance
	Total (A)	To Latin America (B)	(B/A)	Total (C)	From Latin America (D)	(D/C)	(A+C)	(B+D)	(B+D)/(A+C)	(B+D)
1964	119	0.3(-)	0.3	404	1.5 (-)	0.4	523	2.3 (-)	0.4	-1.2
1965	175	0.4 (33.3)	0.2	463	2.2 (46.7)	0.5	638	2.4 (4.3)	0.4	-1.8
1966	250	0.9(125.0)	0.4	716	4.2 (90.9)	0.6	966	4.9(104.2)	0.5	-3.3
1967	320	0.8(-11.1)	0.3	996	4.2 (0)	0.4	1.316	4.8 (-2.0)	0.4	-3.4
1968	445	1.5 (87.5)	0.3	1,463	3.5(-16.7)	0.2	1.908	5.0 (4.2)	0.3	-2.0
1969	623	5.3(253.3)	0.9	1,824	7.5(114.3)	0.4	2.447	13(160.0)	0.5	-2.2
1970	835	4.2(-20.8)	0.5	1,984	6.6(-12.0)	0.3	2.819	11(-15.4)	0.4	-2.4
1971	1,068	9.2(119.0)	0.9	2,394	13 (97.0)	0.5	3.462	22(100.0)	0.6	-3.8
1972	1,624	13 (41.3)	0.8	2,522	7(-46.2)	0.3	4.146	20 (-9.1)	0.5	6
1973	3,225	54(315.4)	1.7	4,240	14(100.0)	0.3	7.465	68(240.0)	0.9	40
1974	4,460	85 (57.4)	1.9	6,852	144(928.6)	2.1	11.312	229(236.8)	2.0	-59
1975	5,081	49(-42.4)	1.0	7,274	51(-64.6)	0.7	12.355	100(-56.3)	0.8	-2
1976	7,715	62 (26.5)	0.8	8,774	164(221.6)	1.9	16.489	226(126.0)	1.4	-102
1977	10,046	177(185.5)	1.8	10,811	89(-45.7)	0.8	20.857	266 (17.7)	1.3	88
1978	12,711	243 (37.3)	1.9	14,972	172 (93.3)	1.1	27.683	415 (56.0)	1.5	71
1979	15,055	355 (46.1)	2.4	20,339	296 (72.1)	1.5	25.394	651 (56.9)	2.6	59
1980	17,505	492 (38.6)	2.8	22,292	369 (24.7)	1.7	39.797	861 (32.3)	2.2	123
1981	21,254	808 (64.2)	3.8	26,131	724 (96.2)	2.8	47.385	1,532 (77.9)	3.2	84
1982	21,853	740 (-8.4)	3.4	24,251	1,001 (38.3)	4.1	46.104	1,741 (13.6)	3.8	-261
1983	24,445	509(-31.2)	2.1	26,192	984 (-1.7)	3.8	50.637	1,493(-14.2)	2.9	-475
1984	29,245	1,079(112.0)	3.7	30,631	1,419 (44.2)	4.6	59.876	2,498 (67.3)	4.2	-340
1985	30,283	1,078 (-0.1)	3.6	31,136	1,859 (31.0)	6.0	61.419	2,937 (17.6)	4.8	-781
1986	34,714	906(-16.0)	2.6	31,584	1,258(-32.3)	4.0	66.298	2,164(-26.3)	3.3	-352
1987	47,281	1,224 (35.1)	2.6	41,020	1,184 (-5.9)	2.9	88.301	2,408 (11.3)	2.7	40
1988	60,696	1,597 (30.5)	2.6	51,811	1,444 (22.0)	2.8	112.507	3,041 (26.3)	2.7	153
1989	62,377	1,738 (8.8)	2.8	61,465	1,544 (6.9)	2.5	123.842	3,282 (7.9)	2.7	194
1990	65,016	2,102 (21.0)	3.2	69,844	1,726 (11.8)	2.5	134.860	3,828 (16.6)	2.8	376
1991	71,870	2,860 (36.1)	4.0	81,525	2,296 (33.0)	2.8	153.395	5,156 (34.7)	3.4	564
1992	76,632	4,962 (73.5)	6.5	81,775	2,521 (9.8)	3.1	158.407	7,483 (45.1)	4.7	2,441
1993	82,236	4,922 (-0.8)	6.0	83,800	2,384 (-5.4)	2.8	166.036	7,306 (-2.4)	4.4	2,538
1994	96,013	6,430 (30.6)	6.7	102,348	3,280 (37.6)	3.2	198.361	9,710 (32.9)	4.9	3,150
1995	125,058	7,370 (14.6)	5.9	135,119	3,964 (20.9)	2.9	260.177	11,334 (16.7)	4.4	3,406
1996	129,715	8,961 (21.6)	6.0	150,339	4,392 (10.8)	2.9	280.054	13,353 (17.8)	4.8	4,569
1997	136,164	8,668 (-3.3)	6.4	144,616	4.076 (-7.2)	2.8	280.780	12,744 (-4.6)	4.5	4,592
1998	132,313	8,867 (2.3)	6.7	93,282	2.197(-46.1)	2.4	225.595	11,064(-13.2)	4.9	6.670

* Variation in parentheses.

Source: Korea Trade Information Service (KOTIS).

America picked up pace with a rapid increase in trade volumes (See Table 1). Korean firms had to look for new frontiers beyond the increasingly conflictive industrial markets like the U.S. and Europe, and needed to move abroad to escape from the high-wage domestic environment with its consequent loss of international competitiveness. In parallel, trade liberalization on the wake of the debt crisis, the subsequent economic recovery and regional integration in Latin America prompted Korean companies to look into these regional markets.

Along with Southeast Asia and China, Latin America emerged as one of Korea's most dynamic regional trading partner and a locus of strategic investments. Korea's exports to Latin America increased faster than those to any other export market, while the highly credit-rated Korean conglomerates could afford to make direct investments in the region by freely borrowing from the international capital markets. Among other developments in Latin America's economy, the Southern Common Market (MERCOSUR) appealed to the interests of Korean entrepreneurs. Its member countries' political economic stability and market potential prompted Korean businesses to enter Latin America targeting the local market. The earlier Korean focus on Central America, the Caribbean and Mexico contrasted with its new concentration on local markets and meaningful investments in South America, particularly in Brazil. As of December 1993, there had been almost no Korean direct investment in Brazil; since 1995, Korean investors have rushed into Brazil (See Table 2). Furthermore, Brazil's import tariff hikes, adopted in early 1995 to correct its trade deficit, favored local investors and prompted Korean firms to produce locally. Rules of origin in MERCOSUR and the North American Free Trade Agreement (NAFTA) again forced Korean entrepreneurs to change their business plans. "Global management" became the new motto for Korean corporate executives in order to achieve higher competitiveness.

Thus, the penetration strategy for the region changed from "detour" to "localization". Latin America would no longer serve as a mere consumer market for finished products or an alternative export market needed to efficiently manage industrial markets. This meant that Korea, shedding an obsolete foreign policy toward Latin America which no longer mirrored the changing international political and economic reality, began to consider Latin American countries as major strategic partners in its new focus on globalization. In 1996 and 1997, according to IMF's data, Korea's trade volume with Latin America accounted for 3.9 percent and 4.3 percent respectively, of Korea's total trade, the highest ratio among Asian countries (See Table 3). This meant that the Latin American market became more significant to the Korean economy than to any other Asian economy, including Japan. While trade and investments were targeted to major Latin American economies, development cooperation was provided to smaller economies through the Economic Development Cooperation Fund (EDCF), and the Korea International Cooperation Agency (KOICA).[3]

Korea's President Kim Young Sam's first-ever state visits to Guatemala, Chile, Argentina, Brazil and Peru in September 1996, and to Mexico in June 1997 reconfirmed this changed strategy. More than a hundred business leaders accompanied him, and announced more than two billion dollars worth of investment projects in the fields of automobile manufacturing, electronic appliances, telecommunications, mining, etc. This signaled a diversification of investment sectors and conversion into capital and greater emphasis on capital and technology-intensive industries, rather than on the formerly dominant labor-intensive ones. Korea's investments in Latin America in 1997

Table 2
Korea's Overseas Direct Investment
(Unit: US$ thousand)

	World total	Latin America (share of the total)	Mexico	Brasil	Panama	Argentina	Peru
1990	1,610,549	85,018(5.3%)	11,028	0	8,640	2,127	0
1991	1,510,688	43,852(2.9%)	2,992	46	13,780	12,339	0
1992	1,206,145	69,959(5.8%)	22,300	0	9,400	23,388	0
1993	1,875,639	47,231(2.5%)	3,850	0	5,857	11,688	0
1994	3,581,081	96,208(2.7%)	22,320	3,439	13,191	4,764	750
1995	4,948,537	246,179(5.0%)	30,755	19,863	18,795	20,013	312
1996	6,220,254	421,578(6.8%)	85,653	112,260	6,955	17,213	77,999
1997	5,847,732	627,805(11%)	47,864	204,401	20,628	29,259	58,248
1998	5,109,782	378,667(7.4%)	41,504	73,260	22,245	36,691	54,688
Total	35,013,629	2,174,167(6.2%)	270,914	440,454	174,107	169,087	191,998

* The data count on accepted cases.

Source: Trends in International Investments and Technology Inducement. Economic Cooperation Bureau, Ministry of Finance and Economy, January 31, 1999.

were the highest in history, US$627 million, accounting for a record-high 11 percent of Korea's total overseas investments. Investment was also encouraged by the elimination of the remaining regulations on overseas investments in June 1996 and August 1997.

The 1996 presidential trip set a milestone in Korea's relations with Latin America in various other aspects. A government think tank had prepared a report for a new policy direction toward Latin America analyzing political and economic situations in the region and reviewing Korean-Latin American economic relations. It suggested a diversified and comprehensive approach towards improving relations and also proposed an Asian-Latin America summit meeting (ALAM).[4] Subsequently, several new initiatives were decided upon through a series of high-level consultations among bureaucrats, scholars, and businessmen.[5] These initiatives included founding a Council on Latin America, upgrading the foreign ministry's office for the region to director-general level, and joining the Central American Bank for Economic Integration (BCIE).

II. Korea's Economic Crisis and Latin America's Recession

Korea's financial crisis of November 1997 and the subsequent economic recession had a number of negative implications for Korean-Latin American relations.

First, Korean entrepreneurs' aggressive investments in the region were suddenly halted. They suddenly found themselves piled with debts accumulated under their "global management" schemes and surrounded by rather hostile international and domestic creditors. The IMF program and the parallel government corporate reform initiatives altogether worsened the family-controlled business groups or *chaebols'* stance on overseas investments. The president-elect Kim Dae-jung, a longtime critic of *chaebols*, pressured them to follow a five-point corporate restructuring program in December 1997. The program demanded an early preparation of consolidated balance sheets, an early phase-out of mutual credit purchases between *chaebol* subsidiaries, an improvement of the financial structure of all *chaebol* firms, a streamlining of the profligate *chaebol* business operations so as to focus on core operations only, and measures to hold the owners responsible for management decisions. While the government forces *chaebols* to reduce their debt-to-equity ratio to 200 percent or lower in two years, the formerly powerful business groups no longer enjoy political

Table 3
Asia's Trade with Latin America
(Unit: US$ million, %)

		1992	1993	1994	1995	1996	1997	1998
Korea	Total trade	157,234	162,703	198,388	260,518	280,896	280,588	243,433
	w/Lat Am	7,388	5,675	7,764	9,163	10,880	12,306	9,274
	Lat Am/total (%)	4.7	3.5	3.9	3.5	3.9	4.3	3.8
Japan	Total trade	572,673	604,187	669,324	778,942	760,750	732,387	677,755
	w/Lat Am	23,420	24,047	26,747	30,159	28,069	31,111	29,133
	Lat Am/total (%)	4.1	4.0	4.0	3.9	3.7	4.2	4.2
China	Total trade	166,077	195,163	236,451	280,955	289,915	325,080	301,994
	w/Lat Am	2,975	3,717	4,689	6,097	6,717	8,095	8,358
	Lat Am/total (%)	1.8	1.9	2.0	2.2	2.3	2.5	2.7
Hongkong	Total trade	242,962	273,601	313,163	366,310	379,077	396,493	358,295
	w/Lat Am	3,861	4,397	5,204	6,140	6,010	6,851	6,283
	Lat Am/total (%)	1.6	1.6	1.7	1.7	1.6	1.7	1.7
Singapore	Total trade	135,321	159,112	199,553	242,581	256,624	257,156	216,334
	w/Lat Am	1,834	2,113	2,276	2,717	3,398	3,519	3,282
	Lat Am/total(%)	1.4	1.3	1.1	1.1	1.3	1.4	1.5
Thailand	Total trade	73,158	83,223	100,127	126.814	129,273	120,364	109,310
	w/Lat Am	1,075	1,005	1,331	1,733	1,932	1,815	1,564
	Lat Am/total(%)	1.5	1.2	1.3	1.4	1.5	1.5	1.4
Malaysia	Total trade	80,636	92,744	118,304	151,336	156,043	158,771	153,812
	w/Lat Am	982	1,186	1,517	2,072	2,029	2,382	2,456
	Lat Am/total(%)	1.2	1,3	1.3	1.4	1.3	1.5	1.5

* Figures for 1998 were obtained by estimation from consolidated data.

Sources: IMF, Direction Of Trade Statistics Yearbook, 1997; Direction Of Trade Statistics Quarterly, 1998. 6.

support for their expansionary projects. Many promises to invest in Latin America were cancelled, reduced in size or indefinetely postponed. Statistics show that Korea's total investments in Latin America in 1998 decreased by almost half, compared to the previous year. Among others, the delay of Asia Motors' Bahia project has been controversial. Due to its financial problem, the project has been dormant since the official groundbreaking ceremony of August 1997. Asia Motors and its major affiliate Kia Motors later were merged with Hyundai Motors, another Korean automobile manufacturer. No immediate decision regarding to the Bahia project was issued from the new owners, and it soon became a bilateral hot issue between the two countries.

Second, the Korean currency *won*'s devaluation rapidly recuperated Korean products' price competitiveness, and caused a rush of Korean products into Latin American markets. In the meantime, the Korean crisis-managing government accelerated exports. As South Korea needed liquidity to service foreign debt, the government sought to retain its trade surplus by encouraging new foreign direct investments. Although the *won*'s devaluation of late-November 1997 did not directly result in a sharp increase of Korea's total exports to Latin America, there were apparent sharp increases to several countries and by sectors. (See Table 4 and 5). Latin American economies responded to the Asian shock with preventive restrictions, establishing tariff and non-tariff barriers. Specifically, the Korean product influx caused sporadic, potential trade frictions though no official dispute has so far erupted. Mexican and Colombian textile industries moved to enforce anti-dumping measures, and Colombian automobile makers pushed the Colombian government to adopt safeguard measures against alleged damage by Korean car imports.

Third, the Korean recession meant a sharp reduction of imports. Traditionally, Korea had imported from Latin America, primary products such as iron ore, copper, steel, aluminium, pulp, and agricultural products, etc. As many factories came to a halt or operated far under capacity, the demand for raw materials and intermediate goods experienced a drastic contraction. In 1998, imports from the region decreased 46.1 percent. The sharp decrease in imports and the moderate 2.3 percent increase of exports combined to produce a greater trade imbalance. As shown in Table 1, the trade balance has been in favor of South Korea since 1977 except during the Latin American debt crisis of 1982-1986. The trade imbalance has been aggravated in recent years due to the slow growth in imports from Latin America compared to the rapid expansion in exports. Slow growth in imports has been ascribed to primary goods' price reductions, the weakening of Latin America's price competitiveness due to the appreciation of its local currencies, and a Korean reliance on Southeast Asia for many of its raw material needs. A Latin American ambassador complained in a meeting that "The imbalance ratio was two to one before the crisis, and is now four to one."[6] The current trade imbalance has become the most popular theme at every Latin American diplomatic meeting.

Korean-Latin American economic relations have had a hard time coping with the preventive adjustments and economic recession in Latin America, and the more recent spread of the international financial crisis to the region. The preventive austerity and recession in South America's major countries such as Brazil, Argentina, and Chile has meant a decrease of the demand for Korean capital and consumer goods. The return of a crisis mood in Latin America has reminded many Korean entrepreneurs and policymakers, who had previously had high expectations for a regional boom, of the notorious 1980s' debt crisis. Such haunting chronic image of the region dissuaded them from their previously aggressive activity and investment in Latin America. Immature institutionalization of Korean-Latin American relations is also responsible for the vulnerability of the boom and the deterioration of economic relations.

III. Strategic Challeges for Future Relations

The question now is where do Korean-Latin American relations go from here. Do the recent troubles mean an end to the

Table 4
Korea's Quarterly Exports to Mexico by Sectors
(Unit: US$ thousand, %)

		Electrical & electronics	Textile	Machine & vehicles	Rubber & plastic	Chemical	Steel & metal
1995	1Q	158,096(-6.3)	25,545(-58.3)	8,701(1.1)	5,338(-61.3)	3,746(24.8)	4,288(-36.1)
	2Q	144,097(-27.5)	16,175(-76.8)	62,596(500.2)	4,488(-73.0)	3,882(22.7)	6,547(-35.4)
	3Q	168,046(-25.4)	37,113(-55.8)	37,269(173.2)	4,775(-65.7)	6,759(124.0)	3,741(-59.7)
	4Q	144,478(-29.8)	32,239(-58.0)	22,466(64.6)	4,440(-66.0)	7,400(89.8)	5,596(-35.9)
1996	1Q	133,492(-15.6)	41,603(62.9)	15,419(77.2)	5,669(6.2)	10,532((181.2)	7,621(77.7)
	2Q	171,494(19.0)	43,266(167.5)	19,657(-68.6)	6,988(55.7)	9,397(142.1)	7,711(17.8)
	3Q	180,203(7.2)	66,036(77.9)	18,902(-49.3)	5,851(22.5)	13,305(96.8)	9,501(154.0)
	4Q	173,937(20.4)	66,848(107.4)	103,772(362)	8,678(95.5)	14,736(99.1)	14,721(163)
1997	1Q	146,676(9.9)	55,370(33.1)	75,036(387)	9,107(60.6)	17,567(66.8)	15,216(99.7)
	2Q	204,422(19.2)	59,143(36.7)	40,394(105.5)	8,477(21.3)	16,766(78.4)	15,441(100)
	3Q	239,326(32.8)	95,412(44.5)	17,392(-8.0)	7,635(30.5)	17,855(34.2)	17,192(80.9)
	4Q	160,259(-7.9)	70,990(6.2)	33,552(-67.7)	9,896(14.0)	18,984(28.8)	11,550(-21.5)
1998	1Q	165,916(13.1)	75,650(36.6)	26,536(-64.6)	8,769(-3.7)	17,660(0.5)	25,735(69.0)
	2Q	175,562(-14.1)	78,323(32.4)	19,966(-50.6)	13,264(56.5)	26,266(56.7)	37,986(146.0)
	3Q	167,912(-29.8)	88,714(-10.2)	26,451(52.1)	9,028(18.2)	25,745(44.2)	39,951(132.4)
	4Q	160,259(0.0)	74,053(4.3)	41,811(24.6)	11,927(20.5)	17,310(-3.1)	24,949(116.0)
1999	1Q	221,927(33.8)	77,221(2.1)	38,310(44.4)	10,099(15.2)	25,051(41.9)	34,696(34.8)
	2Q	292,526(66.6)	81,504(4.1)	41,277(106.7)	11,279(-15.0)	33,860(28.9)	34,016(-10.5)

* Variation against the same period of the previous year in parenthesis.

Source: Korea Trade Information Service (KOTIS).

short honeymoon or are they mere bumps in the road to a deepening relationship?

As mentioned above, there are many obstacles in achieving sustainable economic relations. Formerly, Korean investments in Latin America were "pulled" by the economic boom and by regional integration in Latin America and «pushed» by high Korean production costs, market-seeking, and a corporate strategy that emphasized globalization[7]. Today, few of those pull and push factors remain. Further, the low development of non-economic relations between Latin America and Korea contributes to the fragile relationship. Also, the lack of a wide-spread mutual cultural understanding and the end of the Cold War lessened the propensity for political cohesion. Trade restrictions on the part of Latin America, combined with Asia's contracted demand for Latin American goods and lack of investment resources, may turn both regions' attention to other industrialized partners. All of this implies a negative fallout for Korean-Latin American economic relations.

Policymakers across the Pacific, however, may find that the international financial crisis also entails some positive options for building better *understanding*, *institutionalization* and *strategic alliance.*

First, grief is best pleased with grief's company. Korea's first serious financial crisis since the Korean War of 1950-53 can find parallels in most Latin American economies that have accumulated more than ten years of experience with international political economic reactions to financial crises. Most Korean bureaucrats have wanted to take lessons from Latin American policy responses to the financial difficulties, international pressures and reform challenges, and their socioeconomic results. This may improve the *understanding* of Latin America's economic situation and sociopolitical problems, and open the way to a humbler collaboration between them, which would contribute to remodeling relations with the region.

Second, the contemporary contagion of the international crisis has been a shared challenge for most emerging markets. Especially, a "new international financial architecture" calls for more strategic thinking on the part of emerging market policymakers. While the national proposal for an Asia-Latin America Summit was not picked up by the former Korean government, the current administration will have to deal with the Asia-Latin America Forum (ASLAF) proposed by Singaporean minister Go Chok-Tong. The implication of that proposal is the *institutionalization* of Asian/Korean-Latin American relations.

Korea found itself flooded with communication channels with

Table 5
Korea's Quarterly Exports to Colombia by Sectors
(Unit: US$ thousand, %)

		Electrics & electronics	Textile	Machine & vehicles	Rubber & plastic	Chemical	Steel & metal
1995	1Q	7,350(-30.6)	5,920(-9.9)	22,238(-25.3)	4,349(35.4)	2,999(159.4)	304(-50.9)
	2Q	7,972(-16.8)	6,544(-3.3)	30,589(-26.1)	4,541(18.3)	1,180(-32.8)	732(22.8)
	3Q	7,544(-8.3)	6,984(64.7)	37,251(16.2)	3,346(29.5)	601(-34.3)	789(-3.2)
	4Q	5,955(7.5)	3,881(-15.6)	45,607(-13.3)	5,636(80.7)	565(-41.5)	445(-31.5)
1996	1Q	6,686(-9.0)	4,425(-25.3)	48,159(116.6)	5,317(22.3)	894(-70.2)	311(2.3)
	2Q	5,777(-27.5)	5,133(-21.6)	30,161(-1.4)	4,968(9.4)	1,118(-5.3)	463(-36.7)
	3Q	4,903(-35.0)	6,460(-7.5)	8,190(-78.0)	4,222(26.2)	1,775(195.3)	4,734(500.0)
	4Q	4,855(-18.5)	6,964(79.4)	26,702(-41.5)	4,632(-17.8)	792(40.2)	1,667(274.6)
1997	1Q	6,489(-2.9)	13,688(209.3)	27,110(-43.7)	3,954(-25.6)	2,144(139.8)	753(142.1)
	2Q	8,975(55.4)	9,480(84.7)	47,423(-85.3)	4,093(-17.6)	1,816(62.4)	714(54.2)
	3Q	12,421(153.3)	7,930(22.8)	52,713(543.6)	5,752(36.2)	4,179(135.4)	1,486(-68.6)
	4Q	11,074(128.1)	7,079(1.7)	77,221(189.2)	4,209(-9.1)	4,212(431.8)	1,612(-3.3)
1998	1Q	9,800(70.6)	7,788(-43.1)	44,337(63.5)	3,631(-8.2)	4,371(103.9)	3,023(301.5)
	2Q	9,728(98.4)	9,908(4.5)	55,959(18.0)	3,001(-26.7)	4,795(164.0)	3,247(354.8)
	3Q	4,349(-65.0)	5,542(-30.1)	33,615(-36.2)	3,113(-45.9)	3,392(-18.8)	2,103(41.5)
	4Q	1,791(-83.8)	4,281(-39.5)	38,241(-50.5)	1,774(-57.9)	1,513(-64.1)	2,943(82.6)
1999	1Q	3,126(-68.1)	3,867(-50.3)	17,798(-59.9)	2,431(-33.0)	3,000(-31.4)	2,200(-27.2)
	2Q	5,114(-47.4)	5,951(-39.9)	11,507(-79.4)	2,030(-32.4)	2,710(-43.5)	1,643(-49.4)

Latin America as of early 1997. Foreign ministry bureaucrats zealously opened as many communication windows as possible to the region, this time not at bilateral levels, but at regional levels. Following Japan's path, Korea fostered relationships with the Rio Group,[8] MERCOSUR,[9] and Central America.[10] Additionally, the Korean Council on Latin America and the Caribbean was created in August 1996 to facilitate cooperation at the private sector level. Given the traditionally low profile of Latin America in the Korean framework of international relations and *vice versa*, momentum for strengthened economic relations might have been maintained if they had been well institutionalized. Unfortunately, however, the crisis occurred before all these institutionalizing efforts could mature. Thus, the international discussion on Asia-Latin America inter-regional talks may stimulate better institutionalization of existing communication channels.

Third, because of the financial crisis and the subsequent across-the-board economic reforms the Korean economy resembles that of the Latin American countries which have undergone market-oriented economic reforms and trade liberalization. This could result in enhanced cooperation. One of the immediate outcomes is the free trade negotiation between

South Korea and Chile. "Free trade" is a brand-new item on the Korean policy agenda, and is the product of the latest wave of trade. The newly created ministry-level office for international trade negotiation cautiously selected Chile in early 1998 as its first negotiation partner for free trade although discussions on its feasibility have been going on for several years among scholars and diplomats.[11] Regardless of whether the Korean negotiators take into account South Korea's relations with South America as a whole, the ultimate Korea-Chile free trade, unusual between countries remote from each other, will represent a new momentum for Korea's presence in Latin America and for redefining *strategy* in its relationship with the region. Additionally, Korea's free-trade initiative toward Latin America, the first of its kind from Asian countries, may ultimately promote the intra-industrial trade and cooperation aspired to by Latin Americans, and enhance economic interdependence. Latin American exports are still heavily skewed towards primary products or low value-added primary processed goods, while Korean exports are mainly manufactured goods including electronics and automobiles. Thus, Korea-Latin America trade has followed a typically North-South "inter-industry trading" pattern rather than a South-South "intra-industry cooperation" one.[12]

IV. Conclusions

In the short term, the international financial crisis and its contagion, together with resulting trade policy responses, set back a promising expansion of trade and the intensifying of investment relations between Korea and Latin America. It brought about reduced investment financing, overseas investments, demand for production inputs, and security for existing business relationships. This inevitably led to a contraction of trade, investment, and development cooperation between Korea and Latin America. In the long and medium term, however, the crisis made open and wider the opportunity and space for better mutual understanding, institutionalization and strategic cooperation or alliance between both parties resulting from similar economic, political and socioeconomic challenges at the domestic and international levels. The road both Korea and South America will embark upon depends on their policymakers' awareness of the strategic importance of interregional cooperation.

Even though some academics may try to justify and model the sequence of recent economic relations between Korea and Latin America, it will be hard to find that decision-makers maintained a coherent strategy at both public and private levels. What may differentiate one policy decision from another is whether it has been adapted to a changing environment and whether it contains within it a vision for remodeling international relations. Whether the current major decision-makers have such vision is still doubtful. Yet even incompetent decision-makers cannot dampen the potential of the Korea-Chile initiative for free trade to unexpectedly jumpstart Korea's stalemated relations with the region.

Notes

1. *See Won-Ho Kim, "Korean-Latin American Relations: Trends and Prospects"*, Korean Journal of Latin American Studies *Vol. 1 (1998), pp. 25-48. <http://plaza.snu.ac.kr/~kjlas/PDF/KIMWH.PDF≥*

2. *See Young Chul Park and Won-Am Park. "Capital Movement, Real Asset Speculation, and Macroeconomic Adjustment in Korea", in Helmut Reisen and Bernard Fisher, eds.,* **Financial Opening: Policy Issues and Experiences in Developing Countries** *(Paris: OECD).*

3. *While Korea is putting "priority on strengthening cooperation with Pan-Pacific countries", the total assistance provided to Latin America and the Caribbean increased by 118.5% in 1997 over the previous year to 7.4 billion won (US$7.78 million), 14.1 percent of the total. See KOICA,* Annual Report 1998, *p. 45.*

4. *See Won-Ho Kim,* **The New Economic Order in Latin America and Korea's Policy Directions for Advanced Economic Relations.** *Korea Institute for International Economic Policy, April 1996 (in Korean).*

5. *Among others, see* **Ways to Cooperate with Latin America,** *Symposium proceedings, Institute of Foreign Affairs and National Security, August 1996 (in Korean).*

6. *Jorge Lapsenson, Ambassador of Argentina, speech at a luncheon hosted by Korean Council on Latin Aemrica and the Caribbean, December 16, 1998.*

7. *See Taik-Hwan Jyoung, "Korean Investments in Latin America", paper presented to the conference on Regional Integration in the Americas and the Pacific Rim, University of California, San Diego, February 28, 1997. <http://orpheus.ucsd.edu/las/prrptk.htm≥*

8. *The first ministerial meeting between Korea and the Rio Group Troika was held in September 1996 at the United Nations headquarters in New York.*

9. *The first consultative meeting between Korea and MERCOSUR was held in Asuncion, Paraguay, in April 1997.*

10. *South Korea opened the first annual Forum for Dialogue and Cooperation with Central America in San Salvador in August 1997.*

11. *It was after the visit to Chile by Korean Minister of Trade, Industry and Energy in October 1997 that South Korea seriously began to study the feasibility of free trade with Chile.*

12. *See Young Kon Kim, "The Economic Relationship between Korea and Latin America: Past, Present and Future Prospects", in Soo-Keun Kim et al., eds.,* Comparison of **Development Experiences: Latin America and Korea** *(Seoul: Ajou University Press, 1993), pp. 239-240.*

Globalization with Development

SELA's Permanent Secretariat prepared this document in view of the UNCTAD X meeting to be held next year in Bangkok, Thailand. Its content was analyzed by ministers and heads of state from SELA's member countries at the coordination meeting held in Santo Domingo. The document is divided into three sections. The first section reviews the major traits of the current international scenario which stem from the globalization process and affect the formulation of economic policies in countries of the region. The second section presents some suggestions that could contribute to the formulation of the region's development agenda and highlights the tendencies that appear to be developing for the future. The objective is to discern development's challenges, starting from the assumption that there is room for the formulation of one's own strategy based on positive ways to face globalization. The document also points to the role UNCTAD could play in these issues from a development perspective, including specific suggestions. The third section includes some general thoughts on the major ideas that, in the Secretariat's opinion, should guide Latin America's and the Caribbean's development strategies and underpin UNCTAD's actions in the years to come.

Globalización con Desarrollo

La Secretaría Permanente del SELA elaboró el presente informe con motivo de la UNCTAD X a celebrarse en Bangkok, Tailandia, en el año 2000, el cual fue analizado por Ministros y Jefes de Delgación de los Estados Miembros de esta entidad durante la reunión de coordinación de Santo Domingo. El informe contiene tres partes. La primera presenta una síntesis de las principales características del entorno internacional actual que inciden sobre la formulación de las políticas económicas de los países de la región y que tienen como telón de fondo el proceso de globalización. La segunda incluye elementos que pudieran contribuir a conformar la agenda del desarrollo de la región, así como las tendencias que se vislumbran para los próximos años. El objetivo es destacar en qué consisten los retos del desarrollo, partiendo de la idea de que hay margen para desarrollar estrategias propias, centradas en acciones positivas ante el proceso de globalización. Además se hace referencia al papel que pudiera cumplir la UNCTAD en dichas materias, desde la perspectiva del desarrollo, incluyendo sugerencias concretas de acción. La tercera parte contiene algunas reflexiones generales en torno a las ideas-fuerza que, en opinión de esta Secretaría, deberían orientar las estrategias de desarrollo de América Latina y el Caribe y sustentar la acción de la UNCTAD en los próximos años.

Mondialisation et développement

Le Secrétariat permanent du SELA a rédigé ce rapport à l'occasion de la tenue, à Bangkok (Thaïlande) en l'an 2000, de la CNUCED X. Durant leur réunion de coordination à Saint-Domingue, les ministres et chefs de délégation des États membres du SELA se sont penchés sur ce document, divisé en trois sections. La première section offre une synthèse des principales caractéristiques de l'actuel environnement international qui ont une incidence sur les politiques économiques des pays de la région, sur fond de mondialisation. La deuxième section reprend certains points qui pourraient contribuer à formuler l'agenda de développement de la région, ainsi que les tendances prévisibles pour les prochaines années. Il s'agit ici de relever en quoi consiste les défis du développement, puisqu'il existe une certaine marge permettant de concevoir des stratégies spécifiques, fondées sur des actions positives face à la mondialisation. Le document suggère également quel rôle pourrait jouer la CNUCED en ces matières, dans une perspective de développement, propositions d'action à l'appui. Enfin, la troisième section reprend quelques réflexions générales sur certaines idées fortes qui, de l'avis du Secrétariat permanent, devraient guider les stratégies de développement de l'Amérique latine et des Caraïbes, et soutenir l'action de la CNUCED dans les années à venir.

Globalização com Desenvolvimento

A Secretaria Permanente do SELA elaborou o presente informe com motivo da UNCTAD X , a ser celebrada em Bangkok, Tailandia, no ano 2000, o qual foi analizado por Ministros e Chefes de Delegação dos Estados Membros desta entidade, durante a reunião de coordenação de São Domingo. O informe contêm três partes. A primeira apresenta uma síntese das principais caraterísticas do entorno internacional atual, que tem incidência sobre a formulação das políticas econômicas dos países da região, e que tem como cenário o processo de globalização. A segunda inclui elementos que poderiam contribuir a conformar a agenda do desenvolvimento da região, assim como as tendências que vislumbram-se para os próximos anos. O objetivo é destacar em que consistem os retos do desenvolvimento, partindo da idéia de que existe margem para desenvolver estratégias próprias, centradas em ações positivas ante o processo de globalização. Ademais se faz referência ao papel que pudesse cumprir a UNCTAD nas referidas matérias, desde a perspectiva do desenvolvimento, incluindo sugestões concretas de ação. A terceira parte contém algumas reflexões gerais em torno às idéias-força que, na opinião desta Secretaria, deveriam orientar as estratégias de desenvolvimento da América Latina e o Caribe e sustentar a ação da UNCTAD nos próximos anos.

Globalization with Development

SELA's Permanent Secretariat

CURRENT ISSUES

1. Upon the request of GRULAC in Geneva, in view of the preparation of UNCTAD X to be held in Bangkok, Thailand in the year 2000, and in accordance with the mandate of the Regular Meeting of the XXIV Latin American Council, the Permanent Secretariat of SELA is submitting its thoughts for the consideration of Member States. The objectives and format of this report were inspired by the agreements reached with GRULAC at UNCTAD IX in 1996 when the Secretariat drew up a similar report that contributed to the "Declaration of Caracas", adopted by GRULAC at its Preparatory Meeting.

2. The title of this report –"*Globalization with development*"– reflects a strategic course which, in this Secretariat's opinion, is the result of the experience the region has accumulated during this decade: the search for efficient and beneficial participation in the globalization process remains crucial. It is critical for speeding up the development process and thus guaranteeing democratic governance in the region. The challenge lies in overcoming the divergence that numerous factors seem to confirm, and that exists between participation in financial, commercial, technological and cultural globalization on the one hand, and integral and sustainable development of each State and region on the other. Overcoming this divergence calls for strengthening the link between globalization and development.

3. Emphasizing the dimension of development in the analysis of the policies necessary for integration into the globalization process implies that methods other than those already used by the region in the last two decades must be applied. It is important to recognize achievements as well as errors, but above all the shortcomings of the implemented policies must be identified. Through reflection and investigation it should be possible to move towards what UNCTAD has defined as the developing countries' "positive agenda." In this particular context it relates not only to international trade but also to the various issues that

affect development. The "positive agenda" must be understood as a conceptual base, whose goal is not just participation in globalization but also development. It should propose solutions that are consistent with the conditions and diversities of the developing countries, and project its identity to the global system. Hence a "positive agenda" should not be restricted to dealing individually with each of the international economic issues from the development point of view. Rather, it should consider them as part of a whole, whose components are inter-related and thus indivisible as far as their causes and effects are concerned.

"Ever since the eighties an economic paradigm with few variations has been applied across the board to the very different economies of the Latin American and Caribbean region."

4. One of the essential elements that should guide our thoughts on the subject of a comprehensive and proactive development agenda is the need to take fully into account the diverse nature of the different countries and regions. Ever since the eighties an economic paradigm with few variations has been applied across the board to the very different economies of the Latin American and Caribbean region. By rejecting endogenous models, the same agenda has been applied to the majority of countries: liberalizing trade and finance, privatization, downsizing the public sector, eliminating subsidies, social security reforms, flexibilizing job markets, etc. This agenda assumes, on the one hand, the passive adoption of external and "universal" models and, on the other, the existence of structurally uniform economies, where markets behave similarly. It also makes a dual assumption: firstly that the domestic institutional framework is ready to implement the policy changes required by the model; and secondly, that the international environment will offer favourable conditions - particularly stability and development financing flows.

5. If endorsed by the Member States, the strategic direction that inspires the thoughts put forward in this report, could be covered by UNCTAD's current programme of activities, in addition to those agreed upon in Bangkok. To that effect, the programme adopted by the organization for the medium term should reflect the need to reduce the vulnerability[1] of the developing countries in the face of the new systemic crises, and to design internal and external strategies to overcome the insufficiencies that have been revealed by the current ones.

6. In effect, UNCTAD's relevance depends largely on its capacity to reflect the current national and regional agendas of the developing countries and to contribute elements for thought,

analysis and action that are directly related to those agendas. It also depends on UNCTAD's ability to demonstrate its comparative advantage, which consists in being an institution in charge of ensuring that the development aspect is present in international economic policies. Lastly, it depends on the capacity of the Latin American and Caribbean countries to include UNCTAD in their external economic policies as an instrument that supports learning and thought. The region has very few multilateral instruments for those purposes. There are very few fora for universal participation where development is at the centre of the debate, and where the opinions and experiences of Latin America and the Caribbean can have an international repercussion.

7. This report has three sections:

–The first part summarizes the main characteristics of the current international environment affecting the formulation of economic policies by the region's countries. It includes some brief thoughts on the impact of the recent financial crises, not only on the situation and prospects of the economies of Latin America and the Caribbean, but also on the approach and the ideas behind the development strategies adopted to date. These are presented in the context of globalization which is the framework that defines the limitations and possibilities of national, regional and international policies.[2]

–The second section summarizes the main elements which, from this Secretariat's point of view, could make up the region's development agenda. It outlines the economic issues upon which the attention of the governments of Latin America and the Caribbean is focused today, without making any attempt to present an exhaustive list. Additionally, it delineates probable trends of the next few years. The aim is to point out the challenges of development assuming that there is room (and even need) for distinctive strategies focusing on positive action vis-à-vis the globalization process. The section also refers to the role UNCTAD might play in such matters, including specific suggestions for action. The central idea is that UNCTAD should make an *ex ante* and *ex post* evaluation of the costs and benefits of the guidelines, standards and international economic policies from the development point of view.

–The third section contains some general thoughts about the *idées-forces* which, in the opinion of this Secretariat, should drive UNCTAD's action in the coming years, as well as reflections on the development strategies of Latin America and the Caribbean.

I. The International Environment of Latin America and the Caribbean

8. In 1996, UNCTAD IX held in Midrand, South Africa, coincided with a phase of economic growth and optimistic prospects for Latin America and the Caribbean: the financial crisis that began in Mexico in 1994 had been overcome faster than expected, the capacity to attract foreign capital had been recovered; the implementation of the Uruguay Round agreements had created new expectations regarding the region's position in global trade; the subregional integration processes (MERCOSUR, Andean Community, Central American System and CARICOM) initiated or increased both institutional reforms and negotiation processes aimed at convergence[3]; the FTAA was being perceived as a new potential instrument for free trade and participation in the international economy.

"We are not witnessing short-term disruptions, but profound turbulences, whose oscillations undermine the very foundations of national economies and the global system."

9. Four years later, the preparation and holding of UNCTAD X coincides with a different international and regional environment. Starting in 1997, the crises of Southeast Asia, Russia and their strong impact on Brazil and other countries in the area revealed a new phenomenon in the region which is directly linked to the globalization process and which had been less evident in 1994-95. As of this decade, the monetary and financial crises cause rapid and deep ramifications on trade currents and on the capacity for economic growth.

10. We are not witnessing short-term disruptions, but profound turbulences, whose oscillations undermine the very foundations of national economies and the global system. In effect, the main characteristic of the new crisis is its systemic impact, even though it is far more intense in developing than industrialized countries. It is systemic to the extent that it increasingly affects the international system and simultaneously influences several areas of the national and international economies. Within less than 3 months, the Southeast Asian crisis affected the stock exchanges of Latin America and elsewhere, crossing oceans and indiscriminately affecting countries, subregions and the behaviour of the system as a whole. In addition to its geographic extent, it triggered inter-sectoral repercussions, which were not restricted to exchange adjustments and stock crises, but went beyond them and generated destabilizing short term capital outflows. They also affected long-term investments, albeit more slowly, widened the interest rate spread for bonds issued by the region and had a negative impact on the risk

classifications of all emerging economies, hampering access to international capital markets and passing on the effects to the domestic banking systems.

11. Subsequently, the systemic impact of the new crises widens: inter and intra-regional trade flows change as a result of devaluations and a fall in demand, modifying the patterns of competitiveness of products and countries, and changing the prospects for market penetration.[4] Due to the accumulation of these negative and uncontrollable factors, the impact of the crisis means lost opportunities for growth, as can be seen in Latin America and the Caribbean,: according to ECLAC, in 1998 the region's GDP increased by 2.3% (instead of the 5.1% forecast prior to the crisis); in 1999, in an optimistic scenario, that growth rate will be -0,8 %, 2.5% the following year and 3.9% in 2001, according to the World Bank's most recent calculations.[5]

12. These figures must not be seen as mere indicators of the behaviour of productive activity in the region. They indicate growth, but also the potential for development, because for each percentage point increase in GDP, there is a real possibility of reducing the rate of poverty, generating employment, creating new firms, attracting investments, improving infrastructure and investing in human capital. In its third annual report on development indicators, issued in April 1999, the World Bank pointed out that a sustained rate of annual growth of at least 2.7% is necessary to halve the poverty rate of the Latin American and Caribbean population by 2015.[6] The cost of the crisis is also measured in social and therefore in political terms. Democratic governance of the region's countries depends first and foremost on the governments' capacity to minimize and absorb such intense shocks as those generated successive crises.

13. The impact of the recent crises affects the policies of the countries of the region, the workings of the global economic system, and the capacity of the States and the multilateral organizations to manage and lead it in the right direction. The market economy-based model had not envisaged mechanisms for either the prevention, the forecast or the management of a crisis of this nature and of its repercussions.[7] People are only just beginning to reflect on its inadequacies, above all in Latin America and the Caribbean. But it seems clear, to the governments and companies of the Latin American and Caribbean countries, that a revision of the policies being implemented does not mean a return to the widely questioned interventionist

policies. It is not a matter of having reached a crossroads (and having to choose between keeping the same policies or abandoning them), but of an indispensable and urgent reformulation of the model, critical but constructive, rich in different but feasible proposals, where innovation is going to be more important than the repetition of former policies.

14. From the point of view of Latin America and the Caribbean, the coming years will be marked by the medium and long term financial impact of the Asian and Brazilian crisis –as well as by the concern for preventing and controlling future crises. In this context, it will be essential to learn quickly from new situations occurring during the process of global integration. This learning process, which is at least as important as that of the phase of macroeconomic adjustment at the end of the eighties, will involve changes in government policies and business procedures. It will also require broader and more precise analyses on the development strategies in order to identify those best suited to the period after the present crises, and to the needs of Latin America and the Caribbean.

15. There are two inter-related aspects to the challenges for the countries in the region. Firstly, there is an increasing need to boost the ability of democratic regimes to meet the population's demands for better living standards, if they are to consolidate and increase the political achievements of the last two decades. Not only have the expectations aroused since the end of the eighties by the new policies aimed at opening up and modernizing the economy not been met - since poverty is increasing at an alarming rate - but they are growing exponentially. In addition to having to deal with rising and legitimate expectations at home, governments must handle the implications of crises that sometimes originate very far from their borders, without really knowing whether each country's macroeconomic policies and institutional reforms will be enough to alleviate the domino effect. So far, the monetary and financial impact of the Asian and Brazilian crisis, though not as strong as expected in the region and thus refuting the most pessimistic forecasts, did nevertheless deal a severe blow to its rate of growth. So the success will remain relative, as long as the development of the region continues to deteriorate due to the recession caused by the financial crises.

16. In the second place, on an international level, the region's economic environment is perceived by the public and private sector as an increasingly deciding factor for the success of

domestic policies. The crises and their repercussions have revealed not only the permeability, but also the vulnerability of Latin America and the Caribbean to exogenous factors that fall outside its sphere of influence. Although the achievements reached at high cost in the national economies during the process of liberalization are considered incomplete, they do show that their consolidation and efficacy largely depend on a favourable external environment. When referring to the financial implications of the Asian crisis in Latin America and the Caribbean (capital outflows, limited and costly access to capital markets, deterioration of securities, etc.), the Managing Director of the International Monetary Fund spoke of "unfair punishment". The same principles of economic governance that are required within States should be applied at the international level, incorporating economic concepts (such as crisis prevention, competition, growth and sustainable development), policies (such as the treatment of asymmetries, transparency, participation), and even ethical concepts (such as equity solidarity and human development) in the management of the global system.[8]

"The same principles of economic governance that are required within States should be applied at the international level."

17. Just as a process of learning, re-thinking and reformulation of the model in force has taken place domestically for national economies, it must be applied at the international level in the coming years. In effect, while the shortcomings of the interventionist policies of the past decades have largely been corrected, the time has now come to correct the market-generated failings, within and between the States. In that context the region would probably be well advised to debate on the State's role in the globalized economy from a pragmatic point of view.

II. Elements of the Development Agenda of Latin America and the Caribbean and Proposals for Action by UNCTAD

18. The changes introduced in the development strategies of Latin America and the Caribbean since the end of the eighties have entirely changed the face of the region's economy. Although there are still major differences between different countries and economic sectors, regarding the degree of implementation of the paradigms of liberalization and deregulation, sufficient time has gone by to evaluate the results and lessons from that process of transformation. The development agenda of Latin America and the Caribbean for the next few years largely depends on such an evaluation.

19. UNCTAD has huge potential for action in many of the region's economic areas, and a large number of its analyses and co-operation instruments could be used by the countries or subregional schemes in their efforts. Based on the mandates of the UNCTAD IX, and in the light of the experience acquired by Latin America and the Caribbean in the treatment of various items on the international economic agenda, four main procedures for action can be distinguished where UNCTAD has a comparative advantage when it comes to putting forward ideas on development:

–Analyses and studies of the trends of the international economic system and formulation of a "positive agenda" for endogenous development within the context of the globalization process.

–Exchange of inter-regional experiences between international and regional government officials, academics and sectors of civil society, through fora for dialogue aimed at examining the formulation and implementation of development policies.[9]

–Technical co-operation on certain topics at the request of countries, taking into account the fact that in Latin America and the Caribbean the subregional integration schemes are looking at issues on the economic agenda from the point of view of their integration process –which involves an additional perspective that goes beyond the national scope (for instance, in relation to competition, investments, industrial and agricultural policy, trade policy).

–Support for multilateral negotiation processes and training of developing countries' human resources.

Each of these procedures should be part of an integrated whole. For example, the fundamental inputs from the exchange of experience should contribute to the analytical work and technical co-operation programmes and vice versa. Regular participation and co-ordination with international and regional organizations in each area would also be necessary.

1. Development Policies

A. Growth, Development and Macroeconomic Stability

20. From the domestic point of view, the first assessment of economic policies introduced over ten years ago refers to the *macroeconomic situation*. It can generally be said that the goal of stability has been attained, particularly as far as controlling inflation is concerned. Progress has also been made in reform-

ing and modernizing national financial systems, in particular in the supervision of the banking sector, the attraction of foreign investments, in the area of financial services, and in the development of capital markets.[10] It is interesting in that assessment, however, that in recent years the threat of destabilization among the Latin American and Caribbean economies has come from outside the region rather than from within the region or from the region's countries themselves. In other words, the fairly successful structural adjustments were not sufficient to reduce the vulnerability of the region's economies in the face of systemic disturbances. In the short and medium term, reducing external vulnerability will be one of the key topics on the agendas of the countries of the region.

21. The current debate on the future *monetary policies* of the countries of the region falls within this same order of ideas. It responds to the need to make exchange rates more stable in order to avoid drastic devaluations or overvaluations that become unsustainable, particularly given the risk of a recurrence of the recent international crises. An idea such as "dollarization", which would be tantamount to abandoning national monetary policies and a portion of sovereignty - whose scope goes beyond the financial sphere, and which would have seemed totally unacceptable only two or three years ago - has become a recurring topic in the region and in the hemisphere.[11] Concern over reducing monetary vulnerability will be a sensitive topic for many governments of the region, due to a lack of clarity about the costs and benefits of the monetary policies applied since the structural adjustments were put in place.

22. Each country will have to evaluate its options, considering the characteristics of its economy and its national development path. In any case, no formula –be it a currency board, a crawling peg, or a fixed exchange rate regime- seems to be uniformly applicable to all the countries in the region. UNCTAD could provide studies and organize dialogues of experts from different regions in this field, helping to elucidate such matters as economic obstacles and the social costs of fixed versus flexible exchange rates and the optimum levels of international reserves for the developing countries. Along this line of thought, it is fundamental to analyze the subject of exchange rate stability with a perspective covering not only the different interactions within the economy, but also its links to the political and social dimension. It has to be examined, for example, whether mea-

sures like "dollarization" are capable of having the desired effect when the rest of the region's conditions and financing differ in so many ways from the one taken as a model.

23. In the light of the external vulnerability, it appears essential for all the subregional integration schemes in Latin America and the Caribbean to speed up their efforts to *harmonize* (and if possible co-ordinate) *macroeconomic policies*: it has been seen, above all during Brazil's recent monetary crisis, that integration processes are highly sensitive to changes in the macroeconomic situation of their partners, in both political and economic terms.[12] It can be assumed that in the next few months the topics of "dollarization", of "sole currencies" inspired by the Euro, and of the dilemma between fixed and flexible exchange rates, will spread from the national sphere to the subregional agendas and to the hemispheric forum of the Free Trade Area of the Americas (FTAA). It is therefore a subject whose domestic and international aspects must be simultaneously addressed by the Latin American and Caribbean governments.

> "*If it is impossible to grow fast enough to reduce the poverty rate, the social and political cost –measured in terms of democratic governance– will keep rising, casting doubts on the strategies designed for entry into the global economy.*"

24. If it is impossible to grow fast enough to reduce the poverty rate, the social and political cost –measured in terms of democratic governance– will keep rising, casting doubts on the strategies designed for entry into the global economy. Growth, conceived as a necessary but insufficient condition for integral development, will continue to be the focus of the economic policies of the region's countries. It must be a primary concern when choosing, designing and sequencing all the sectoral policies. It also increasingly affects the focus of internal and external economic policies: they will be less fragmented by areas of ministerial competence, and more interdisciplinary, in favour of integral human development. UNCTAD's contribution must focus in particular on the sequence, intensity and multidisciplinary nature of macroeconomic and sectoral policies, through the exchange of practical experiences and through research centred on the link between growth and development.

B. Sectoral Development Policies

25. After abandoning the import substitution model of the eighties, and embracing trade liberalization, privatization and the drastic reduction of state instruments supporting productive activity, *industrial policies* have changed radically. The vacuum left by the State's withdrawal in favour of the private sector has

in many sectors been filled by transnational corporations rather than local or regional firms. Although this has led to the creation of jobs and an influx of direct investments, it has also been responsible for the widespread closure of local companies. It would therefore be useful for the evaluation to include an assessment of the results of the change in model. This should discuss the competitiveness of Latin America and the Caribbean as well as diversification and modernization achieved through state industrial policies that ceased to be active and became reactive. Reference should also be made to the capacity of the private sector of the developing countries to compete in international markets, to attract strategic allies who agree with the need to develop, or to generate employment and technological progress. The structure of the national and regional firms should also be analyzed in this context in order to determine how and in which sectors the small and medium-sized enterprises have benefited from the new industrial policies.

26. The evaluation should not be restricted to the internal aspects of industrial policies, but should also cover the analysis of the *role of foreign direct investment and trade agreements on industrial development*, linking internal instruments to external economic policies.[13] It would not suffice to determine the competitiveness of the exports of one country or one region; it would also be necessary to gauge whether the exportable supply has been expanded and diversified as a result of the new development policies and foreign investments. Within each country, and within each productive sector, the design of future industrial (and agricultural) policies must be based on this kind of diagnosis, and a fair balance must be struck between state support and the private sector's responsibility.

27. *The role of privatization* should also be considered, since it has been a very important factor in the change of the economic model and in the attraction of foreign investments to Latin America and the Caribbean. It bears a direct relationship with the new industrial development, the employment situation, export competitiveness and the new productive structures being generated within the countries. One of the challenges the region now faces is the need to achieve successful and lasting results in the second phase of the privatization process. After the transferal of firms or activities to the private sector, the design and implementation of *regulatory frameworks* that respect competition and consumer interests gain high importance.[14]

28. It should also be stressed that the subject of *competition* is already on the consolidated agenda for economic policies of Latin America and the Caribbean. UNCTAD's contribution is widely known among government institutions in the region, and the academic centres have included the subject in their plans for research on public policy. There are still two areas that warrant further analysis and an exchange of experiences, however. Firstly, "international" competition issues, generated by trade liberalization and regional integration (which are directly related to trade protection measures like anti-dumping); secondly, the implications for competition and development that arise from the increasingly frequent mergers between transnational corporations, which aim at a growing oligopolistic concentration of the world economy. It is thus necessary to determine the implications of those processes for the developing countries and for intra-company trade. It can be asked to what extent one can speak of free competition in the presence of such huge imbalances as those that continue to exist between transnational corporations and the developing countries.[15] Even more so, one must wonder whether these mergers would lead to intra- and inter-sectoral trade negotiations whose main participants are the transnational corporations rather than the States.

29. Just a few years after introducing the structural adjustments that made up the "first generation" reforms, Latin America and the Caribbean was headed for the "second generation" reforms", addressing the *institutional infrastructure* needed in order to sustain the new liberalization strategies. To different degrees and at different times, but following a widespread tendency in the region, government institutions appeared that are in charge of implementing new public policies or of improving those that existed only in the legal frameworks,. From the beginning of this decade, agencies emerged that work in the fields of privatization, competition, consumer protection and the environment, financial supervision, intellectual property, investment promotion, and trade defence. Moreover, in some of those fields not subject to multilateral agreements, general guidelines or standards of a universal nature are being worked on in an attempt to reconcile national legislations.[16]

30. The future development agenda will continue to improve these functions and the corresponding institutions; but one might well wonder if the institutional reforms have been sufficient and efficient enough as regards their consistency with the "first generation" structural reforms and development needs. For

example, the assessment should not merely consider the "new" institutions derived from the international economic agenda, but also the "traditional" institutions, such as the ministries of trade, agriculture, health and education. It is necessary to see whether the latter become more efficient and whether it is possible to speak of successful institutional development in the different areas of public policy. In other words, it remains to be asked whether the countries of the region now have the right legal and institutional framework to continue to work towards their participation in globalization, and what are their needs with regards to financing, co-operation, training of human resource in policies and public institutions, which are determining factors for their development. All this would lead one to expect UNCTAD to contribute knowledge and novel points of view on these matters –regarding their fundamental aspects as well as the operating difficulties derived from the new institutions.

31. Neither the structural adjustments nor the institutional reforms have alleviated one of the major obstacles to development in Latin America and the Caribbean: the *infrastructure deficit* (access to drinking water, roads, telephone lines, electricity supply, etc.), which lowers living standards and the systemic competitiveness of economies. Here the subject is linked to the internal and external financing available in the region. Faced with the limitations of domestic savings (accentuated by an insufficient rate of growth, by low rates of productivity, by budget restrictions and by foreign debt service), the development of infrastructure depends largely on foreign investments and bilateral or multilateral financing. The persistent reduction in official development aid, and the tendency of multilateral financial institutions to stimulate the financing of infrastructure projects with private foreign capital, do not seem to support the pressing needs of the population and the companies of the region. It would be a good idea to identify the most important infrastructure deficits, considering the welfare of the most vulnerable populations, as well as those most necessary for business development, and to determine to what extent the internal and external, public and private financing that received by the region during this decade has contributed to reducing those deficits.

"*Neither the structural adjustments nor the institutional reforms have alleviated one of the major obstacles to development in Latin America and the Caribbean: the infraestructure deficit.*"

2. Trade policies

A. Trade Reforms and Integration Arrangements

32. The trade reforms undertaken at the end of the eighties

have, in the majority of the Latin American and Caribbean countries, been rapid, profound and unilateral. The *commitments under the Uruguay Round* have, generally speaking, consolidated those national processes of trade liberalization. The trade policies of the next few years will continue to be governed by that multilateral framework. However, two kinds of margins of manoeuvre must be taken into account: firstly, the longer implementation schedules foreseen in the agreements of the Round for developing countries (which it would be wise to extend[17]); secondly, the reviews and new rounds of negotiation envisaged both in the "built-in agenda" and in the WTO's work programme, or in the agenda that is ultimately adopted for a possible "Millennium Round". There are already elements of information and analysis that facilitate an evaluation of the implications of the Uruguay Round agreements, regarding the participation of Latin America and the Caribbean in international trade, access to markets by their exports and, therefore, their development.[18] These elements will also help to determine the position of the Latin American countries in the WTO and in the next trade negotiations.

33. Knowledge of the rights and duties of developing countries regarding multilateral trade standards, as well as the identification of costs and benefits, should be central to all UNCTAD's activities on this matter. The exchange of experiences in the area of trade policy between government officials and experts, the business sector, and regional organizations must be the starting point for new analyses and serve as a reference in order to identify the needs for training trade negotiators.[19] Within this context, efforts should build on the project that has already been begun by UNCTAD: identifying and designing mechanisms which operationalize the concept of preferential treatment as it is sanctioned in trade commitments.

34. The subregional *integration schemes*–MERCOSUR, Andean Community, Central American System, and CARICOM-represent a considerable political and economic investment for their members, as do the other free trade agreements and intra-regional preferential trade agreements. Much has been attained in furthering those schemes within the framework of "open regionalism". But the challenge in the medium term consists of progressing towards more complex stages of integration that go beyond the strictly commercial sphere and involve other areas of economic and social policy, such as the harmonization of macroeconomic policies, the establishment of common mar-

kets, social and cultural integration, and external policy co-ordination. All these integration efforts, independently of the strategic objectives of each scheme or agreement, increasingly depend on two areas: in the first place, on the multilateral commitments in force, or those derived from future negotiations, and secondly on the results of the FTAA negotiation process.

35. Within this context, the future evolution of intra-regional integration schemes depends on the speed and intensity of convergence achieved among the countries. To the same extent to which the FTAA will determine the indiscriminate trade and economic liberalization of its members, it will lead to the disappearance of existing trade liberalization agreements. It also represents the likely case that these subregional integration schemes do not achieve a degree of integration that allows them to preserve their economic identity and therefore their *raison d'être*. Consequently, the dilemmas of co-ordination and convergence characterize –and in the next few years will dominate– the formulation of the trade policies of Latin America and the Caribbean. Those dilemmas are neither technical nor legal: their solution is an integral part of the development strategies and determines the nature of participation in the globalization process[20]. The studies being conducted by UNCTAD on the multilateral trade system, as well as the support given for the preparation of negotiating positions, should take into account the implications of regional integration and foster knowledge of those implications in other regions and other international fora.

B. Policies in Key Sectors

36. As of 1999, the subject of *agricultural trade* has become a priority linked both to the design of internal development policies and to the definition of positions in the WTO, in view of the new round of negotiations set to commence at the end of the year. Internal and external decisions of each country in the region should be based on diagnoses and prognoses of the agricultural sector that provide the means: (i) to determine, at the national level, the costs and benefits derived from the Uruguay Round's Agricultural Agreement, examining in particular the implications of the fact that such an important sector for the trade of the developing economies is not governed by the same disciplines as general trade in goods; (ii) to identify the points of negotiation on which the positions between exporting and importing developing countries may match best; (iii) to define the

leeway for negotiation, considering the agricultural commitments that exist between members of subregional integration schemes, the commitments that may arise from FTAA, and the objectives to be reached in the new multilateral agricultural round.[21]

37. For reasons similar to those of agricultural trade, the subject of *commodities* should continue to occupy a central position in the development agenda of Latin America and the Caribbean, given that the structural dependency of the export revenue from those products has not varied in the last couple of decades. International prices, on the other hand, have varied –and negatively so– furthering the deterioration of the terms of trade for nearly all the countries in the region.[22] In the formulation of trade policies and the positions to be taken at the WTO, considerations such as the following should be taken into account: (i) the subject of commodity exports seems to have vanished from the multilateral agenda, insinuating that the agreements of the Uruguay Round are response enough, whereas no analytical or political effort was spared to speed up the treatment of other topics such as electronic trade; (ii) in addition to the chronic tendency towards lower international prices, the Asian crisis has shown once more that, for the developing countries, commodity trading is one of the key elements of their external vulnerability, both in the case of products whose prices follow a persistent downward trend, and for those products that, within a downward trend, show a high degree price volatility (petroleum, for instance). In both cases, the impact of falling or unstable prices on the developing economies is analogous to the impact of volatile capital flows, and from a political and conceptual point of view this impact can be seen as an additional factor of vulnerability when it comes to talking about equity in the international economic system. The impact of the deterioration of commodity prices has a higher cost for the developing economies than for the industrialized countries, as in the case of capital flight.

38. The issue of *trade in services* appeared in the trade policies of Latin America and the Caribbean in the mid-eighties, since it was included in the Uruguay Round's agenda. Although the region has made considerable progress in acquiring knowledge about this subject and in defining domestic policies (particularly in the field of financial services and tourism), the majority of countries have just begun to identify their service exports, their most competitive activities, or those which require

investments in technology and human resources. In other words, in the field of trade in services, globalization has moved faster than the capacity to diagnose the sector's role in the economies and to give it a place in internal and external development strategies. Therefore, the general provisions on the treatment of development, such as Article IV of the GATS of the Uruguay Round have not yet been implemented. Within the framework of UNCTAD, it will be up to Latin America and the Caribbean, together with other developing regions, to identify this sector's economic potential, to define the multilateral rules and co-operation modalities that would allow countries to take better advantage of the globalization process in trade in services.

39. The topic of *"trade facilitation"* has recently appeared on the trade agendas of both the WTO and the FTAA. Undoubtedly it is of interest both to the Latin American and Caribbean countries and to the industrialized countries. It is important that the topic be looked at from an "export facilitation" and not only an import point of view in the studies and activities of technical cooperation undertaken at UNCTAD, i.e. the development of the physical and institutional infrastructure necessary for exporters and importers should be the central objective. This means linking the topic to financing and training of human resources needed to support the trade operations of a developing country. UNCTAD might, for example, analyze and design multilateral loan projects that take this approach. It should be pointed out that trade facilitation is particularly necessary for Latin America and the Caribbean, in order to support regional integration, border trade and economic *rapprochement* between the Caribbean, South America and Central America.

40. In the short run, the formulation of commercial policies by the Caribbean countries that are members of the Lomé Convention will focus on the minimization of costs produced by the revision or eventual disappearance of this preferential trade agreement. In principle, several options have been put forward that should be evaluated in terms of the level of benefits, which could accrue from their participation in the global economy. One option would be to accept the EU proposal to enter into reciprocal free trade agreements with six groups of ACP countries which would substitute for the current ACP regime, which is based on non-reciprocal free access to the EU market.[23] Another could be not to have a special trade agreement with the EU, but to move towards liberalization at a multilateral level, within

the framework of the WTO. The third option would be to seek a greater *rapprochement* of the Caribbean countries with the hemisphere and design preferential treatments within the framework of the FTAA or in agreements with Latin American countries. UNCTAD, together with CARICOM, SELA and other regional and international organizations working on the issue, might analyze these options and support *rapprochement* of the ACP's Caribbean countries with the existing integration and co-operation schemes in Latin America.[24]

"One of the most recent items on the multilateral trade agenda is electronic commerce, but to date the interest aroused does not meet the quantity and quality of the studies conducted on its impact on development."

41. One of the most recent items on the multilateral trade agenda is *electronic commerce*, but to date the interest aroused does not meet the quantity and quality of the studies conducted on its impact on development. It is neither clear how this topic could be included in the framework of multilateral trade disciplines, nor what the legal guidelines for electronic trading in goods and services should be. In any event, there is plenty to investigate, starting with the infrastructural requirements, technical co-operation in preparation for any future negotiations and the training of human resources from both the private and public sectors.

C. Trade Defence

42. Prior to the Uruguay Round, the use of *trade defence policies* (anti-dumping, countervailing duties and safeguards) were fairly uncommon in Latin America and the Caribbean, since tariffs and para-tariff measures were defence enough. As a result of trade liberalization, the region has become one of the major users of the standards agreed on at the Uruguay Round, particularly in the field of anti-dumping, above all in recent months, because of the increase in imports from countries that have devalued their currencies as a consequence of the Asian financial crisis. The region's products also continue to be affected by several defence actions, particularly by the United States, where the use of such measures has recently increased.

43. The subject of compatibility between these policies and international competition has appeared at the negotiating table again and needs to be closely examined: in the first place within the context of intra-Latin American customs unions, as it has been proposed that their members refrain from the application of those measures, and adopt common defence standards vis-à-vis third parties; in the second place, within the context the FTAA, where one of the objectives of the Latin American and

Caribbean countries should be to obtain more protection for its exports given the United States' trade defence legislation; and in the third place, within the framework of the WTO where this subject should be considered alongside the subject of competition standards and policies. The question is technically and politically relevant, regarding both the preparation of negotiating positions at regional, hemispheric and multilateral fora, and the exchange of experiences among institutions in charge of implementing trade defence mechanisms.

44. As far as the general trend in trade policies is concerned, it is important to point out that those forecasts predicting *protectionist* measures in the region have not been fulfilled, despite of the increase in Asian and Russian imports in 1998, the growth of trade deficits, and the recession sparked off last year by the impact of the financial crises. In 1998 and at the beginning of 1999, there has only been a slight increase in anti-dumping measures. However, these were isolated instances and did not signify a reversal of the route towards freer trade that is being taken, and there was only one case of a safeguard being applied. By contrast, the concern about protectionist tendencies in the U.S. has increased, given the debates in the U.S. Congress since 1988 and the increase in anti-dumping claims brought by that country since that same year. The impact of the financial crisis on the trading policies of the developing and industrialized countries should be analyzed by UNCTAD, expanding the study presented in the 1988 Report on Trade and Development.

D. Settlement of Disputes and New Issues

45. One of the achievements of the Uruguay Round has been to provide the WTO with a *Dispute Settlement Mechanism* that has been designed to guarantee the fair application of multilateral standards by all its members, replacing negotiated settlements, based on economic and political power, as was the case under the GATT regime. The credibility and legitimacy of the WTO largely depends on the effective operation of these "quasi-judicial" mechanism and not only on the multilateral agreements reached. Over the past two years, disputes between the United States and the European Union have put the efficacy of that mechanism to the test and have introduced a new type of trade conflict into the multilateral forum which is relevant to the interests of all the member countries and to the role of the WTO in the trade system. Despite the success attained, the mecha-

nisms seem to need more political weight and improved legal procedures: the members most interested in it are the developing countries.

46. *The banana dispute* had some "traditional" characteristics, but there were also new elements derived from the rules laid down in the Uruguay Round. In effect, the subject under dispute is situated in the traditional area of access to markets (in this case the European Union's), hampered by non-tariff barriers (the quotas granted to the ACP) which countries considered as incompatible with free trade principles. The transnational corporations that dispute over their share in the international banana market play a predominant role in the controversy, although indirectly through the two parties in conflict (the U.S. and the E.U.) –as happened in the frequent trade disputes that arose under GATT. The use of the WTO's dispute settlement mechanism is novel and promotes transparent settlements, but is not devoid of shortcomings: in the first place, the final ruling was questioned on three occasions by the European Union, thereby harming the credibility of this type of mechanism. In the second place, there was a clear decision to apply sanctions, but the mechanism was not capable of defining them precisely, allowing the affected party a margin of manoeuvre.[25] Lastly, from the point of view of the principles being disputed, the substance of the controversy refers both to access to the market and to the special and preferential treatment in favour of the ACP countries. It is significant to note that this last aspect, which is of interest to the developing countries, did not play an important role in the solution of the problem.

47. *The dispute about hormone treated beef* between the United States and the European Union is typical of the increasingly frequent trade conflicts. Here the central topic is consumer health protection and the use of biotechnology– a subject with social and ethical implications that go beyond what only until recently only belonged to the field of plant health standards. As in other "new topics" in the field of trade, it is a question of considering certain domestic standards as trade barriers, in this case, those relative to the condition of meat. What is at stake now is not the protection of a national industry, but the protection of standards that represent social values.[26] The solution to this new type of conflict cannot be the same as for disputes over tariff barriers, where the negotiation of a lower tariff, or some compensation in another sector, might be sufficient. In addition to this, the players in these new disputes are not just the States and the

firms they represent, but consumer organizations or environmental groups whose political role might be more important than that of firms. In the dispute about beef, the WTO's dispute settlement mechanism does neither carry sufficient political weight nor does it have the legal base necessary to prevent the dispute, which began ten years ago, from spreading and from being fought with economic and political instruments by the two superpowers of the trade system. The subject of beef is only one example of potential conflicts about "genetically modified" cereals and vegetables, or about the use of fertilizers, insecticides and chemicals in foods or even in textiles, so that not only high tech products from industrialized countries are concerned. It is hard to define to what extent there may be multilateral standards that sanction national criteria and values and where the line should be drawn between free trade and the right to set internal standards and policies.

48. The same questions are applicable to the treatment of *environmental and labour standards*. The topic of trade and environmental protection, introduced in the WTO following the Uruguay Round, has not led to a multilateral code of conduct that might prevent future pressure within and between the States conducting trade negotiations. Something similar has occurred as regards the treatment of the link between trade and labor standards within the framework of the ILO. In effect, both Congress and the U.S. Executive[27] have spoken out in favour of negotiations that include these topics; in Congress, those who make the fast track authorization conditional upon the definition of clear negotiation objectives in both topics are gaining fresh impetus. It is important for Latin America and the Caribbean to prepare solid technical and political arguments on the matter, applicable in a coherent manner both to the WTO forum and to the FTAA.

49. *The definition of priorities for trade policies in developing countries* not only depends on identifying each country's comparative and competitive advantages, or on commitments reached through regional or multilateral instruments. It also depends –sometimes immediately and inevitably– on the trade agenda defined by the industrialized countries, which largely pursue their interests at negotiating fora like the WTO. It is probable that in the "new trade topics" already dealt with or to be dealt with in the near future in the WTO, the Latin American and Caribbean countries will have many interests at stake and important specific objectives (for instance in the sphere of trade

and the environment, government purchasing, competition, investment). But whatever the national interest and order of priorities, Latin America and the Caribbean should place emphasis on the treatment of development issues in each topic and the co-ordination of trade policies with development financing policies. An organization like UNCTAD, together with regional organizations like SELA, ECLAC and ALADI, has a favorable position to take initiatives on these issues.

3. Development Financing

A. Capital Flows and Development Financing

50. In the early nineties, when the countries of Latin America and the Caribbean regained access to international capital markets and opened their foreign investment regimes and financial systems, their economic strategies gave priority to *the attraction of foreign capital.* The financing of development increasingly relies on external resources (including multilateral loans) and yet domestic savings have not increased at a similar rate.[28] The region learned many lessons from its own experiences as well as from the Asian crisis. First of all, the region learned that the inflow of foreign capital stimulates domestic economic activity and complements domestic investment. There are two risks involved, however: non-productive consumption and the rising value of assets, bearing no direct relationship with the increase in domestic savings.[29] The other possible deviation is capital flight. In this sense, ECLAC has indicated the need to learn to manage "bonanzas". More specifically, countries need to learn how to manage inflows of foreign capital, much the same way one learns to handle the crises set off by sudden outflows of capital.[30]

51. The second lesson, still in full discussion and for which no consensus is yet visible on behalf of the region, concerns the turbulence and imbalances generated by *short-term capital,* and the possibility of eventually controlling these flows. In addition to papers prepared by international financial institutions, UNCTAD could contribute additional elements to the debate from its own perspective, using as its bases some of the countries practical experiences. UNCTAD could also analyze the advantages and disadvantages of measures such as mandatory cash reserves,[31] or dissuasive taxes such as the one proposed by Nobel Prize winner, James Tobin which is applicable to all transactions involving currency conversions and which

has been mentioned recently but studied only little in terms of its viability.[32] In general, analyses of controls on short-term capital flows do not deal with the aspect of its compatibility with the globalization process. On the one hand, there is a need to avoid destabilizing and contagious "capital flight" but there is no desire to place restrictions to international capital flows. On the other hand, increased monitoring by international financial institutions is required but no country (particularly in the industrialized world) is willing to delegate its sovereignty over the area of monetary policy to a multilateral body.[33] Lastly, the main operators of short-term flows are private institutions that are generally organized transnationally, and have their own performance criteria, visions, and interests that are beyond the reach of the decisions made by governmental international organizations. The implementation of any control over "volatile" capital will depend on the resolution of these contradictions.

"*Criteria and conditions should be studied to reconcile the attraction of foreign capital with the need to avoid speculative capital.*"

52. The third lesson learned refers to the pace at which the *capital account is opened* in developing countries.[34] Seemingly, it is not yet fully understood how globalization affects the operation of national financial systems when the opening up process is too fast. Similarly, the sequence of the measures adopted is important and there is no "manual" available, providing instructions to follow in this respect. These instructions would need to treat issues such as criteria, the sequence of steps and additional safety measures that smaller economies should take in order to reduce the risk of an increased openness.[35] In this case, "financial safeguards" could be considered, similar to those applied for trade in goods, in the event of a sudden rise in imports.[36] In general, criteria and conditions should be studied to reconcile the attraction of foreign capital with the need to avoid speculative capital.

53. The fourth lesson concerns the *allocation of responsibilities regarding international capital flows:* private investors and recipients should assume the risk of an eventual massive capital flight. Thus, the cost of "bailouts" would not automatically be covered by State or multilateral resources. The assumption that the State or the international financial community will come to the rescue when bank institutions or enterprises are in difficulties ("moral hazard") can imply very high costs for the population of the affected states.[37] Another point that could be treated, along these same lines, would be to determine whether these bailouts should distinguish between national and foreign enterprises and banks. For example, when it comes time to distribut-

ing the emergency aid, is it fair to grant national treatment to a transnational financial enterprise affected by a crisis such as the one in Asia?[38] What is needed here is to find a point of equilibrium (similar to that mentioned in the previous item) between the need to attract foreign capital and the risk that the banking or business sectors of a developing country can assume; in other words, finding the balance between successfully attracting capital and excessive indebtedness. This is an issue that UNCTAD could treat in the framework for analysis and proposals for the "new international financial architecture."

54. Within the framework of development financing through private international resources, a new actor has emerged which at times has a more effective decision-making power than governments and international financial institutions: *risk classification agencies.* As is widely known, these extrapolate the evaluation methods used for businesses and apply them to the behavior of economies and their future perspectives. there is only a limited number of analyses of their impact on capital flows to and from developing countries.[39] Even scarcer are ideas of how to avoid that these agencies play such an important role not only in respect to capital flows, but also in respect to flows of information on the situation of countries, which determine short and long-term investment decisions. In this regard, there is a need to study the implications stemming from the fact that multilateral financial institutions no longer have a "monopoly" over the evaluations of economic policies in developing countries. Along these lines, it would also be advisable to examine the operations and the impact of the mechanisms for transparency and information dissemination put in place by financial institutions such as the IMF and the World Bank. These should, in principle, provide access to accurate information from official sources to economic agents.

55. Another experience that has been drawn from the course of the recent crises is the observation that in the event of financial turbulence, international capital markets *perceive all emerging economies as being the same*. Moreover, risk perception is passed on from short-term to long-term capital, thus affecting the direct investments already made or planned by foreign companies, even in geographically distant countries or in those whose macroeconomic situation had exhibited the "right" parameters. This is the "unfair punishment" mentioned by the Managing Director of the IMF when he commented on the effects of the Asian crisis on the access to capital markets by

Latin American and Caribbean countries'. As in the case of the preceding item, this should also be considered in the framework for analyses of the functioning of the international financial and monetary system. This would allow to determine the possibility of preventing these indiscriminate perceptions from occurring and of counteracting them effectively in the context of free circulation of information.[40] It has to be asked whether or not policies to promote investments enacted by the region's countries has been successful in correcting the "risk" image that had spread throughout the capital markets as a result of the Asian crisis. At the same time, it should be determined whether competition to attract foreign investment has been sufficiently assessed.

B. Foreign Direct Investment

56. In the mid-nineties, Latin America and the Caribbean was able to change the proportion of short- and long-term capital in favor of a greater percentage of foreign direct investment. While this new tendency has undoubtedly been beneficial for the region, a debate on the *quality of foreign direct investment,* should be initiated. UNCTAD has made significant progress in analyzing the behavioral pattern of foreign direct investments in developing countries and in evaluating policies to attract and promote investments. Now UNCTAD should devote itself to formulating criteria to determine how this capital can contribute to the development process: technology transfer, infrastructure, broadening of the productive capital stock, employment generation, export and market diversification, accordance with national development plans. A similar evaluation could be pursued regarding multilateral loans or bilateral development aid: to what extent have external resources been used to address the priorities defined by recipient countries, and to what extent have they satisfied the agenda of donor countries during the past decade?[41]

57. Negotiations of international investment agreements are tied to the concern over foreign investment quality. They tend to regulate national regimes on the basis of international guidelines. In the case of the project advanced by the OECD, efforts are aimed at ensuring that the interests of the more developed countries are given priority over those of the developing countries. At least in the case of Latin America and the Caribbean, it should be borne in mind that upcoming negotiations will not involve a hypothetical multilateral agreement; they will revolve

around bilateral agreements which in many cases already exist or are already being negotiated, and around the possibility of a hemispheric agreement in the framework of the FTAA which is already well advanced. An additional aspect is the recent increase in intraregional capital flows which has been stimulated by the developments in the integration schemes and the agreements for co-operation and free trade among Latin American and Caribbean countries. As these developments advance at a faster rate than the multilateral debate and provide precedents, they also play an important role in determining the position of the region's countries vis-à-vis a number of issues treated by the WTO. These include: the links between trade and investments, the TRIMS agreement, the future of the WTO Working Group on investment, the implementation of GATS and sectoral agreements such as those on financial services and the delicate issue of performance requisites, which also needs to be looked at in the context of active development policies. The training of negotiators to represent the developing countries needs to encompass foreign investment negotiations as an area in itself, not as a minor point linked to trade issues. From a development perspective, the quality of investment attracted and the efficiency of policies to promote investments will depend largely on the negotiation of agreements adapted to the actual needs of the recipient country.

C The Foreign Debt

58. The economic situation in Latin America and the Caribbean has undergone such considerable changes that the parameters that applied to the analysis of the foreign debt during the eighties are no longer valid. Despite the facts that both the debt structure and its impact on national economies have changed, that some important restructuring has taken place, and that the topic does not seem to have the same urgency for foreign economic policies as before, *the weight and importance of the debt for the region's economies has not diminished.*[42] It is important that UNCTAD, together with ECLAC, includes the analysis of the implications of the region's foreign debt in its activities that are related to the financing of development. Likewise, UNCTAD could analyze to what extent the debt service, the debt structure which is primarily based on bonds[43], and the conditionalities derived from schemes such as the Brady Plan and the IMF loans affect the region's capacity to formulate its own development strategies. The "new debt", above all contracted with multilateral finance institutions, should

be considered within this same context, taking into account the significant disparities between the region's countries in this matter.

59. To date, only 8 of the 41 countries eligible for official foreign debt reduction under the World Bank's *"HIPC initiative"* (for highly indebted poor countries) have benefited from its restructuring terms. It would be important to find restructuring formulae applicable to the medium income countries that account for the bulk of the region's foreign debt. These could include mechanisms inspired by this initiative but relative to the private external debt, as well as the expansion of the terms of Naples and Lyon for the debt with the Club of París.[44] Likewise, the role played by the international financial institutions in the eighties for the process of restructuring the region's foreign debt must be analyzed and compared with the present circumstances.

D. The New "International Financial Architecture"

60. *The scheme forged at Bretton Woods* in 1944 to govern the post-war international economic system comprises three converging areas: *the monetary,* entrusted to the IMF, *the financial,* in the hands of the World Bank, and *trade,* envisaged to be overseen by the International Trade Organization, but actually managed through the provisional scheme of GATT. This scheme proposed an interdisciplinary "architecture" that went far beyond strictly financial matters. However different, the lesson learned from the crises of the 30s is the same as the one we can learn from the systemic crises of our day: dealing with interdependence effectively cannot be achieved through sectoral policies and institutions, as if reality was dividable into separate parts. One of the Ministerial Declarations of Marrakech makes reference to the need for coordination between the WTO, the IMF and the World Bank.[45] It would be advisable to study the implementation of this coordination, given the international economic system's current behavior and the review of the relevance of interdisciplinary concepts as envisaged by the Bretton Woods agreement. It should also include the development dimension and the role that would be assigned to UNCTAD. Along the same lines, the performance of the institutions established under the Bretton Woods agreements also need to be reconsidered; these institutions were devised for a system in which the State was the main actor and where globalization did not have the same characteristics as today. Further, they were

designed to tackle national problems that could bear an impact on economic relations with other countries, but not to contend with a systemic crisis with repercussions in a large number of national economies, particularly developing economies.[46]

61. Hence, an analysis of linkages between monetary, financial, and trade spheres of the globalization process is needed as regards international institutions and policies. First and foremost, *transmission mechanisms linking the three spheres* should be studied *from the viewpoint of their impact on development*. From this analysis, conclusions applicable to the corresponding institutional mechanisms can be drawn. Although this analysis would be more important, it would not replace a revision of the individual operations of multilateral financial institutions.

62. The Mexican, Asian, Russian and Brazilian crises have opened the path for numerous changes in policies and operating modalities of the IMF and World Bank. These profound and significant propositions certainly go beyond those suggested in the numerous reports that were prepared for the 50th Anniversary of Bretton Woods in 1994. Financial aid operations have surpassed the level of even the most important loans granted in previous years. Conditionalities are also being reconsidered: in the case of Indonesia, for example, the IMF accepted a fiscal deficit of 8.5% of GDP and assigned resources to social programmes to counteract the impact of the crisis.[47] The World Bank has openly criticized several IMF assistance packages. Until recently, decisions such as the moratorium on debt payments by Russia would have meant not having access to new multilateral loans. In the present situation, on the other hand, the IMF granted new financing to Russia, as observed in March 1999. The new line of contingency credit established by the IMF forms part these operative and conceptual changes. It remains to be seen, however, whether this new tool capable of responding to crises similar to those of Asia.[48] We are witnessing the move towards a greater flexibility in the policy of financial institutions and in their criteria, and a questioning of models that not long ago seemed rigid and unalterable. The overall development perspective provided by UNCTAD is particularly opportune in this context.

63. Further, UNCTAD could also actively support the *treatment of the issue of a new architecture that contains the political elements necessary to ensure its viability:* the debate cannot exclusively be carried out in the sphere of the IMF and World

Bank, whose decision-making fora depend to a large extent on the Group of Seven and where developing countries, acting as borrowers, have no freedom of expression. The possibility of a Conference or "high level forum", convened by the General Assembly of the United Nations to treat the matter of Development Financing in the year 2001 and following up the work of the Second Commission, would be of great political significance. In the present circumstances, it is difficult to conceive a new architecture of the international economic system that is both politically sustainable and credible without first having met "governance" criteria such as participation, equity and transparency of decisions.

" *UNCTAD has the capacity to contribute conceptual and practical elements related to the need for a "positive agenda" to the debate on the operability of both international finance and trade institutions.* "

64. UNCTAD has the capacity to contribute *conceptual and practical elements related to the need for a "positive agenda"* to the debate on the operability of both international finance and trade institutions. The technical support it provides to the Group of 24 is particularly relevant in this respect. Based on its analytical work and exchanges of experiences, UNCTAD can underscore the limitations of "universally applied" models that do not distinguish between national and regional models. Likewise, UNCTAD can also strive for monitoring mechanisms that are not exclusively addressed to developing countries but also towards policies of industrialized countries that can bear a negative impact on the functioning of the global system.

III. General Thoughts

65. The issues referred to herein are not meant to be exhaustive or exclusively of interest to the countries of Latin America and the Caribbean as regards the subject of development. At the same time, these issues do not present the full range of UNCTAD's possibilities for current and potential actions. Instead, these issues are presented in order to stimulate initiatives and ideas, promote debates and analyses, and emphasize some points of view and priorities based on the experience of the SELA Permanent Secretariat.

66. Thinking beyond the scope of UNCTAD's future work programme (both broad and detailed), the essential matter is the institution's capacity to convey an *idée-force* among the international community by carrying out specific activities. UNCTAD should not be viewed only as an instrument for cooperation or analysis, but also as a means for the dissemination of ideas; the formulation of the "positive agenda" referred to at the beginning

of this document will require that this function be consolidated and that the developing countries manifest political support.

67. To this end, it is important that UNCTAD's actions achieve tangible and immediate results for developing countries. These actions should therefore include: (i) analyses of current and possible issues on the international economic agenda from the viewpoint of developing countries, as well as proposals for multilateral agreements or new initiatives at economic fora, with a multidisciplinary focus; and (ii) assistance in preparing proposals of developing countries, not only in the WTO but also at other international economic fora, particularly financial institutions.

68. Without wanting to be utopian, new ideas might be incorporated into international economic relations within less time than seems imaginable today. These relations should essentially be based on guidelines leading, in a positive manner, to globalization coupled with development. Much in the same way that we daily witness changes that surpass even the most far-fetched predictions, we cannot discard the possibility of formulating principles and policies that see sustainable human development and growth as complementary rather than contradictory.; that harmonize solidarity with competition; that establish constructive inter-relations between the areas of trade, money and finance; that define codes of conduct for governments and enterprises alike; that show respect for both equity and diversity; and that support governance in the States and in the operation of the global system. These elements could well be integrated into new development models and hence, also become part of a new positive agenda. This should promptly be transformed into viable and practicable mechanisms. UNCTAD has an important role to play in this process.

Notes

1. It is interesting that in the most recent communiqué of the Interim Committee of the IMF, the term "vulnerability" is used and given a limited content, since it refers only to internal economic policy shortcomings, pre-supposing that crises of external origin could be avoided if those shortcomings did not exist,: "the Committee emphasized, in particular, the need to address the sources of economic vulnerabilities in a timely way, such as inappropriate policy mixes, leading in particular to significant exchange rate misalignments; excessive debt accumulation; imprudent debt management policies; financial sector fragility particularly in a situation of weak financial supervision and regulation; limitations in information available to markets; weaknesses in corporate structures; inappropriate sequencing of capital account liberalization; and deficient risk management by creditors": Communiqué of the Interim Committee of the Board of Governors of the International Monetary Fund, *April 27, 1999. But the term "vulnerability" can also be defined referring to both domestic and international structural weaknesses: "the economies of the developing countries are much more vulnerable at present than before because of their own weakness and also exposure to uncertain external environment.", Bhagirath Lal Das:* Strengthening Developing Countries in the WTO, *in:* **International Monetary and Financial Issues,** *Vol. XI, to be published, UNCTAD, 1999.*

2. The approach that inspired this report considers vulnerability from a broad perspective, which covers both internal and external policies, because these are inseparable and both determinants of development.

3. It should be remembered that between 1991 and 1997 the economic policy climate in the region has been marked by important events in relation to subregional integration: the Ouro Preto Protocol of Mercosur was adopted in 1994: the following year, the transformation of the Andean scheme began with the Trujillo Protocol; the Central American and CARICOM schemes adopted fundamental decisions on their institutional operation and policies. In 1995 and 1996, Bolivia and Chile became associated members of MERCOSUR, and negotiations between that scheme and the Andean Community began.

4. See SELA: **Impact of the Asian Crisis in Latin America and the Caribbean,** *Caracas, June 1998 (SP/DRE/DI No. 21-98/Rev.1).*

5. World Bank: **Global Development Finance,** *Washington, D.C., 1999.*

6. In that regard, the Inter-American Development Bank has pointed out that the GDP must increase by 6%in order to obtain a 4% increase in real GDP per capita.

7. These three shortcomings are pointed out by Barry Eichengreen: **Toward a New International Financial Architecture. A Practical Post-Asia Agenda,** *Institute for*

International Economics, Washington, D.C., 1999.

8. *It is worth remembering that the concept of governance applied to the internal policies of the developing countries, has been dealt with in greater depth and implemented through several technical co-operation loans and programmes of the World Bank and the Inter-American Development Bank. By contrast, the South Centre speaks of "hegemonic global governance" (see South Centre:* **Towards an Economic Platform for the South,** *Geneva, 1998), and "Governance of the Global economy" (South Centre:* **Elements for an Agenda of the South,** *Geneva, 1999).*

9. *SELA has gained positive experience in this matter, thanks to the consolidation of regional fora that meet periodically, with the participation of extra-regional representatives, to exchange experiences on issues such as privatization, trade policy, competition, industrial policy and small and medium enterprises, and financial systems. UNCTAD could complement and expand that experience, becoming a privileged inter-regional and inter-agency forum.*

10. *See in particular: Joseph Norton and Ernesto Aguirre:* **Latin American Banking Systems. Recent Reforms and Perspectives.** *AECI, SELA, BCV, Caracas, 1998.*

11. *Even the U.S. Congress discussed "dollarization", after the topic had been dealt with at the Annual Meeting of the Inter-American Development Bank last March, and had been included in the declarations made by several top Treasury and Federal Reserves officials.*

12. *It is still too early to quantify precisely the impact that the devaluation of the Brazilian real has had on intra-Mercosur trade flows: however, everything seems to indicate that there has been a significant drop in reciprocal trade, especially between Argentina and Brazil.*

13. *See paragraph 57 of this document.*

14. *SELA organized a joint meeting on the subject attended by the regional networks of the institutions in charge of privatisation and competition on March 22 and 23, 1999. See SELA:* **Privatisation, Deregulation and Competition: A Framework of Analysis for Case Studies in Latin America and the Caribbean,** *Caracas, March 1999 (SP/RRPMR/DT No. 2).*

15. *See Manuela Tortora:* "Competition, international trade and development: from the virtuous cycle to the vicious cycle", *in:* Comercio Exterior, *Vol.48, No.10, Mexico, Oct.1998.*

16. *For example, in the field of competition, where UNCTAD has played an important role. On the subject of bank supervision, "the Basle standards" are developing into a similar kind of code of conduct, which would be worth evaluating from the point of view of its efficacy in reducing the vulnerability of the developing countries (a recent study by Morris Goldstein includes those standards within the framework of the essential remedies for avoiding financial crises:* **The Asian Financial Crisis: Causes, Cures, and Systemic Implications,** *Institute for International Economics, Washington, D.C.,* *June 1998). On the subject of investments, the attempt to codify national regimes through a multilateral investment agreement is well known. In relation to intellectual property, there is already a codification in the TRIPS agreement.*

***17.** This refers to deadlines for compliance with the TRIPS, TRIMS agreements, export subsidies, subsidies for agriculture, and customs valuation. See Diana Tussie:* "Flexibility in the New International Trade Rules", *in:* Capítulos No.50, *April-June 1997.*

***18.** Many meetings have been held and documents produced on the subject by several regional and international organizations. In addition to the analytical work there is the evaluation made on a regular basis within the framework of the SELA/ALADI/ ECLAC mechanism, Meetings of Officials Responsible for Trade policy in Latin America and the Caribbean. See too the reports of the Meetings of ad hoc Experts organized by UNCTAD on the positive agenda of the developing countries, as well as the South Centre, see South Centre:* The WTO Multilateral Trade Agenda and the South, *Geneva, 1998.*

***19.** It is important that UNCTAD continue to participate and support the annual Meeting of Officials Responsible for Trade Policy in Latin America and the Caribbean, organized by SELA, ECLAC and ALADI.*

***20.** See SELA:* **Perspectives of the Latin American and Caribbean Countries in the FTAA**, *Caracas, August 1998 (SP/DRE/Di No. 27 - 98), and* **Dynamics of the External Relations of Latin America and the Caribbean,** *Ed. Corregidor, Buenos Aires, 1998.*

***21.** See SELA: Implementation of the Uruguay Round Agreement on Agriculture: Issues for Latin America and the Caribbean, Caracas, April 1998, (SP/DRE/ Di No. 22-98); Agricultural Trade in the Multilateral Framework: Latin America and Caribbean, April 1999 (SP/Di No. 4-99); and South Centre: Universal Food Security. Issues for the South, Geneva, 1997.*

***22.** UNCTAD estimates that in 1998, the prices of various basic products exported by the region fell significantly by comparison with 1997, for example coffee –15.3%; sugar–25.1%; maize–9.5%; wheat –8.9%; cotton –13.3%; petroleum–21.4%: UNCTAD:* Trade and Development Report, *Geneva, 1998. ECLAC points out that in 1998 "a relative expansion of the export volume, close to 8%, only partially compensated for the drop in prices and (...) for the first time in 12 years the value of regional exports fell compared with the previous year. Despite the drop in price of manufactured products and oil, the value of imports increased to higher rates than those of exports, which increased both the trade and current account deficits. Between the end of 1997 and November 1998, the aggregate commodity price, excluding oil, fell 13%, although that average conceals considerable variations among products, from 3% to 41%: ECLAC:* Panorama de la inserción internacional de América Latina y el Caribe, *Santiago de Chile, 1999.*

***23.** A recent study by Alan Winters of the University of Sussex pointed out that this option would be* *particularly costly for the ACP countries: "if they allow in European imports duty-free, ACP governments stand to lose tariff revenues of around $ 7.5 billion. (..) Since imports from the rest of the world would still face large tariffs, European producers would have little reason to lower their prices. Thus, most of the $ 7.5 billion in lost tariff revenue would be likely to end up in the pockets of European producers rather than ACP consumers.". In:* The Economist, *April 24th, 1999, p. 71.*

***24.** SELA has put forward several initiatives in this matter. See SELA:* **Policy Options for the Caribbean in Trade Relations with Europe and the Americas**, *Caracas, November 1997 (SP/DD/Di No. 7-97);* CARICOM/**Central America Business Cooperation,** *Caracas, March 1999 (SP/Di No. 1-99) and* **Trade Liberalization Among the ACS Countries, Initial Proposals,** *Caracas, March 1999 (SP/Di No. 3-99).*

***25.** Something similar occurs when the panel examines disputes regarding anti-dumping duties: nothing can be said about the legitimacy of the duties applied, and the matter can only be examined if the procedure envisaged in the national legislation has been followed properly.*

***26.** It is obvious, however, that in this dispute as well as in the one over bananas and other products that there is an economic backdrop: on the one hand, the United States' growing trade deficit vis-à-vis the European Union, which reached US$ 30 billion at the beginning of 1999 according to the Department of Trade, and, on the other hand, the protection of European farmers within the framework of the Common Agricultural Policy (CAP).*

***27.** See SELA:* Antenna in the United States, *several editions, 1998.*

***28.** This is perhaps one of the most notorious matters that distinguishes the Latin American from Asian countries, whose domestic savings rates exceed 30% of GDP, inclusively after the financial crisis (the regional average rate for Latin America and the Caribbean is 20%) and where as a result, external financing does not play the same role.*

***29.** In fact, according to ECLAC "when external savings increase one percentage point above its tendency level, domestic savings decrease by approximately half a percentage point of the product". ECLAC:* **Quince años de desempeño económico. América Latina y el Caribe,** 1980-1995, *Santiago de Chile, 1996, pp. 51-52.*

***30.** Many Latin American countries' situation differs from that of developing countries where the free flow of capital provides no benefits and external resources remain scarce: "under free competition, capital does not flow into the many developing countries that need it." Ha-joon Chang and Ajit Singh:* "Lessons from the Asian Crisis and the New International Financial Architecture: A Developing Country Perspective", *In:* South Letter, *No. 33, Geneva, 1999, p. 5.*

***31.** Chile and Colombia, and Costa Rica, to a smaller extent, have applied measures of this kind. It would be interesting to compare these experiences and analyze the effects that resulted from the reduction to zero of reserve requirements in Chile in September*

1998.

32. *Barry Eichengreen's views represent an exception in this regard. Eichengreen considers a tax of this nature as one of the least effective measures. See* **Toward a New International Financial Architecture**...op.cit., pp. *88-90.*

33. *The delegation of national monetary policies to Europe's Central Bank forms part of the process of European integration and would not be a valid example in this context. Regarding the management of the international monetary system, the European Union would be considered a national entity that has the same status as the United States as regards potential multilateral institutions with monetary competence. Nevertheless, it would be advisable to look into the problems facing several EU countries to keep their growth policies in force with the existing structural differences and disciplines established vis-a-vis the Euro.*

34. *"The Committee encouraged the Fund to continue its work on the appropriate pace and sequencing of capital account opening and in particular, to further refine its analysis of the experience of countries with the use of capital controls (...)":* Communiqué of the Interim Committee... *op. Cit., April 27, 1999. Also see Jesus María Fannelli:* "Financial Liberalization and Capital Account Regime: Notes on the Experience of Developing Countries", *in:* **International Monetary and Financial Issues for the 1990s.** *Vol. IX, UNCTAD, Geneva, 1998.*

35. *See Gerry Helleiner:* "Financial Markets, Crises and Contagion: Issues for Smaller Countries in the FTAA and Post-Lomé IV Negotiations", *Caribbean Regional Negotiating Machinery, Kingston, January 1999.*

36. Ibid.

37. *International Monetary Fund:* **World Economic Outlook,** *Washington, April 1998, Part 2, Box 3.*

38. *Gerry Helleiner,* op. cit.

39. *More studies focus on the "limitations" of macroeconomic management of countries that have undergone financial crises than on the functioning of risk agencies and the relation these have with international capital flows.*

40. *Unlike the Interim Committee of the IMF, on several occasions G-24 has pronounced its opposition to "total" transparency and free circulation of information that could spur uncontrollable reactions by financial operators: "Ministers (...) reiterate their concern that publication of Fund staff surveillance reports is likely to compromise the quality and candor of discussions with member countries, thereby undermining the effectiveness of the Fund's surveillance function. This issue is especially pertinent in the case of a number of countries for which the publication of documents might lead to disproportionately large effects (...)." Intergovernmental Group of Twenty-four on International Monetary Affairs.* Communiqué, *April 26, 1999.*

41. *In the framework of policies to promote investments, mechanisms could be devised to protect and encourage those capital flows that are directed towards the most important and* *most underdeveloped sectors of developing countries.*

***42.** According to ECLAC figures, the debt grew from $ 452.338 billion in 1991 to $ 697.797 billion in 1998. See ECLAC:* **Balance Preliminar de la Economía de América Latina y el Caribe,** *Santiago de Chile, 1998. See also SELA:* **External Financing and External Debt in Latin America and the Caribbean in 1997,** *Caracas, October 1998 (SP/CL/XXIV.O/Di No.6).*

***43.** See SELA:* **External Financing and External debt in Latin America and the Caribbean in 1998** *(being prepared): "commercial banks account for a decreasing share of the region's total debt (between 1980 and 1996, its share dropped from 63% to 18%, while that of bonds jumped from 5% to 47%). Only a small part of the global funds that circulate in financial markets (of which 2% is made up by mutual funds and pension funds) goes to emerging countries and of this only 10% forms part of the foreign debt. Of this amount, an even smaller proportion goes to Latin American countries. Hence, the exposure of bond holders is of limited significance."*

***44.** "The problem faced by middle income Latin American countries is different from that of countries with lower income. For the latter humanitarian criteria should prevail. Here one deals with a matter that embodies economic, political and social aspects where developed countries should compare the cost of debt alleviation and the cost of rescuing countries in crises situations." Ibid.*

***45.** See Esperanza Durán:* "The Institutional Triangle": IMF-World Bank-WTO, *in:* Capítulos, *No. 43, April June 1995. It is surprising that in recent communiqués, G-24 pronounced itself in favor of a closer rapport between the IMF and the World Bank, but made no mention of the WTO, as it had done previously in communiqués issued during the negotiations of the Uruguay Round.*

***46.** SELA:* **Reflections of the Permanent Secretariat on the Dynamics of the External Relations of Latin America and the Caribbean,** *December 1998 (SP/CL/XXIV.O/DT No. 9), p. 21.*

***47.** In the light of this modality, it would be convenient to consider criteria and social compensation operations that are automatically financed with multilateral resources in the framework of adjustment operations required in the case of financial crises. Regarding the latter, this could include support for microenterprises, the most vulnerable sectors, or employment generation. In this sense, it would be important that UNCTAD study the contents and implementation of the "comprehensive development framework" (CDF) that is being discussed and applied to several pilot projects of the World Bank to maintain a balance between macroeconomic and social concerns: see* Communiqué of the Development Committee, *28 April 1999, paragraph 8.*

***48.** In his recent study, Barry Eichengreen referred to the need to reform this institution's functioning going beyond additional lines of credit yet not going as far as including "radical reforms": op. cit., pp.*

97-121. "The notion that the IMF should be abolished flies in the face of a century and more of experience with the operation of financial markets. Accidents can happen, and preventing fatal consequences requires the provision of a financial safety net. IMF loans can play a useful role in limiting the systemic consequences. But IMF resources will always be small relative to those of the markets." Ibid., pp. 119- 120.

The Santo Domingo Declaration

This text was adopted at the SELA convened Latin American and Caribbean Consultation and Coordination Meeting held in Santo Domingo, Dominican Republic, on August 5 and 6, in preparation for the X United Nations Conference on Trade and Development.

Declaración de Santo Domingo

Este texto fue aprobado al finalizar la Reunión de Consulta y Coordinación de América Latina y el Caribe, convocada por el SELA, y realizada en Santo Domingo, República Dominicana, entre el 5 y 6 de agosto, previa a la X Conferencia de las Naciones Unidas sobre Comercio y Desarrollo.

La déclaration de Saint Domingue

Ce texte a été adopté à l'issue de la Réunion de consultation et de coordination de l'Amérique latine et des Caraïbes, convoquée par le SELA et tenue à Saint-Domingue, en République Dominicaine, les 5 et 6 août 1999, au préalable de la Dixième Conférence des Nations unies pour le Commerce et le Développement (CNUCED).

Declaração de São Domingo

Este texto foi aprovado al finalizar a Reunião de Consulta e Coordinação da América Latina e o Caribe, convocada pelo SELA, e realizada em São Domingo, República Dominicana, entre o 5 e 6 de agosto, prévio à X Conferência das Nações Unidas sobre Comércio e Desenvolvimento.

The Santo Domingo Declaration

The following document was approved at the SELA-UNCTAD consultation and Coordination Meeting convenet in preparation of the of the UNCTAD X Meeting to be held in Thailand in the year 2000.

The Ministers and Heads of Delegation of Latin America and the Caribbean, attending the Consultation and Coordination Meeting held in Santo Domingo, Dominican Republic, on 5 and 6 August 1999 prior to the tenth session of the United Nations Conference on Trade and Development (UNCTAD X):

Considering that, unlike the economic growth and optimistic prospects for the countries of Latin America and the Caribbean which characterized the international environment at the time of UNCTAD IX, the background to the Tenth Conference will be an international situation of great uncertainty for the developing world, linked to the phenomena associated with the increase in globalization;

Considering that the recent monetary and financial crises have shown how contagious they can be in countries and regions, with farnreaching effects on trade and economic growth;

Considering that the international financial crisis that originated in southneast Asia has had severe adverse effects for the region, which have become more acute with the fall in demand on world markets, the drop in commodity prices to the lowest levels in the last 30 years, the restriction of access to external finance and the flight of shortnterm capital, all of which has led to a significant slowdown in the economic growth rate of Latin America and the Caribbean;

Considering that, despite the farnreaching structural reforms and macroeconomic management measures adopted by the region throughout this decade, little progress has been made in reducing the vulnerability of our countries, which has become a key element of our agenda;

Considering that the effect of the natural disasters that have occurred in the region creates an urgent need to redirect development strategies and aid flows, so as to improve our countries' capacity to prevent and mitigate the effects of these disasters, reduce our vulnerability to them and alleviate their impact on the economies of the region;

Considering the need to promote solidarity in action to eliminate poverty;

Considering the need to strengthen the role of UNCTAD as an appropriate forum for analysing and designing development strategies which promote economic growth and social development and strengthen the growth of the developing countries;

Considering that UNCTAD X will be held just a few months after the Third Ministerial Conference of the World Trade Organization (WTO) to be held in Seattle, and on the eve of the South Summit, the process of evaluation of the World Summit for Social Development, and the United Nations Millennium Assembly, a fact which enhances its importance and significance as the first major multilateral economic event of the new millennium;

Hereby declare:

1. The model based on the market economy must give greater priority to social protection policies and effective measures to prevent, predict or manage economic and financial crises such as those which have occurred recently. The challenge we face is the urgent definition and adoption of new development strategies that will:
– improve the living standards of the population;
– integrate our countries harmoniously within a more receptive global system;
– promote sustainable and sociallynbalanced growth capable of creating more and better jobs;
– speed domestic saving and productivity;
– help to increase and diversify the supply of goods for export;
– raise our share in the value added of the production chain; and
– incorporate new technologies.

2. The smooth functioning of the international financial markets is a key factor for the external financing of our countries. The influx of foreign capital stimulates economic activity and complements investment. The financial crisis that originated in southneast Asia has highlighted the deficiencies of the existing international system. These deficiencies require a vigorous international response aimed at establishing a Anew international financial architecture@, in whose design UNCTAD should participate, in close consultation and cooperation with other competent entities, with proposals that guarantee the full participation of the developing countries. Such proposals should include, among other aspects, reforms of the monitoring and regulatory systems and enhanced early warning and response capabilities for dealing with the emergence and spread of financial crises (as specified in United Nations General Assembly resolution 53/172), and should give the developing countries greater flexibility and autonomy in the management of capital flow policies. It is also important that these reforms should include greater participation by the developing countries in the decisionnmaking processes of the international financial institutions, consistent with the growing weight of these countries in international trade and investment flows and the significant impact the reforms will have on them.

3. The burden of external debt has become one of the main obstacles to the achievement of the social and economic development objectives of the developing countries. Current conditions make it necessary for a high percentage of the gross domestic product to be devoted to debtnservice payment, with the consequent risks for social and political stability. There is a need for UNCTAD to study and propose strategies with a view to arriving at a lasting solution to the problem of the external debt of the developing countries, one which also covers the elimination of the structural causes of indebtedness. These proposals should comprise various types of solution which take into account the payment capacity of each country and the measures provided for in General Assembly resolution 53/175. The proposals should also incorporate the strengthening of international financing for development.

4. The countries of Latin America and the Caribbean consider that the attraction of foreign direct investment (FDI) constitutes a very important element in our development strategies, and in this connection we consider that progress will have to be made in the process of market opening and in improving access to financial markets. Since the midn1990s, the region has managed to reduce the proportion of shortnterm capital in favour of a growing percentage of FDI. We hope that this trend will accelerate and that FDI will continue to contribute to the modernization of our production processes through the transfer of technology and the strengthening of physical infrastructure, local enterpreneurship and job creation. The trend could be stimulated through incentives to facilitate the flow of capital, such as a multilateral fund supplying part of the resources required for investment projects, as a supplement to the resources contributed by banking entities in the private sector. We consider that UNCTAD should play an active and important role in the design of appropriate mechanisms for achieving these objectives.

5. A more stable international economic environment is essential for the growth of our economies and job creation. International trade plays an essential role in the generation of opportunities for the development of our peoples. The activities of the World Trade Organization (WTO) will need to take account, in a balanced manner, of the interests and concerns of all its members. For example, in connection with trade in agriculture, it is necessary to consider whether it is reasonable for a sector of such importance for our countries not to be governed by the same disciplines as general trade in goods. In this connection, the activities of WTO need fully to recognize the objectives and interests of all the developing countries. UNCTAD must continue to support the preparation of the developing countries for the multilateral trade negotiations, including the formulation of a positive agenda and the enhancement of their institutional capacities for taking advantage of the opportunities of the multilateral trading system. We appeal for the effective application of special and differential treatment for the developing countries, as provided for in the general principles of WTO.

6. We note the importance for all countries of consistency between national trade policies and the multilateral trade agreements. However, we are concerned to note that the developing countries continue to be subjected to, or threatened with, unilateral trade reprisals and the application of legislation with extraterritorial effect. Similarly, the preferential trade access granted to some of our countries continues to be tied to conditionalities that have nothing whatsoever to do with trade. We believe that these harmful practices should be eliminated.

7. We undertake further to improve the mechanisms for regional and subregional integration, together with the other agreements and projects on free trade and intraregional trading preferences in Latin America and the Caribbean, as a basic tool for our development. They represent an important political and economic investment for their members and are facilitating their economic openness and integration into the system of international economic relations within a framework of Aopen regionalism@. The multilateral system must be taken into account as a framework for the conclusion and development of regional trade agreements since these facilitate its objectives. The integration processes enable us to progress towards a more open multilateral system.

8. The issue of commodities continues to occupy a priority place on the development agenda, inasmuch as the revenue from exports of these products continues to be of cardinal importance. Apart from the periodic downward trend in international prices, the international financial crisis has shown once again that our countries' dependence on the export of unprocessed commodities or raw materials is one of the key factors in our external vulnerability. UNCTAD must carry out analytical studies and provide technical cooperation to support our countries in the horizontal and vertical diversification of the goods we produce for export. The countries of Latin America and the Caribbean stress the importance of the Common Fund for Commodities in financing development measures and promoting market stability, and express their interest in revising its rules so as to bring them into line with the new realities.

9. We reaffirm the full validity of UNCTAD's mandate as the focal point of the United Nations responsible for the comprehensive consideration of development problems and related issues in the fields of trade, competition, finance, external debt, monetary aspects, technology, investment and sustainable development, and as a prime forum for debating development strategies and policies. In this connection, its mission must be the promotion of development; in order to achieve this it is essential to bring about the appropriate integration of the developing countries into the world economy and the trading system, ensuring comprehensive development in the context of globalization centred on the individual. In view of the urgent need to design and promote new development strategies for the future, UNCTAD should extend its work to the new problems faced by the developing world.

10. UNCTAD's analysis and research activities should contribute to the study of the changes in the world economy, and their impact and consequences for the developing countries with regard to trade, competition, raw materials, foreign investment, technology, financial resources for development, electronic commerce and the environment. Special measures are needed to deal with the situation of structurally weak, vulnerable and small economies, landlocked countries and small island developing States, and we request UNCTAD to facilitate the identification and application of such measures through its research, analysis and technical cooperation activities.

11. We emphatically support the efforts of the Secretaryn-General of UNCTAD to strengthen the organization and to enhance its mission as an institution structured for the service of development. In this context, UNCTAD should facilitate the formulation of global and national policies through dialogue and the promotion of consensus and technical cooperation. This action should be converted into tangible results through the presentation of new ideas and concepts, the promotion of understanding on new agreements, and the development of a positive agenda for proactive participation by developing countries in the trade negotiation forums and for their contribution to the implementation of these ideas and to the new international arrangements.

12. We advocate the establishment, within UNCTAD, of a development centre or institute with teaching, research and support capacity for the developing countries. The centre's principal activities would include ongoing and intensive courses in Geneva to prepare negotiators from developing countries in the topics of the multilateral trade agenda and in UNCTAD's areas of competence.

13. In the light of UNCTAD's Technical Cooperation Strategy, which the Trade and Development Board approved in June 1997, we note with concern the substantial and sustained reduction in participation by the Latin American and Caribbean countries in UNCTAD's technical cooperation programmes. Consequently, the UNCTAD secretariat should, in conjunction with the countries of the region, design and propose new strategies which are aimed at restoring our traditional participation in its programmes and which will enable our growing needs in this field to be met, under its regular budget. In addition, we support the expansion of UNCTAD's funds for technical assistance in order to continue financing the participation of the developing countries in the expert meetings.

14. We affirm that economic cooperation among developing countries (ECDC) is still of great value. Some developing countries are acquiring new potential in becoming important foreign investors and protagonists in international trade. This means that there are greater possibilities of cooperation among developing countries in order to increase investment and reciprocal trade and to enhance industrial and technological cooperation. The South Summit, to be held in Havana in the year 2000, should be a milestone in the field of ECDC. We also note that the second round of negotiations on the Global System of Trade Preferences among Developing Countries (GSTP) has ended, and in this connection we consider it important to rationalize, deepen, expedite and expand GSTP so that its effects will be increased.

15. UNCTAD X will provide a propitious opportunity to examine the state of the world economy, evaluate the impact of globalization on the economies of the developing countries and identify the basic elements of a new consensus for development aimed at the eradication of poverty and the harmonious, fair and sustained economic growth of the developing countries. Our Governments undertake to promote a study that will establish the components of this new consensus for development with the aim of incorporating the social elements essential for sustainable human development alongside the economic elements on which development is currently based. For this purpose, we propose that UNCTAD should always devote the highnlevel segment of the sessions of the Trade and Development Board to the debate on new strategies for development. We therefore request the UNCTAD secretariat, when preparing the relevant documentation for those meetings, to suggest possible options for the attainment of the new consensus. The meetings should be attended by the highest authorities of the competent organizations.

16. We undertake to help to provide UNCTAD with the necessary capacity to become the driving force behind the new consensus for development.

17. We thank the Government and people of the Dominican Republic for their hospitality and for the excellent organization of the technical and ministerial phases of the Consultation and Coordination Meeting of Latin America and the Caribbean prior to UNCTAD X. We also express our appreciation for the support provided by the secretariats of UNCTAD and the Latin American Economic System (SELA) in ensuring the success of our Meeting.

Santo Domingo, Dominican Republic, August 6, 1999.

The Quantitative Dimension of States' Power

This article suggests a possible formula to examine the dynamics of states' power. In it, an abridged version of this formula is applied to the study of the evolution in time of the power index of the major world powers between the years 1950- and 1996. It also analyzes the distribution of power in the European Union and NAFTA and defines ways to improve the quantification of the power index of states. In the authors' opinion, this type of indicators are a useful tool for the analysis of international relations.

La dimensión cuantitativa del poder de los Estados

En este trabajo se plantea un posible formalismo para estudiar la dinámica de los índices de poder de los Estados. Se utiliza una versión reducida de dicho formalismo para estudiar la evolución temporal del índice de poder de las principales potencias entre los años 1950-1996. Se analizan la distribución de los índices de poder de la Unión Europea y del TLCAN y se definen líneas de trabajo para mejorar la precisión de los indicadores cuantitativos del poder de los Estados. En opinión de sus autores, la introducción de estos indicadores constituye una herramienta indispensable para el análisis de las relaciones internacionales.

La dimension quantitative du pouvoir des Etats

Cette étude présente un modèle formel permettant d'analyser la dynamique des indices de pouvoir des États. Le modèle est mis en application en version résumée, afin d'étudier l'évolution, dans l'intervalle 1950-1996, de l'indice de pouvoir des principales puissances du monde. Sont ensuite comparés les indices de pouvoir de l'Union européenne et de l'ALENA. Des lignes d'action sont également suggérées qui permettent d'obtenir des indicateurs quantitatifs plus précis du pouvoir des États. De l'avis des auteurs de ce travail, de tels indicateurs sont des outils appréciables d'analyse des relations internationales.

A dimensão quantitativa do poder dos Estados

Neste trabalho se oferece um possível formalismo para estudar a dinâmica dos índices de poder dos Estados. Utiliza-se uma versão reduzida do referido formalismo para estudar a evolução temporal, do índice de poder das principais potências, entre os anos 1950-1996. Analizam-se a distribuição dos índices de poder da União Européia e do TLCAN, e definem-se linhas de trabalho para melhorar a precissão dos indicadores quantitativos do poder dos Estados. Na opinião de seus autores, a introdução destes indicadores constitui uma ferramenta indispensável para o análise das relações internacionais.

A Quantitative Dimension of States's Power

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DEBATES

Introduction

Power has always accrued in the hands of those societies that have managed to imbue themselves of a collective vision of global affairs of such a nature as to mobilize them in the pursuit of their shared goals throughout generations. Such is the kind of power that Mallmann (1994) defines as ethnic-political, since ethnic groups are social groups mobilized by a common culture, to be differentiated from other groups for which power can only be the result of their insertion into a society and of their participation in the hegemonic political coalition that controls it. The latter is defined as primary power while secondary power would be the one based on a society's ability to access "natural resources", as well as on its capacity to transform them in order to enjoy favorable conditions vis-à-vis other societies or States. Wallerstein (1984) proposes a different four tier classification: State power, ethnic-demographic power, class power (as defined in Marxist terms), and domestic-entities power. In this paper, temporal changes in a series of "primary power" and "secondary power" indicators, as defined by Mallmann (1994), will be analyzed with a view to quantifying "State power" throughout the second half of the century.

On this basis we will try to identify trends for the main world powers in order to thereby establish relative power variations among and between them. Paul Kennedy (1987), for instance, analyses and describes the rise and fall of world powers throughout the last five centuries. Following Kennedy's approach, a nation projects its military might on the basis of its economic resources but the high cost of maintaining military supremacy ultimately causes its fall. Indeed, major powers in a crisis situation react by increasing defense expenditures thereby debilitating themselves by way of a non productive allocation of their available resources. For Kennedy there has been, throughout history, a significant correlation between productive capabilities and military might. In his work he clearly shows that the relative strengths of major world powers never remain constant, due in particular to the irregular growth pattern followed by each society and to the greater advantages provided to one over the other by developments in technology and organization. Following we will undertake a preliminary approach to a quantitative analysis of world power distribution. In so doing, we will avoid an analysis of Schattschneiders's (1960) power models. This suggests that the end result of conflict among powers depends not on their relative strengths but on the scenario in which such a conflict takes place. It would ensue that in politics the most important strategy is to predetermine the scope of a conflict. Even more so if, assuming power balances shift once the scope of a conflict is widened, it is understood as inevitable that the weaker party will foster such an expansion. It follows that the ultimate power of a State resides in its capacity to forge strategic alliances in order to consolidate its goals, even if it has "less" power in comparative terms.

I. Developing an Indicator of the Dynamics of State or Country Power

Measuring the relative power of states has been a constant problem for geopolitics given that it can not be measured in a direct way (Taylor, 1985). The first mathematical models applied to the dynamics of power were developed by Lewis F. Richardson between 1920 and 1950. Richardson (1953) was most probably one of the founding fathers of mathematical sociology. His models, in general terms, concentrated on the study of the dynamics of the arms races that took place in Europe during the XIX and early XX centuries. His analysis of the power of nations remained circumscribed to "military power".

More often than not, to estimate the power of a State or a Nation, some of the more relevant characteristics of States are chosen and combined in some ingenious way to formulate a predetermined ordinal classification (Mallmann, 1994; Muir, 1981;Neumann,1997). In general, such theoretical approaches can intuitively be held as reasonable although not always satisfactory since the measurement units or dimensions chosen for each indicator are definitively arbitrary.

Taking into account the weaknesses of prior models, and the fact that in such models each power indicator is static in its scope (for only one year), we will try to develop certain criteria for the establishment of a power index capable of showing changes in the long term (some 50 years), and which includes "non dimensional" units in order to avoid, thereby, inconsistencies derived from adding "apples and pears". The proposed model has the following characteristics:

1. It is suggested that chosen power variables be represented as a **fraction** (f_p) of the **total available resources on Earth for each variable**. Some of the possible categories could be the following: **natural resources** (land and sea territory, energy production, monetary reserves in national Central Banks, Gross Domestic Product, total exports,...); **human resources** (population,...); **military resources** (military expenditures, military personnel, nuclear power,...); **research and innovation resources** (number of scientists, technology experts, artists, scientific publications, innovations and patents, etc.). Such values as assumed by each variable would factor in time (i.e. would fluctuate from year to year).
2. Each fraction of the factors identified in (1) must necessarily be "modulated" by a quality parameter (i.e. the Humid Pampa's land quality is not the same as that of the Sahara desert). This C_p factor will assume values between 0 and 1. Due to a factoring-in of technology and organizational change, as well as of each society's own dynamics, such quality indicators will be time-dependent.
3. Each "Nation-State" society will have a different **synergic integration** level (I_s), (or antagonic disaggregation), which will have an effect on the dynamics of the use of each power factor. Thus, some will see their power index increase while others will see it decrease sensibly. Mallmann (1994) concentrates on a detailed study of possible synergic and antagonic indicators of a societal origin. He considers different degrees of ethnic, religious and linguistic integration, as well as a so-called **political synergy coefficient** along which to classify societies within certain rythmic dynamics (Mallmann and Lemarchand, 1998 and Mallmann, 1999).
4. Taking into account the previous considerations, a country power index *(Pp)*, as a function of time, can be established as

$$P_p(t) = I_s(t)C_i(t)(\prod_i f_i(t)) \qquad (1)$$

wherein *(p)* represents the country or group of countries under analysis (for example, the European Union or Nafta); (s) the synergy coefficient under use; and *(i)* the fraction of world resources. N would represent the product of all *i* fractions taken into account. This formula has the following mathematical property:

$$\sum_{p} \prod_{i} f_i(t) = 1 \qquad (2)$$

That is to say that the sum of the product of all fractions for all countries will always equal 1. Such a property will be of interest once regional alliance policies are analysed. Even more, as by definition the quantities *Ci(t)* and *fi(t)* are non dimensional, i.e. are not quantifiable in units, all we need to do is choose the kind of social synergy indicators in order to equally represent them by non dimensional numbers.

5. The above could be made more realistic if it could equally take into account the dependence or weakness of one State vis-a-vis the other. For example, in such cases where external commitments weaken a State's autonomy in the exercise of power. External indebtedness, border conflicts, massif immigration phenomena, etc. would exemplify such situations. A P_d index, similar to the P_p index, could thus be defined. A matrix of dependency indicators would be required since a certain country P_1 might be indebted to another P_2, be engaged in an armed conflict with P_3, receive migration flows from P_3,...Each of these different countries, P_j (with j = 1, 2, 3...), will have its own synergy coefficient and societal characteristics. In this line of thought, a first approach would be to try to measure power balances among pairs of countries. The total power P_T of one country vis-a vis another would be the difference between its own power P_{p1} and that which is the result of the measurement of its P_1 dependence to a certain other P_2. Thus considered, the **Power Indicator** would be defined as:

$$P_T(t) = P_p(t) - P_d(t) \qquad (3)$$

II. Applying the Formula to the Study of Major World Powers

Below, we will apply the proposed formula in a very simplified manner, selecting the most representative power variables whose values it was possible to establish on the basis of published international statistics. To simplify, we shall analyse only power variations for each country between 1950 and 1996. Coefficients for the loss of power due to dependency factors, P_d, will not be taken into consideration for the purposes of this paper.

Moreover, in order to simplify calculations it will be assumed that $C_i(t) = 1$ for all coefficients.

Fractions of power under consideration. Annual values for the period 1950 – 1996 for the following fractions of world totals will be considered: territory, population, gross domestic product, international reserves in central banks, export values and total military expenditures.

Societal synergy indicators. Although Mallmann (1994) defined a very complete set of indicators to measure the degree of synergy within a certain society, the lack of an homogeneous and complete set of data for such indicators for the 1950 to 1996 period, along with the fact that it is not always feasible to establish a non dimensional indicator, implies that this factor can not be represented as originally considered. In replacement, the Human Development Index, as calculated following the United Nations Development Program's (UNDP) methodology, has been adopted. The advantage of this indicator is that it fairly well represents the degree of societal synergies in measuring three important components: *life expectancy at birth*, an *education coefficient* which takes into account the degree of alphabetization within a society and the average number of school years in its educational system, and the *per capita gross domestic product* calculated taking into account each society's purchasing power. Thus, the UNDP developed a non dimensional indicator which fluctuates between 0 and 1, and which allows us to classify each society along the lines of such coefficient's values. UNDP started publishing the HDI yearly since 1990 and it has calculated its values for each country for 1960, 1970 and 1980. Following the same methodology as the UNDP and with data published in the United Nations Statistical Yearbooks, calculations were also made for the 1950 HDI. Next, using the HDI values for 1950, 1960, 1970, 1980, 1990, 1991,1992, 1993, 1994, 1995 and 1996 and on the basis of a calculation program, an interpolation of the different annual values between 1950 and 1996 was made, using for such purpose a soft adjustment function known as "*smoothlowess*".

Summing up, the function applied to estimate the evolution in time of the power index is as follows:

$$P_p = IDH_p(t) \times f_{sup}(t) \times f_{pob}(t) \times f_{PBI}(t) \times f_{Res}(t) \times f_{exp}(t) \times f_{gas.mil}(t) \quad (4)$$

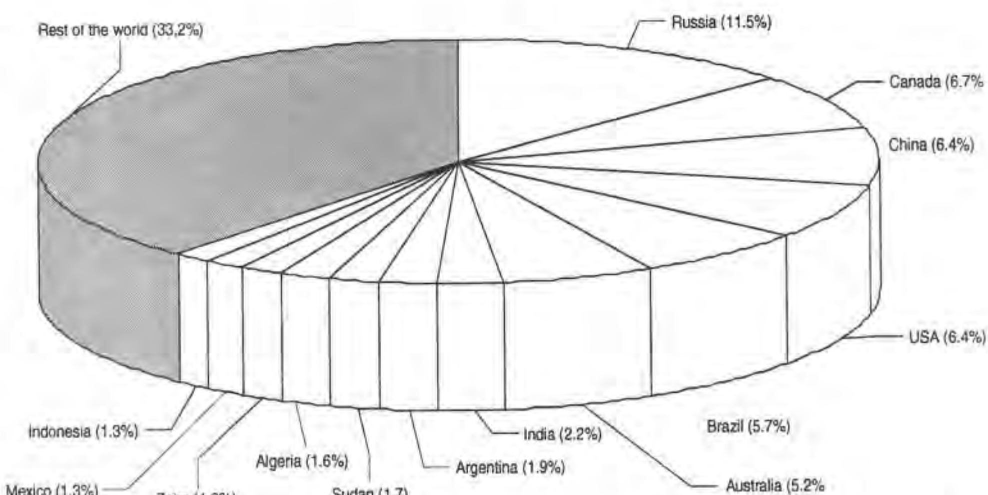
Wherein P_p is country p's power index, HDI_p represents its Human Development Index, f_{sup} its territorial share in relation to world total, f_{pop} its share of the world's population, f_{gdp} its contribution to world gross domestic product, f res the share of world reserves held by its central bank, f_{exp} its share in world exports and $f_{mil.exp}$ its part in total world military expenditures. All these indicators are shown in annual terms for the period 1950 – 1996.

This is, obviously, a very preliminary approach to a much more complex problem and only some of the many possible variables have been taken into account, with no other purpose but to illustrate the kind of results that can be obtained by applying the proposed formulation.

By way of example, let us take one of the variables of world power, territorial extension. Table 1 shows the fraction of total world territorial extension occupied by the largest countries. Only one year coefficient values are shown since it is obvious that in general, unless we have a situation such as the dismemberment of the former Soviet Union into a number of different countries and the creation of the Russian Federation, which implied a loss of territorial extension, this is the only coefficient among those considered that remains practically constant along the last decades.

Table 1
Territorial Extension Share of Total Planet Earth Landmass by Largest Countries

Distribution of each country's share of territorial extension
in relation to total surface land on planet Earth



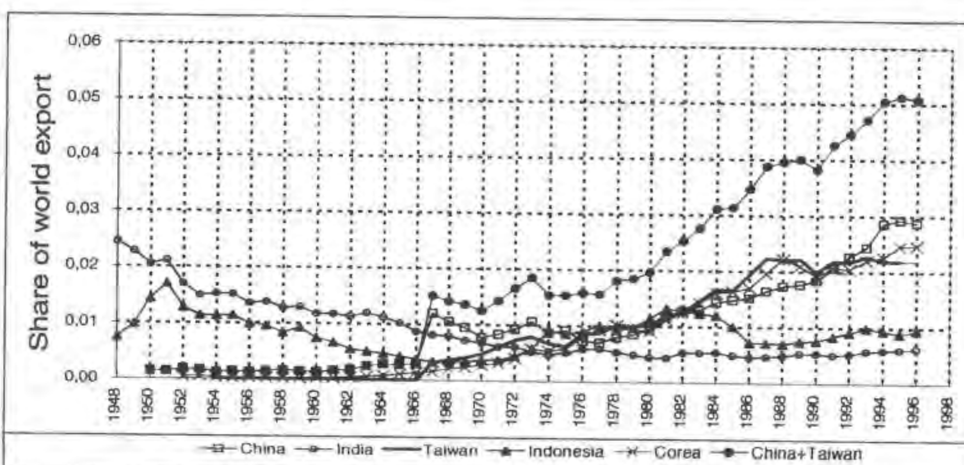
It is important to note how a coefficient such as a country's share of total world exports changes from year to year. This indicator, by showing the fraction of the world markets a country controls, illustrates in a general way its long term capacity to become more or less competitive at the international level. Table 2 shows this indicator's evolution in time for some Asian countries. It is to be remembered that only a share of the total, a value between 0 and 1, is represented. To obtain its percentage value in relation to world totals, such share is to be multiplied by one hundred.

Regional groupings: The same analysis could be applied to the study of what would be the accumulated power held by a group of countries united by political, ethnic, religious, trade or military ties, among others. On the basis that

$$\sum_{p} \prod_{i} f_i(t) = 1$$

each country in the new grouping's f_i fraction is simply added up. Nevertheless, when considering the "regional" HDI, the annual value of the HDI for each country must be adjusted by each country's share of the region's total population and then all such values must be added. Therefore,

Table 2
Evolution of Indicators on World Market Shares by a Group of Asian Countries



$$IDH_{regional} = \sum_{paises} \frac{Población_{pais}}{Población_{region}} \times IDH_{pais}$$

Following is a list of those country groupings, basically of a trade related nature, which have been or are in the process of being the object of our analysis:

- **EU (European Union):** Germany, Austria, Belgium, Denmark, Spain, Finland, France, Greece, Ireland, Italy, Luxembourg, Holland, Portugal, United Kingdom, Sweden.
- **OPEC (Organization of Petroleum Exporting Countries):** Saudi Arabia, Algeria, Libya, Nigeria, Gabon, Venezuela, Ecuador, Iraq, Kuwait, United Arab Emirates, Qatar, Iran, Indonesia.
- **ADE (Asian Dynamic Economies):** China, Taiwan, Hong Kong, Korea, Malaysia, Singapore, Thailand.
- **NAFTA (North America Free Trade Agreement):** Canada, United States, Mexico.
- **CIS (Community of Independent States):** Armenia, Azerbaidjan, Belarus, Georgia, Kazhakstan, Kirghistan, Moldova, Russian Federation, Tajikhistan, Turkmenistan, Ukraine, Uzbekhistan.
- **CEEC (Community of Eastern European Countries):** Albania, Bulgaria, Check Republic, Slovaquia, Slovenia, Estonia, Hungary, Letonia, Lithuania, Poland, Rumania.
- **MERCOSUR (South American Common Market):** Argentina, Brazil, Paraguay, Uruguay.
- **OECD (Organisation for Economic Co-Operation and Development):** Germany, Austria, Belgium, Denmark, Spain, Finland, France, Greece, Ireland, Iceland, Italy, Luxembourg, Norway, Holland, Portugal, United Kingdom, Sweden, Switzerland, Turkey, Australia, Canada, United States, Japan, Mexico, New Zealand.

What follows is a presentation of the evolution of power indexes, on the basis of the final formula (4) and for the period

Table 3
Trends in Power Indicators as Defined by the Formula (4) for a Selection of Latin American Countries

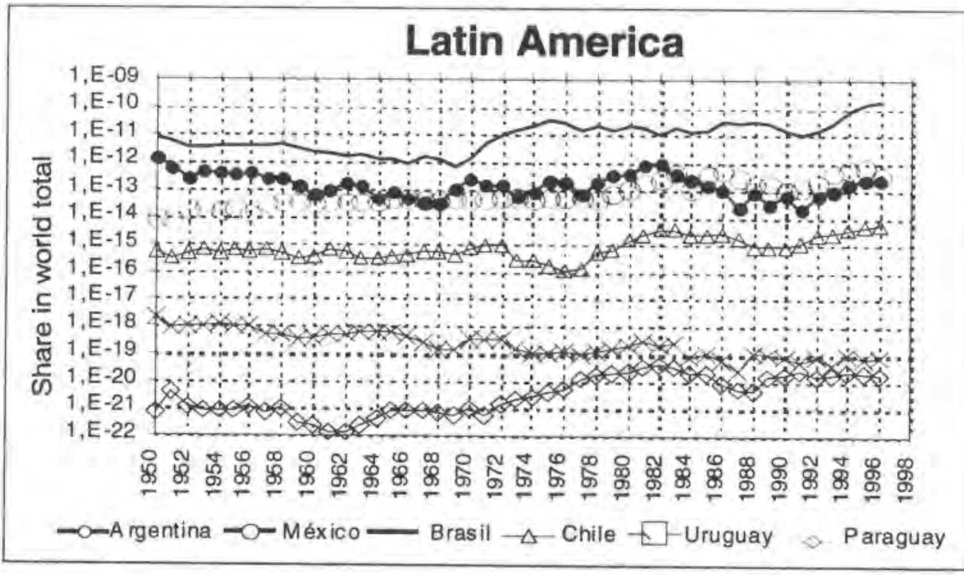


Table 4
Trends in Power Indicators as Sefined by the Formula (4) for So Called Intermediate Powers.

Intermediate Powers

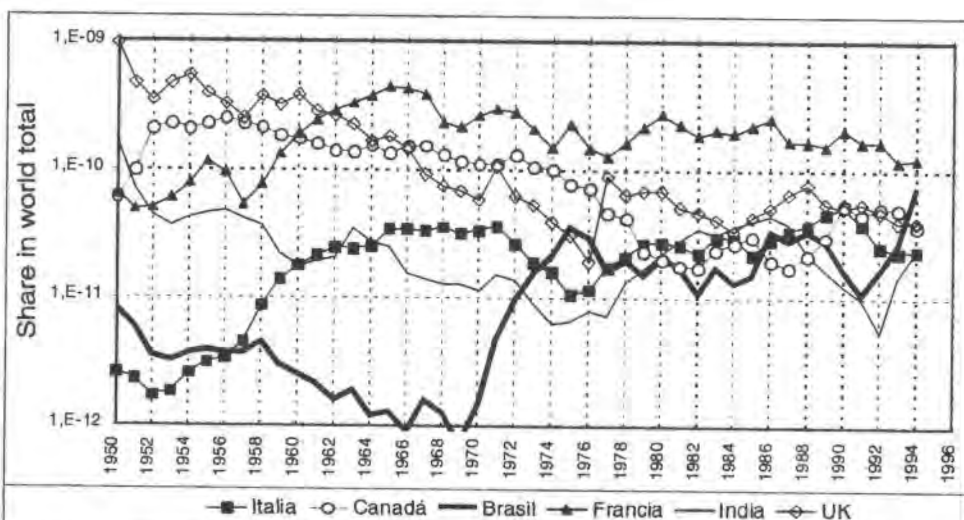
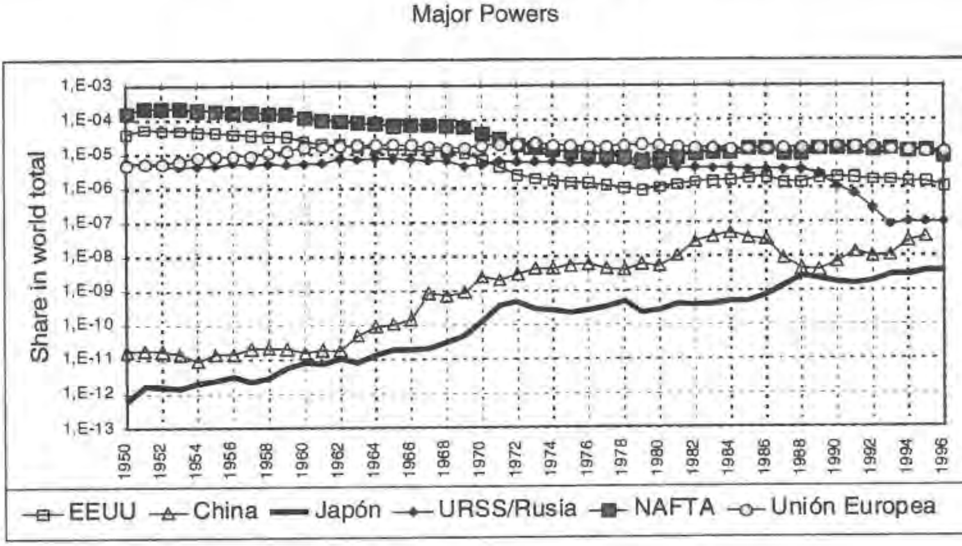


Table 5

Trends in Power Indicators as Defined by the Formula (4) for the Major Powers. The European Union and the Nafta groupings have been represented on the basis of formula (5). Their evolution was represented as if such groupings, with their current membership, had existed since 1950. The transition of the USSR into the Russian Federation is equally taken into account.



1950–1996, for a selection of countries and groups of countries taken from among the 56 included in our analysis. Tables 3, 4 and 5 show the results for a selection of Latin American countries, for the so-called intermediate powers, and for the main powers, Nafta and the European Union, respectively.

Conclusions

We believe that quantitative indicators for the study of State power-dynamics are an indispensable tool for the analysis of international relations. The one presented here, of which a simplified version has been applied in a preliminary fashion, already shows their relevance. We have been able to show the indicator's numerical values and their variations in time for some selected countries and groups of countries. They show the supremacy of Brazil in Latin America; the evolution of some intermediate powers; the supremacy of the United States after 1989; and the equal status shared by NAFTA and the European Union. We shall endeavor to follow this line of research with the goal of making a contribution to the understanding of the dynamics of the indicators of power among States, in particular those of Latin America.

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Acknowledgment: This paper was prepared and financed within the framework of the UBACYT TC 004 and CONICET PIP 0154/1998 research projects. The authors wish to thank Sergio Labourdette, Ph.D., and Dario Codner, B.A., for their important comments and suggestions throughout the preparation of this paper.

Towards a Stable and Predictable International Financial System and its Linkage to Social Development

In Resolution 53/172 of the United Nations General Assembly, the Secretary-General was requested to submit a report on the current trends in world financial flows and on ways of improving the capacity for early warning, prevention and management of financial crises with a broad, long-term perspective, in the awareness of the problems of development and the need to protect the most vulnerable countries and social groups.

On the basis of that resolution and in order to enrich Secretary-General Kofi Annan's report to the fifty-fourth session of the United Nations General Assembly, the High-Level Regional Meeting "Towards a Stable and Predictable International Financial System and its Linkage to Social Development" was held at the initiative of the Mexican government and with the support of ECLAC on September 5-6, 1999 in Mexico City.

The main conclusions of the meeting, which we are submitting to the consideration of the Secretary-General of the United Nations, are as follows:

1. The financial crises of recent years, the effects of which had a deep-seated impact on the international system as a whole, highlighted the disruptive capacity of international financial markets; the insufficiency of isolated actions; the urgent need to identify and coordinate preventive measures that can be implemented at the national, regional and global levels; and the need for stability in the financial system to advance on the social agenda and towards a new development strategy.

2. The recurrence, deepening and complexity of global phenomena and their systemic nature make it necessary to redefine the existing international cooperation mechanisms and thus establish the causes, solutions and preventive measures for problems that surpass the national sphere. Global economic problems pose a challenge to countries' social development efforts. Therefore, international economic problems and national development issues must be ad-

dressed from a comprehensive perspective, involving national governments, regional and multilateral organizations and the relevant market agents.

3. The economies most affected by the crises have recently shown a recovery. However, this should not lead to an attitude of complacency in international financial circles. Moreover, it is important that both the countries that have undergone periods of crisis and those that have not should redouble efforts to prevent future periods of instability. Similarly, in Latin America and the Caribbean we consider that international financial stability is a global public asset and that the region should participate with a sense of joint responsibility in the processes aimed at strengthening international financial governance.

I. Advances and Challenges of a New International Financial Arquitecture

4. International financial institutions should redefine their policies to respond to the major challenges posed by international financial markets and carry out the changes needed to prevent and avoid new crises. Similarly, the varying characteristics of each institution should be taken into account in order to prevent duplications and make their operation more efficient through a clear definition of their roles.

5. The design of mechanisms to extend financing in difficult times is an important point to be borne in mind in designing the new international financial architecture. However, the magnitude of recent financial crises and the large amount of funds needed to provide liquidity during periods of instability make it impossible for international financial institutions to act as lenders of last resort in crisis situations.

6. The assessed-contribution system of international financial institutions needs to be reviewed in order to increase the funds available and thus provide timely support to economies in difficulties. Moreover, supplementary sources of liquidity, such as the anticyclic use of special drawing rights and the creation or strengthening of regional reserve funds should also be sought.

7. In this regard, strategies such as the contingency borrowing facilities recently designed by the IMF are considered to be a

breakthrough. It is essential that the requirements for gaining access to such resources be clear and known in advance, and that such borrowing facilities be sufficient, timely and accessible.

8. Crisis prevention and management calls for greater consistency and harmonization in national and multilateral policies, which does not necessarily imply following the same norm, and respect for the economic and social conditions of each country. This points up the need for a more effective supervision and coordination of a preventive nature. In this respect, the contributions made in this regard by the countries of Latin America and the Caribbean through their financial stabilization and rehabilitation programmes deserve mention.

9. It is indispensable to develop an Early Warning/Prevention System to avoid, or, if applicable, to promptly reduce the risks of a financial crisis. In this context the efforts of the IMF to build empirical models to help to predict balance-of-payments crises are encouraging. It is essential to recognize the shifting nature of crises and the variability of their causes, as well as the possibility of their spreading to fundamentally sound economies.

10. There is a need to ensure the transparency of international financial markets and particularly of short-term capital flows, and to improve methods of collecting and disseminating economic information.

11. Banking and financial supervision and regulation are two props for the stability of international financial markets. In this regard continuing to advance in the design of appropriate regulatory frameworks that take into account the standards of the Basle Committee for Banking Supervision and the International Organization of Securities Commissions (IOSCO) is recommended, with special attention on the needs of developing countries.

12. An important element in reforming the international financial architecture should be to strengthen incentives in industrialized countries to exercise greater discipline in investment decisions, reduce leverage and limit systemic risk, and to establish the supervision of extraterritorial financial centres.

13.It is necessary to strengthen the joint responsibility of the private sector both in preventing and in managing crises. Creditors must effectively assume their share of risk on extending loans. The aim of the measures proposed is to reduce the moral hazard that arises when creditors and investors are bailed out continuously. Additionally, the burden of crises should be distributed more evenly between the public and private sectors, and between debtors and creditors and investors.

14.The assessment of sovereign risk must be subjected to strict, objective and public parameters. It is important for risk-assessment agencies to provide full, consistent information on a regular basis.

15.The orderly liberalization of capital flows is essential for countries to gain access to funds for development and productive investment. An appropriate institutional framework needs to be established to facilitate productive investment and limit the volatility of short-term capital flows. Until clear international rules are established for the management of speculative capital, at its origin and destination alike, each country must safeguard its capital account in keeping with its exchange regime and the use of market instruments and mechanisms.

16.Defining the role of multilateral agencies and regional and subregional institutions is of the utmost importance in all the above tasks. Equally important is to ensure an equitable representation of developing countries in defining and implementing the corresponding mechanisms.

17.In this context it is important to conclude the studies and consultations being carried out by developed countries within the framework of the G-7, with the support of the Bretton Woods institutions and of their central banks. The regional and coordination groups of developing countries, such as the G-77, G-24, G-15, and G-Río should strengthen their participation in discussions with the G-7 and industrialized countries, in order to ensure the consistency and universality of economic policy measures and of the design and implementation of the new international financial architecture. Regional and subregional financial institutions must play a vital role in this task.

II. The Challenges of Social Development in a Context of Financial Globalization

18.In addition to their effects on the international financial system, the financial crises of this decade have had a devastating impact on social development projects of the countries concerned. This situation is particularly serious in view of the poverty levels observed in affected countries.

19.Official global flows for development assistance by donor countries have fallen to 0.22 per cent of the Gross National Product (GNP) of developed countries, the lowest figure in the past twenty years. Efforts must be redoubled in this regard, in order to fulfil the commitment undertaken at the World Summit on Social Development for donor countries to allocate 0.7 per cent of their GNP to official assistance for development and, for their part, for receiver countries to earmark an average of 20 per cent of such financial assistance to social development programmes and another 20 per cent of their national budget to basic social programmes.

20.It is important to give impetus to productive investment and to secure financing under favourable terms to less developed countries in order to ease their debt burden. We therefore support the initiative to reduce the debt of highly indebted poor countries (HIPC). In this respect emphasis was placed on the importance of ensuring that the cost of debt relief to multilateral regional and subregional agencies be financed by the borrowing and non-borrowing members of the multilateral institutions involved, in accordance with their payment capacity and level of development. It would also be advisable for donations of international funds for this initiative to be allocated primordially to support regional and subregional banks and bilateral debt between developing countries.

21.The IMF's adjustment programmes to correct the structural causes of crises should take care that this process does not lead to an over-adjustment resulting in a severe drop in economic activity or sharp cuts in social spending.

22.The level of social spending must be a sovereign decision made by each country on the basis of its possibilities and conditions. Efforts must be made to bring economic and social development into harmony, achieve a fairer distribution of income, promote gender equity and give impetus to proactive social policies, while placing particular attention on the needs of the most vulnerable groups, such as children, women, the disabled, the elderly, indigenous groups and the unemployed.

23. International development banks, particularly the World Bank and the Inter-American Development Bank, should give preference to financial support for social-welfare networks and favor human development as a final aim. For their part, governments should direct efforts to the universal improvement of social services, implement consistent macroeconomic and social policies, and reduce the economic and social costs of financial crises.

III. The Role of the United Nations in Designing an International Financial Strategy with Social Projection

The work of the meeting concluded with the following aspects, which in the opinion of the participants should be taken into consideration by the United Nations as a world political body par excellence.

24. The structural problems of the international financial system continue to exist. We are concerned that the overcoming most critical stages of the crisis has now given rise to complacency and to a reduction in efforts at systemic reform. The countries of Latin America and the Caribbean are willing to participate actively, together with other developing regions, in giving new impetus to the reform process.

25. A new national and international development strategy must take into account the challenges and opportunities of globalization. The financial aspect of this strategy is a central element of efforts geared towards sustained economic growth and comprehensive social development. The aim of the international community is to reduce the volatility of international financial markets and achieve more harmonious, equitable development.

26. In view of the complex nature of global issues that affect development, such as the financial crises, it is essential to devise formulas for the United Nations to carry out its responsibilities in the search for solutions to international problems, of an economic and social nature, particularly in harmonizing

the efforts of nations to deal with the problems that affect development.

27.It will be important to count on the participation of all the appropriate forums of the United Nations system, particularly specialized and regional agencies and other international organizations that deal with specific aspects of development financing.

28.The United Nations should help to devise and implement systems to strengthen early warning, prevention and prompt response capabilities to tackle the emergence and propagation of financial crises on time.

29.An important, pressing challenge for the United Nations is to include, as part of its activities in the economic, social and financial spheres, an in-depth examination of topics such as the prevention and management of financial crises, issues dealing with development financing, the rules of access to multilateral funds, the role of regional institutions, and the areas in which national autonomy should be preserved. In this context, the discussions between the United Nations and the Bretton Woods institutions should be continued and strengthened, in order to create the conditions needed to ensure that the new international financial architecture reflects the global interests of the international community.

30.At the same time, the United Nations should strengthen the promotion of comprehensive social development by giving greater impetus to the fulfilment of the commitments taken on at the Social Development Summit, designing international cooperation plans and executing a greater number of programmes and projects with which to deal with the consequences of financial crises. Financial reforms should favour the aims of high-quality sustained growth as an effective means of fighting poverty.

31.The above proposals should contribute to the preparation of a high-level conference in 2001 on financing for development, which should also include a comprehensive, systematic examination of this issue and of the impact of instability and financial crises on social development.

32.The conference is an important opportunity for approaching development from the financial perspective in a systemic, comprehensive manner, in order to contribute to the analysis and mobilization of resources for the appropriate implementation of the results of recent United Nations conferences and summits.

33. In order to ensure that Latin America and the Caribbean's contribution to the changes promoted by the Conference includes the points of view of all those involved, we consider it important to hold prior regional high-level meetings involving the governmental and intergovernmental officials in charge of foreign relations, finance, central banks, trade and social development.

34. Similarly, we consider it important for the United Nations to disseminate the conclusions of this meeting in order to contribute to the examination and consultations being carried out in the different forums and institutions involved. We believe that these conclusions could complement the study undertaken to date on the subject and give impetus to a greater coordination of efforts and the exchanges of points of view and information needed to build a global consensus.

Declaration of Rio de Janeiro

Introduction

The First Summit between the Heads of State and Government of Latin America and the Caribbean and the European Union, with the participation of the President of the European Commission, was held in the city of Rio de Janeiro, Brazil, on the 28th and 29th of June 1999, under the Co-Presidency of the President of the Federative Republic of Brazil, the President of the United Mexican States and the Chancellor of the Federal Republic of Germany in his capacity as President of the European Council. On the basis of this First Summit and the implementation of its decisions, a Second Summit could be organised in due course.

This historic Summit was convened as a result of the political will to enhance the already excellent biregional relations based upon shared values inherited from a common history. The objective of the Summit is to strengthen the links of political, economic and cultural understanding between the two regions in order to develop a strategic partnership.

The meeting of Foreign Ministers held on the eve of the Summit also reinforced this fruitful co-operation by their substantial contribution to the biregional dialogue.

To advance this process, the Heads of State and Government decided to implement the commitments contained in this declaration through the accompanying "Priorities for Action". This will be achieved through the well-established fora of political dialogue and co-operation and through further biregional efforts.

As a result of the deliberations that took place at the Summit, the Heads of State and Government of Latin America and the Caribbean and the European Union decided to adopt the following:

Declaration of Rio de Janeiro

1. We, the Heads of State and Government of the European Union, Latin America and the Caribbean, have decided to promote and develop our relations towards a strategic biregional partnership, based upon the profound cultural heritage that unites us, and on the wealth and diversity of our respective cultural expressions. These have endowed us with strong multifaceted identities, as well as the will to create an international environment which allows us to raise the level of the well-being of our societies and meet the principle of sustainable development, seizing the opportunities offered by an increasingly globalised world, in a spirit of equality, respect, alliance and cooperation between our regions.

2. The strategic partnership gathers together two important actors on the current international stage. Latin America and the Caribbean is set to be one of the most flourishing regions in the 21st century as a result of important progress made in the political, economic and social spheres in recent years. For this reason, the region is determined to persevere in the advancement of democratic processes, social equality, modernisation efforts, trade liberalisation and broad-based structural reforms. The European Union, in its turn, has advanced towards a historic integration with multiple implications at the global level on political, economic, social, financial and trade matters, which has brought about constant improvement in the living standards of their societies.

3. This strategic partnership is based on full compliance with International Law, and the purposes and principles contained in the Charter of the United Nations, the principles of non-intervention, respect for sovereignty, equality among States, and self-determination are bases for the relations between our regions.

4. This partnership is built upon and will contribute to the furthering of common objectives, such as strengthening representative and participatory democracy and individual freedom, the rule of law, good governance, pluralism, international peace and security, political stability and building confidence among nations.

5. We highlight the universality of all human rights; the need to reverse environmental degradation and foster sustainable development through the conservation and sustainable use of natural resources; co-operation for the recovery, preservation, diffusion and expansion of cultural heritages; the efficient incorporation of scientific knowledge and technological advances in educational systems at all levels and the fight against poverty, as well as against social and gender inequalities.

6. We welcome the progress made in integration in Europe and Latin America and the Caribbean in the political and economic areas under the principle of open regionalism.

7. In this process we envisage providing new momentum and equal attention to the three following strategic dimensions: a fruitful political dialogue respectful of International Law; solid economic and financial relations based on a comprehensive and balanced liberalisation of trade and capital flows; and more dynamic and creative co-operation in the educational, scientific, technological, cultural, human and social fields.

8. The priorities for action adopted by the Summit will be promoted and implemented through the current ministerial discussions between the European Union and the countries and groups in Latin America, and between the European Union and Caribbean countries, in the framework of the Lome Convention. These discussions will maintain their present format and regularity. Ministerial meetings could also be held on certain matters of common interest, such as education, research, science.

9. We also decide to establish a biregional group at a Senior Official level. This group will meet regularly, monitor and encourage the achievement of the priorities for action, from a political viewpoint, and with the objective of contributing, on the basis of existing mechanisms, towards global dialogue with a view to strengthening the strategic biregional partnership in its political, economic, social, environmental, educational, cultural, technical and scientific dimensions.

In this context, we commit ourselves to:

In the political field

10. Reinforce the existing institutional dialogues between both regions and promote direct communication between governments on matters of regional integration, in particular its political dimension, and international co-operation based on an exchange of experience and information.

11. Preserve democracy and the full and unrestricted functioning of democratic institutions, pluralism and the rule of law, by guaranteeing the holding of free, fair and open electoral processes based on universal suffrage as fundamental elements for economic and social development and strengthening of peace and stability.

12. Promote and protect all human rights and fundamental freedoms, including the right to development, taking into account their universal, interdependent and indivisible character, recognising that their promotion and protection is a responsibility of States and of all citizens. We stress that the international community has a legitimate interest in this task, under the Charter of the United Nations, with emphasis on the implementation of universal and regional human rights instruments and standards.

13. Strengthen education for peace and reject all forms of intolerance including xenophobia and racism, for the benefit of international and regional security and national development, as well as promote and protect the rights of the most vulnerable groups of society, particularly children, youth, disabled and displaced persons and migrant workers and their families.

14. Defend the principles of an independent and impartial judiciary, to promote, implement and uphold International Law and international humanitarian law. Recognise the importance of progressive development in the norms regarding the criminal responsibility of the individual who commits certain crimes of international repercussion. For this reason, we note with interest the recent approval of the Constitutive Statute of the International Criminal Court.

15. Reaffirm full gender equality as an inalienable, integral and indivisible part of all human rights and fundamental freedoms, thus committing ourselves to incorporate a gender perspective into the public policies of our governments.

16. Promote and protect the rights of indigenous populations, including their right to equally participate in and enjoy the opportunities and benefits of political, economic and social development, with full respect for their identities, cultures and traditions.

17. Intensify efforts to meet the needs of present and future generations through the adoption and fulfilment of sustainable development strategies, making compatible economic growth, environmental protection and social progress.

18. Give priority to overcoming poverty, marginalisation and social exclusion, within the framework of sustainable development promotion, as well as to modify patterns of production and consumption, to promote conservation of biological diversity and the global ecosystem, the sustainable use of natural resources and to prevent and reverse environmental degradation, especially that arising from excessive industrial concentration and inadequate patterns of consumption, the destruction of forests and erosion of the soils, as well as the depletion of the ozone layer and the increasing greenhouse effect, which threaten the world climate.

19. National and regional efforts in these fields, combined with international co-operation, will promote the right of individuals to a better quality of life and incorporate the whole population in the processes of economic and social development.

20. Recognise that, in the majority of countries, there is insufficient availability of internal resources to implement the range of the actions being proposed internationally to promote sustainable development. As such, we stress the need to promote adequate levels of investment and technology transfer.

21. Underline the importance of the contribution of new actors, partners and resources from civil society with the objective of consolidating democracy, social and economic development and deepening respect for human rights. International co-operation involving public resources requires a dialogue in which both governments and civil society participate. Development co-operation partners will have to comply with the laws of the countries involved, as well as with transparency and accountability. We will encourage exchange and co-operation of civil society between Latin America, the Caribbean and the European Union.

22. Work together to confront the threats to international peace and security and intensify efforts to continue the disarmament process under strict and effective international control, with emphasis on the elimination of weapons of mass destruction, including nuclear, chemical and biological weapons. In the framework of the Disarmament Agenda, we consider that, after entry into force of the convention of the prohibition of chemical weapons, one of the main objectives is the conclusion and adoption of the verification protocol of the convention on the prohibition of biological weapons, leading to eradicate this category of mass destruction weapons.

23. Attach special importance to achieving universal adherence to the Treaty of the Non-Proliferation of Nuclear Weapons, to fight against excessive and destabilising accumulation of small arms and light weapons, and their uncontrolled dissemination, and call upon all States to join efforts to achieve the total elimination of anti-personnel landmines.

24. Tackle the global drug problem under the principle of common and shared responsibility based on a global, comprehensive and balanced approach in full conformity with the purposes and principles of the Charter of the United Nations and International Law. The Panama Comprehensive Action Plan on Drugs is based on these principles and will give a new dimension to co-operation on drugs. The Co-ordination and Co-operation Mechanism between the European Union and Latin America and the Caribbean should be used to develop this co-operation.

25. Also express our will to fulfil and to follow-up on the agreements reached at the XX Special Session of the United Nations General Assembly Dedicated to Common Action to Counter the Problem of Drugs.

26. Join efforts to combat all forms of organised transnational crime and related activities, such as money laundering, trafficking of women, children and migrants; the illegal manufacture and trade of firearms, munitions and other related materials.

27. Reinforce individual and joint actions against terrorism in all forms and manifestations, since the latter erodes peace, the rule of law and democracy.

28. Strengthen individual and joint actions and increase collaboration among our Governments to face corruption in all its forms, taking into account the important instruments recently adopted in both regions, since this serious problem erodes the legitimacy and functioning of institutions and represents a threat to democracy, society, the rule of law and development.

29. Join efforts to increase dialogue, international co-operation and the exchange of knowledge in the prevention of natural disasters, while taking advantage of experience gained through the United Nations International Decade for Natural Disaster Reduction. Moreover, initiatives in this field should consider the links between prompt emergency aid, rehabilitation and reconstruction, while observing criteria for long-term sustainable development.

30. In this context, acknowledge the efforts undertaken by the Governments and people of Central America for the reconstruction and transformation of their countries after the tragedy of hurricane «Mitch». We also attach great significance to international co-operation for the relief and reconstruction of Central America, in particular to contributions from Latin American and Caribbean countries, and to the successful implementation of the European Union plan for reconstruction of Central America, as well as to the efforts of the European Union Member States, amounting together to more than one billion euros.

31. Strengthen multilateral institutions, particularly as fora for international dispute resolution and the promotion of development. In this regard, we jointly support intensifying multilateral relations, including advancing the process of reforming the United Nations system, in the search for a new balance between its principal organs, so as to improve their effectiveness.

In the economic field

32. Enhance international economic co-operation, to promote a comprehensive and mutually beneficial liberalisation of trade, as a means of increasing prosperity and of combating the destabilising effects of volatile financial flows. In this context, the asymmetries in development level shall be taken into account.

33. Reaffirm our conviction that regional integration plays an important role in growth promotion, trade liberalisation, economic and social development, democratic stability and a more symmetrical inclusion in the process of globalisation. We particularly stress our willingness to strengthen the multilateral trade system, open regionalism, and intensify economic relations between our regions.

34. Recognise the shared responsibility for an effective and result-oriented contribution to all these aspects. Through our new interregional partnership we resolve in particular to:

35. Join our efforts to guarantee the complete and timely entry into force, and effective application of the Uruguay Round commitments.

36. Highlight the importance of the World Trade Organisation as the main forum to promote trade liberalisation and the establishment of bas.

37. Jointly propose, at the next WTO Ministerial meeting, to launch a new round of comprehensive trade negotiations without excluding any area, directed towards the reduction of tariff and non-tariff barriers to trade in goods and services.

38. Reiterate our firm rejection of all measures of a unilateral character and with extraterritorial effect, which are contrary to International Law and the commonly accepted rules of free trade. We agree that this type of practice poses a serious threat to multilateralism.

39. Promote further development and diversification of trade, taking into account ongoing and future multilateral and bilateral negotiations for the liberalisation of trade, such as in the case of the European Union with Mexico, Mercosul and Chile, as well as future developments in our regions.

40. Promote dialogue on and stimulate a favourable climate for financial flows and for productive investment between Latin America and the Caribbean and the European Union, in particular the promotion of joint ventures, through the European Investment Bank (EIB), as well as of other co-operation instruments, such as bilateral investment promotion and reciprocal protection agreements.

41. Provide special attention and support for countries with smaller economies, including through incentives for productive investment. Favourable financing conditions and measures should be examined and implemented to provide a fair and adequate treatment to highly indebted poor countries in the specific and competent fora. In this regard, we welcome the agreement by the G7 Heads of State and Government of a new package of debt relief measures for the highly indebted poor countries.

42. Promote greater contact between economic agents and to encourage an enlarged dialogue between the members of the business community and sectoral fora on both sides, which are important for the relations between our regions, and in particular for sustained economic and social development.

43. Promote co-operation in science and technology in order to strengthen national capabilities in these areas and contribute to efforts, to tackle global problems; to encourage investment and business partnerships involving the transfer of technologies and know-how.

44. Support the strengthening and enforcement of intellectual property rights in all areas as an important condition for enhancing trade and investment flows.

45. Promote, in the context of globalisation and the progress of the information society, trade in services and to support new forms of co-operation in this field as important factors for closer economic ties between both regions.

46. Encourage technology transfer in order to improve the processes and standards of economic links between the European Union and Latin America and the Caribbean in the fields of the production of goods, foreign trade, port infrastructure, and telecommunications and transport.

47. Promote a favourable climate for small and medium enterprises whose role is important in the context of the development of stable market economies, for the furthering of economic exchanges and for the implementation of joint ventures between the two regions.

48. Underline the decisive role of efficient infrastructure, including transport, and administrative procedures for the liberalisation of trade and the intensification of economic co-operation.

49. Strengthen our partnership in development co-operation, which offers an important opportunity to put the shared values and ideals into practice and to mutual benefit.

50. Actively participate, in view of the seriousness and recurrence of financial crises and the severity of their impacts at national and international levels, in the design of a new international financial architecture, to allow both regions to obtain the full benefits of capital markets integration and reduce the risks involved with their volatility.

51. Continue strengthening the financial systems of our countries and to develop regulation and monitoring mechanisms, in order to implement international best standards and practices. This will contribute to establishing a dynamic, stable, international economic and financial system. Such a system will ensure the prevention of future crises or, should they occur, assure their early identification and their rapid and effective solution so as to contain their spread.

52. Acknowledge that the introduction of the euro does contribute to strengthen our biregional economic and financial ties as well as the international monetary and financial system, and provide it with stability and dynamism.

53. Promote the active participation of our Governments in the consultations taking place at the United Nations on current trends in global financial flows. Joint efforts to reform the international financial system, as well as to define and to implement an agenda for international financial stability, which includes monitoring the global financial system for crisis prevention.

In the cultural, educational, scientific, technological, social and human fields

54. Reiterate our commitment towards the establishment of a solid partnership between Latin America and the Caribbean and the European Union in the educational, cultural and human spheres, based on shared values and on the recognition of the importance of education for achieving social equality and scientific and technological progress. We also commit ourselves to conduct our relationships on the basis of the principles of equality and respect for plurality and diversity, without distinction of race, religion or gender, precepts that constitute the ideal means of achieving an open, tolerant and inclusive society where the individual's right to freedom and mutual respect is enshrined through equitable access to productive capacity, health, education and civil protection.

55. Agree that there is no better investment than developing human resources, which is both a commitment to social justice and a requirement for long-term economic growth.

56. Assign more resources to address the just and urgent social demands and to improve the scope and quality of our social programs.

57. Intend to share experiences between our two regions on diverse social policies that we apply so as to strengthen co-operation in this area, particularly in health, nutrition, education and employment.

58. Also stress the importance of creation of sufficient and well-paid and productive employment in our countries. For this purpose, education and professional training of workers of all ages is essential.

In particular, we agree to

59. Promote the recuperation, preservation and a better knowledge of our vast cultural heritages, including patrimony, and of our diversity as a fundamental link of integration between Latin America and the Caribbean and the European Union, permitting closer and more enduring relations between our peoples and promoting cultural creativity as a dialogue for peace and tolerance.

60. Foster actions, in both regions as well as in multilateral fora, to promote cultural diversity and pluralism in the world.

61. Encourage interregional exchanges among educational and cultural actors as one of the most efficient and effective means to promote mutual understanding, learning and cultural production. The promotion of close contacts between artists and organisation in all cultural sectors will encourage respect for cultural and linguistic diversity, guaranteeing human dignity and social development.

62. Encourage further co-operation and exchange between cultural industries as well as in the audio-visual sector as major pillars in the cultural and economic co-operation, meeting an increased interest in high quality productions.

63. Consider the strengthening of educational co-operation as a special challenge, with particular emphasis on basic education, vocational training and co-operation between higher education institutions, including universities, and distance education, and take into account the particular needs of our societies. In this context we recall the successful co-operation programmes already in existence.

64. Promote universal access to education and professional training as determining factors for diminishing social inequalities, reducing poverty and achieving better paid employment, assuring a full basic education for all people of school age and the right of peoples to maintain their cultural and linguistic identity; we stress the right to education itself, based on the specific national responsibility of each country to provide adequate education to all its citizens.

64. Promote scientific research and technical development as fundamental elements in our relations and as an essential condition for the successful insertion of countries in a globalised world, which requires the advances of scientific knowledge, its mastery and adaptation to constantly evolving technology.

65. Favour innovation and technology transfer in order to obtain greater economic and technical linkage between the two regions in the fields of production of goods and services, foreign trade, infrastructure, and telecommunications and transport, among others.

66. Welcome the various events promoted before and during the Summit involving different sectors of civil society

67. These solemn commitments guide our current dialogue and our co-operation in inter-regional and international fora. At the same time, they contribute to the successful establishment of our strategic partnership.

68. The participants expressed their profound gratitude to the people and Government of Brazil for the courtesy and support received in carrying the work of the Summit through to a successful conclusion.

Priorities for Action

We, the Heads of State and Government of Latin America and the Caribbean and of the European Union, meeting in the city of Rio de Janeiro on 28th and 29th June, 1999, have decided to advance in the consolidation of a strategic partnership of a political, economic, cultural and social and co-operative character between both regions which contr.ibutes towards the development of each of our countries, as well as towards the achievement of better levels of social and economic well-being for our peoples, taking advantage of the opportunities offered by an ever more globalised world, in a spirit of equality, respect, alliance and co-operation.

We agree that the priorities for action are based on a common commitment to representative democracy, the rule of law, good governance, pluralism and social development including a more equitable distribution of wealth and opportunities and to a harmonious integration into the global economy.

We have therefore decided to strengthen the dialogue between governments at all levels and with organisations from the civil society, with the aim of ensuring the achievement of the objectives of development and strengthening the rule of law in both regions. In this context, we will strengthen mechanisms to guarantee the fulfilment of the laws of both regions, as well as transparency and accountability, especially in the use of public resources.

We have also decided that the Biregional Group, at the level of Senior Officials, established by the Declaration of Rio de Janeiro, will monitor the actions contained in this document.

Taking this into account, as well as the principles and commitments contained in the Declaration of Rio de Janeiro, we will promote the following:

PRIORITIES FOR ACTION

In the political field:

1. Promote closer co-operation and exchange of points of view in international fora on matters of common interest. Work jointly for the improvement of the capability of the United Nations

Organisation to respond in an ever more effective manner to its tasks in the new millennium, with full respect for the objectives and principles of the Charter, and the Universal Declaration of Human Rights adopted by the United Nations 50 years ago. We will co-ordinate biregional efforts to guarantee that the Millennium Assembly develops in such a way that the Organisation is strengthened.

2. Formulate programmes of co-operation aimed at further strengthening the protection and promotion of human rights, as well as training programmes to support offices and institutions for human rights, such as those involved in protecting the rights of the more vulnerable groups of society. We support specific training programmes aiming to promote tangible steps forward in this field. Likewise, we will promote programmes to disseminate humanitarian law.

3. Design and put into practice joint programmes and adopt national measures to prevent and combat xenophobia, manifestations of racism and other related forms of intolerance, as well as to promote and protect the rights of the most vulnerable groups of society, especially children, youth, disabled persons, indigenous peoples and migrant workers and their families.

4. Adopt programmes and projects in the twelve priority areas identified in the Fourth World Conference of Women (Beijing, 1995), through mechanisms of financial and technical co-operation, with prior identification of actions of common interest with a biregional dimension. The gender aspect will be taken into account as a basis for all co-operation programmes.

5. Work towards the modernisation of the structure of our respective States, in particular with regard to electoral systems, the administration of justice, the tax systems and the budgetary policies as mechanisms for the redistribution of wealth and revenues generated by economic development. We encourage dialogue on the matter.

6. Invite actors of civil society to participate in the implementation of joint initiatives between Latin America and the Caribbean and the European Union. We therefore regard co-operation between the public sector and civil society as positive and recognise the relevant role of decentralised co-operation programmes. We agree to co-operate closely and exchange knowledge and experience in the field of reforming social security.

Encourage parliamentary contacts between both regions

7. Welcome in particular the activities of various fora in the context of the preparation of the Summit.

8. Recalling the successful conferences on Security and Confidence Building Measures, underline the need to continue regular dialogue on security issues between the European Union and the Rio Group.

9. Promote the signing or ratification of instruments in the field of disarmament and prohibition of certain particularly inhumane weapons, including the conventions on chemical and biological weapons; the Non Proliferation Treaty (NPT), the Comprehensive Nuclear Test Ban Treaty (CTBT). Also, support negotiations currently in progress, in particular in the Conference on Disarmament.

10. Welcome the entry into force, on 1st March 1999, of the Ottawa Convention on the prohibition of use, stockpiling, production and transfer of anti-personnel landmines (APL) and on their destruction and emphasise the importance of full and speedy implementation of the Convention. We call on all States to join efforts to achieve the total elimination of APL world-wide and agree to attach high priority to efforts dealing with the suffering and destruction caused by their use.

11. Continue to provide technical and financial co-operation through mine action programmes, with particular attention to Central American countries.

12. Emphasise the fact that a serious challenge to the international community is raised by the combination of conflicts with the uncontrolled dissemination of small arms. In this context, we welcome the Joint Action of the European Union on combating the destabilising accumulation and spread of small arms and light weapons, as well as the Inter-American Convention to Combat the Illegal Production and Traffic of Firearms, Munitions, Explosives and other Related Materials, and underline our determination to co-operate closely in this field.

13. Co-operate in the fight against transnational organised crime and related criminal activities, work for the elaboration of instruments against corruption, as well as actively promote the implementation of the international conventions on the matter, and also increase collaboration between our governments.

14. Intensify international co-operation to combat terrorism, based on the principles established in the framework of the United Nations Organisation. To this end we will work together to advance in the signing and ratification of the conventions and protocols of the UN and to strengthen the international legal framework on the subject, supporting the elaboration of instruments to fight terrorism.

15. Support projects for the conservation and sustainable use of natural resources, especially those which contribute to overcoming poverty, marginalisation and social exclusion, to modifying patterns of production and consumption, and to promoting the conservation of biological diversity. Special importance will be attached to promoting the sectors likely to generate productive employment.

16. Reaffirm our commitments to implement the Rio Convention on Climate Change, Biodiversity and Desertification and to promote actions oriented towards the early application of the Mechanism for Clean Development foreseen in the Kyoto Protocol. We resolve to co-operate and exchange experience in the field of preserving forests world-wide through sound economic exploitation in line with the principles of sustainable development. Close attention will be paid to projects dealing with a more rational use of energy, the development of renewable energy sources and solving the problems of industrial and urban pollution. We resolve to exchange experiences in the field of soil productivity loss and management of arid ecosystems. We stress the successful co-operation between the European Union and the Brazilian Government in implementing the «International Pilot Programme to Conserve the Brazilian Rain Forests» (PPG7), as a promising strategic alliance. We underline the importance of education on environmental protection for the implementation of Agenda 21 and agree to co-operate closely in this respect.

17. Put into practice programmes of co-operation in the field of environmental and natural disasters, with the aim of contributing to the improvement of the capabilities of the more vulnerable countries of both regions to prevent and respond to disasters; to set up an adequate system to take advantage of international aid for the phases of prevention, early warning, emergency, mitigation, rehabilitation and reconstruction. This co-operation will include the elaboration of a directory of responsible national civil-protection organisations, the integration of an inventory of existing resources for disaster relief, and the drafting of a handbook of guidelines for international co-operation in case of disaster.

18. Promote the complete application of the objectives of the International Decade for Natural Disaster Reduction, and of the Programmes for Disaster Preparation, Mitigation and Prevention of the Department of Humanitarian Aid of the European Community (EC DIPECHO), executed in Central America and the Caribbean.

19. Appreciate the active role that civil society is playing for the relief and reconstruction work in Central America, as recognised in the Stockholm Declaration of 28th May 1999.

20. Endorse the implementation envisaged in the Panama Comprehensive Action Plan for European Union/Latin America Counter-Drugs Assistance including interregional co-operation with the Caribbean as an important part of the priorities for action.

21. Welcome the results of the XIV European Union-Latin America Interparliamentary Conference (16th–18th March, 1999), in particular the message relating to the Institute for Relations between Europe and Latin America (IRELA), and consider the recommendations of the members of parliament of both regions in this respect.

In the economic field:

22. Promote joint action in international economic co-operation. In the World Trade Organisation, we will ensure the full implementation of the results of the Uruguay Round and agree on the launching of a new comprehensive and mutually beneficial round of multilateral trade negotiations.

23. Strengthen our economic and trade relations, taking maximum advantage of existing trade agreements between our regions and working for the establishment of new ones.

24. Hold high-level consultations to exchange points of view and to agree on positions in multilateral efforts in appropriate fora, including those in the United Nations system, oriented towards the establishment of mechanisms that promote a stable and dynamic global economic and financial system, as a way to prevent crises in the future, and should they occur, to ensure their effective and swift solution.

25. Formulate, in the framework of our consultations, proposals of biregional co-operation directed to strengthening national financial systems and developing mechanisms of monitoring and regulation in order to implement international best standards and practices.

26. Create specific programmes to support economically relatively less-developed countries by establishing training fora and stimulating productive investment and adequate conditions of financing, including effective national and global measures to resolve the problems generated by excessive levels of debt.

27. Call on the business communities of Latin America and the Caribbean and of the European Union to meet periodically in a Business Forum, with the aim of analysing matters of common interest and, where appropriate, presenting conclusions and recommendations for the consideration of governments. Such a Forum, whose starting point could be the promotion of biregional electronic networks of business associations, could be enriched with existing initiatives such as the Mercosur/European Union Business Forum and the Multisectoral Business Encounter AL-Partenariat 99 European Union-Mexico-Central America.

28. Promote a biregional programme of government and business training to foster competitiveness in business and in the negotiating capacity of entrepreneurs, as well as in the search for effective solutions in the area of facilitating business.

29. Encourage the conclusion of bilateral reciprocal investment promotion and protection agreements and conventions to avoid double taxation and to stimulate initiatives directed towards facilitating and increasing investments between both regions.

30. Promote programmes and mechanisms to support small and medium enterprises in the fields of financing, including better access to financial guarantees and risk capital, management training, technology and inter-business co-operation, with the aim of raising competitiveness and achieving better insertion into international markets. In particular, to promote joint ventures for the establishment of enterprises in both regions.

31. Invite the European Investment Bank (EIB) to consider strengthening and broadening its activities in Latin America and the Caribbean and encourage co-financing between European financial institutions and those of Latin America and the Caribbean.

32. Support the development of national capacities to strengthen and protect intellectual-property rights in all fields, in accordance with the rules established in the framework of the WTO, as an important requisite for increasing trade and investment flows.

33. Establish a dialogue to study standards and certifications based on current agreements on Technical Barriers to Trade. We will examine the possibility of preparing negotiations for bilateral agreements on mutual recognition of technical standards.

34. Establish a dialogue to promote customs co-operation and the harmonisation of nomenclature, especially in the field of training, setting up databases and networks of experts, and formulating proposals for possible bilateral co-operation agreements on the subject.

35. Encourage co-operation and investment for the development of tourism in both regions. We attach special attention to the development and promotion of sustainable tourism, given the need to contribute to the conservation and management of the rich biodiversity of our regions. The active participation of local and indigenous communities, local administration and the private sector in the sustainable development of tourism contributes to regional and local economies.

36. Reinforce programmes of co-operation in the alternative-energy sector and in energy saving, especially decentralised co-operation –European Community Investment Program (ECIP), América Latina Investment (AL-INVEST), Latin America Rational Use of Energy (ALURE). We will also continue to support relevant programmes.

37. Promote programmes of co-operation in the field of infrastructure, including transport, and administrative procedures for the liberalisation of trade and the intensification of economic co-operation.

38. Ensure high-quality legal framework provisions for consumer protection and dialogue between the social partners; encourage the full implementation of international labour conventions.

In the cultural, educational, scientific, technological, social and human fields

39. Agree to implement programmes in the areas of health and education in order to combat marginalisation, social exclusion and extreme poverty. Close attention should be paid to the implementation of the recommendations of the World Summit for Social Development of 1995 and to the preparation of the Special Session of the General Assembly in June 2000 to follow up on the Summit.

40. Strengthen co-operation in the fields of primary, secondary and higher education and design biregional programmes to support compensatory educational policies that contribute to improve the quality of education and the training of teachers, as well as the preparation of human resources, with special emphasis on vocational training and on the use of new technologies applied to education. We highlight the continuous and successful efforts in the last decades by all parties to foster co-operation also through bilingual and bicultural schools.

41. Firmly support biregional co-operation in the university sector aimed at increasing grants to students and researchers on all levels, as well as broaden post-graduate studies in science and technology, industry and business, the mobility of academics and students and for the processes of accreditation of programmes and the recognition of diplomas. We can look back on an impressive history of co-operation in the university sector, in particular the «América Latina Formación Académica» (ALFA). On both sides we have granted countless scholarships for students and researchers of all levels. These projects will be extended in the future.

42. Promote co-operation to put to better use the possibilities offered by new technologies and instruments, such as distance education, with the aim of integrating them into national education frameworks, particularly for those people and social groups that do not have access to them.

43. Special care will be given to promoting the rights of minorities and implementing training schemes which lend value to cultural and linguistic identities. We agree to promote co-operation aimed at enhancing opportunities for capacitation of indigenous populations to participate in the planning and implementation of social and economic development programmes.

44. Incorporate in educational programmes content that is oriented towards the diffusion of our tangible and intangible cultural heritage, identifying projects of co-operation between the two regions and taking into consideration the cultural offerings which exist on both sides of the Atlantic.

45. In this respect, for the purpose of lending visibility to and renewing the cultural dialogue between our regions, we will consider the establishment of a European Union-Latin America and the Caribbean cultural forum.

46. Implement programmes to promote cultural and linguistic identities, sensitising the population to their importance and to the need for their preservation. We will promote, in particular, research in the field of anthropology and culture, exchange of experts and transmission of conservation techniques.

47. Also agree to continue to provide appropriate support to community instruments such as «Urbs América Latina» (UR-BAL).

48. Promote the establishment of a joint initiative in the field of the "information society" on certain priority matters (e.g., electronic trade, industrial technologies and telecommunications, the environment, health, social services and education). Encourage greater co-operation in the field of audio-visual, cinematography and multimedia as well as the organisation and classification of archives and printed matter.

49. Support the work conducted by the European Union-Latin America Working Group on Scientific and Technological Co-operation and the agreements derived from the IV and V Biregional Conferences held in June and October of 1998 in Madrid and Guatemala, respectively. In this sense, we will establish a working group of representatives of both regions for dialogue and advice on the best way to derive benefit, as concerns future scientific and technical co-operation between Latin America and the Caribbean and the European Union, from the possibilities offered in the Fifth Framework Programme of the European Community for research, technological development and demonstration activities, particularly through co-operation agreements, taking into account the specifics and capacities of the countries concerned, as well as the strategic importance of this sector in our new biregional partnership.

50. Promote and facilitate initiatives for co-operation and exchange in the field of science and technology. Special attention should be paid to the ties between production processes and scientific and technological research, including the ecological aspects that bear a positive effect on the sustainable development of both regions and their environment.

51. Give continued priority to the centres of excellence through trans-regional networks comprising institutions of an academic, scientific and technological nature. Within this framework, we undertake to promote the exchange of knowledge, co-operation in joint initiatives and the mobility of students and research workers between equivalent institutions of the respective regions. We also stress the importance of inter-university co-operation in the human, social and scientific fields and the need, *inter alia*, of a focal point for common research and training of highly qualified personnel, particularly in matters relating to development and integration processes.

52. Encourage the European Institutes and Institutions for Integration (Bruges, Florence and Maastricht), and the network of academic institutions of all Latin American and Caribbean countries and the European Union Member States, to support activities relating to research, post-graduate studies and training in the field of integration processes.

53. Strengthen regional integration policies and the development of the internal markets as fundamental growth and stability factors. For this purpose, we will support the adoption of common policies and co-ordinated sectoral approaches with a view to drawing the best advantage from the existing and future policies of trade liberalisation. Special attention will be given to combating cartels and to the creation of suitable legal and fiscal frameworks.

54. Continue to support the objectives and activities of regional institutions, such as the «Centro de Formación para la Integración Regional» (CEFIR), in Montevideo, aimed at the training of professionals in the public and private sectors and of new generations, strengthening specialised capacities in fields such as analysis, training and management of integration processes.

55. In order to ensure the most efficient use of the available financial resources and to maximise existing complementarities and synergies, agree on the special importance of the principle of subsidiarity and on the need to strengthen co-operation on all sides.

Joint Communiqué of Rio de Janeiro

Meeting of Heads of State and Government from Mercosur and Chile and from the European Union

Assembled in Rio de Janeiro, on the occasion of the Summit Meeting of Latin America and the Caribbean with the European Union, the Heads of State and Government of Mercosur and Chile and of the European Union reaffirmed their determination to continue to strengthen their relations, which are based on deep historical, political, economic and cultural links, as well as on common values.

To this end, they decided to attach renewed priority to their relations in the -political, economic, trade, cultural and co-operation fields, aiming at building a deeper and fuller partnership between the two regions, which should be based on democracy, sustainable development and economic growth with social justice.

They attached a special significance to fostering the political dialogue between the two regions which will serve to enhance co-operation in dealing with bilateral and international issues of mutual interest. They furthermore underlined the importance of the cultural dialogue which will strengthen the existing cultural links between the peoples of the two regions.

They reaffirmed the commitment set out in the Interregional Framework Co-operation Agreement signed in December 1995 between Mercosur and the European Union, of forging closer relations with the aim of encouraging the increase and diversification of trade, by means of gradual and reciprocal liberalisation of trade and promoting conditions which are conducive to the establishment of an Interregional Association, taking into account, in conformity with WTO rules, the sensitivity of certain goods and services. They also reaffirmed the similar commitment set out in the Framework Co-operation Agreement signed in June 1996 between Chile and the European Union, for the creation of an economic and political association.

The Heads of State and Government agreed that the expansion of trade, through the development of free-trade between Mercosur and Chile and the European Union, constitutes a central element in the construction of a more dynamic relationship, in the promotion of their integration processes and in the strengthening of the multilateral trading system.

With this purpose, they agreed to launch negotiations between Mercosur and Chile and the European Union aiming at bilateral, gradual and reciprocal trade liberalisation, without excluding any sector and in accordance with WTO rules. It was agreed that both the results of the Mercosur-European Union negotiations and those of the Chile-European Union negotiations should in each case constitute a single undertaking to be implemented by the Parties as an indivisible whole.

On initiating both negotiations, the Heads of State and Government decided that meetings of the Co-operation Council established in the Interregional Framework Co-operation Agreement Mercosur – European Union, and of the Joint Council established in the Framework Co-operation Agreement Chile – European Union, should be held in November 1999. At those meetings, proposals should be formulated regarding the definition of the structure, methodology and calendar for the negotiations.

The Heads of State and Government discussed the preparations for the launching of a new comprehensive and balanced round of multilateral trade negotiations in the World Trade Organisation. They expressed their expectation that this process shall be concluded within three years and that its results should strengthen the multilateral trading system and prepare it for the challenges of the forthcoming century.