

Floor Discussion of the Mistry Paper

Macroeconomic Stability

Manuel Marfan, Chile's Deputy Minister of Finance, in his opening address to the conference, stressed that the new process of economic integration in Latin America has been largely the result of the economic reforms of the 1980s. According to Marfan these reforms have diminished the heterogeneity of the ways in which the Latin American economies operate, and this reduced heterogeneity, in turn, has eased the process of economic integration.

“One of the characteristics of the Latin American region in the last decades was precisely the volatility of the rules of the game. This is one of the main reasons why intra-regional trade in Latin America has been so low compared to other regions. The economic reforms of the 1980s have created a consensus on the need to base growth on investment, savings and exports, especially non-traditional exports. This consensus has stimulated private producers and investors to start operating in different markets, thus establishing more solid and more stable relations between countries. The first element of successful integration is therefore stable economic relations and stable rules of the game.”

A second crucial element of successful integration was, in the view of Marfan, macroeconomic stability.

“It is useless to reduce tariffs from say 30 per cent to 15 per cent when subsequently the real exchange rate moves 50 per cent or more. There are many examples of countries in the region which initiated efforts to increase their bilateral trade and immediately after they signed an agreement one of them started developing an economic package which introduced a lot of noise in its internal macroeconomic events including relative prices which affect trade. One important way to strengthen economic relations in the region is therefore a common effort to stabilise our economies. By stabilising I mean stabilising mainly relative prices, which is important in order to create a less risky environment for private agents,” Marfan said.

Augusto Aninat, president of a large Chilean export firm, wondered whether Marfan's emphasis on the need for macroeconomic stability would mean that a new component was to be added to the definition of a region.

“What is a region?” Aninat said. “I think the components of the definition are changing. In the past, a region was geographically defined. Neighbour-

hood was very important. Secondly, it had to do with socio-cultural elements in common. But today new components are added such as the one given by Marfan: macroeconomic stability. I think this change in the definition of a region is important.”

Hector Assael, chief of the International Trade, Finance and Transport Division of ECLAC, argued that the main issue in the coordination of macroeconomic policies is the achievement of stable exchange rates.

“If you have a stable real rate of exchange, you are in a good position to solve problems. If you take, for instance, the case of the ‘Crónica de una muerte anunciada’ of Mexico and Argentina, it is very clear that because their real rate of exchange has been going down all these years, there is trouble. It is not because they had a good policy or a bad policy, but because they had a real rate of exchange that was coming down in a strong and stable way. Take another example, the case of Chile. Some people say that Chile is also having a big decline in its real rate of exchange. But that is not true. If you take the basket of countries with which Chile is having trade, you will see that there are very small movements in terms of real rate of exchange, and that is why the Chilean situation is more stable than the Mexican or Argentinean situation.”

Antonieta del Cid, Vice-President of the Central Bank of Guatemala, emphasised the need for harmonising macroeconomic policies.

“When the Latin American countries were discussing their access to NAFTA, the United States and Canada were very clear about the aspects of macroeconomic stability. That is why Chile, for instance, is the main candidate to enter into NAFTA. It is the most successful country in the Latin American region in macroeconomic stability in the last decade. And after the recent crisis of Mexico I think macroeconomic stability is going to be considered an even more fundamental issue than before. In the case of the Central American integration agreements there is no clear commitment to macroeconomic stability – it is just agreed ‘to make the best effort’. But to make the best effort is not going to guarantee any success in terms of macroeconomic stability. In fact, we in the Central American countries have signed an agreement in October 1993, but last year Costa Rica and Honduras went into macroeconomic disequilibrium again. My point is that macroeconomic stability is a must. Of course, exchange rate arrangements are helpful. It is not the best way to do it, but at least they help to enforce some macroeconomic discipline among the countries.”

Ricardo Ffrench-Davis, principal advisor on economic policy at ECLAC, suggested that macroeconomic stability and regional integration might be reinforcing each other. Ffrench-Davis elaborated on the question of whether integration would help to achieve macroeconomic stability.

“It depends on how you do integration,” Ffrench-Davis said, “If you are integrating two parts and one part assumes that other countries will integrate

to the macroeconomic activity of that part, that might imply macroeconomic instability for the second part. Only if integration is complete, then the two or three parts turn into one part in all senses: one currency, one political entity, one Minister of Health, one Minister of Social Security, and so on. In other circumstances – if you have only some parts integrating – integration might imply macroeconomic instability for some of the partners.”

Roberto Bouzas, an Argentinean economist engaged in policy research, thought one should not place too much emphasis on the issue of macroeconomic stability as a precondition for integration.

“The problem is that we live in a second-best or third-best world and, at least in the South, macroeconomic instability is here to stay. It has returned recently in a very obvious manner in the Mexican case. So I think that placing the issue of macroeconomic stability as a precondition for integration is too strong a wording for the issue. Mercosur is a clear case in which a very large increase in trade has taken place in an environment of macroeconomic instability. Of course, probably the increase in trade and investment flows might have been larger in a more stable macroeconomic environment. But the fact is that this process took place in a context in which the largest partners, Brazil and Argentina, were going through serious macroeconomic instability. Why did this happen? Well, the basic reason is that trade among many countries, and particularly among natural trade partners such as Argentina and Brazil, has been long repressed. So once you liberalise unilaterally on the one hand, and on the other hand you give preferences to the partner, the boom in trade is very large even when macroeconomic imbalances are there. So there is room to increase trade through preferential agreements even in the context of macroeconomic instability,” Bouzas said.

Following up on the issue, Robert Devlin, chief of the Integration, Trade and Hemispheric Issues Division of the Inter-American Development Bank, stated that in Washington there is still a focus on macroeconomic conditions as a precondition for integration and accession in NAFTA. “I therefore think what Roberto Bouzas just said is very important. There are a lot of things you can do in integration even when there is disequilibrium in many areas of the macroeconomy.”

Percy Mistry added that the recent turbulence in European exchange rates was an important example which showed that regionalisation does not lead automatically to stability.

“While in Europe everyone thought that the exchange rate mechanism would anchor stability, it in fact proved to be the opposite when there was a policy twist between the anchor country (Germany) and the others at entirely the wrong time. So you can’t be axiomatic about it. In fact, the problem has just been repeated in Mexico. I don’t think joining NAFTA helped, even though it was supposed to be a lock-in, to assure Mexican stability.”

Regionalism, Multilateralism and Unilateralism

Hector Assael observed that Latin American countries have also embraced regional cooperation as a means to build a more safe base from which they can operate internationally. "Being inside such regional groupings, Latin American countries feel much more comfortable when they are opening up to the rest of the world. There is a kind of special agreement in terms that the openness with the rest of the world needs some kind of support from inside the region."

Robert Devlin added the argument that there is often a defensive component in regionalism vis-à-vis globalisation itself and vis-à-vis other countries or groups of countries.

"I think that is part of the US interest in regionalism. As a consequence, you have this problem of a maze of agreements which do not necessarily match, and can be a stumbling block. So you need some type of coordinating mechanism to have a common standard by which you can prevent regional integration agreements from becoming stumbling blocks to international trade. That is why the World Trade Organisation (WTO) and above all Article 24 are of increasing importance. Now there is a new understanding of Article 24 which presumably will enhance surveillance of preferential trade. This is important because today 50 or even 60 per cent of trade is preferential. Article 24 and the WTO are going to be very important to ensure that regionalism emerges in a way which is compatible with world growth, more trade and more cooperation. It really has to be in front stage if we want regionalism to be a building block instead of a stumbling block."

Percy Mistry agreed that regionalism may have an element of defensiveness, but he thought that this was largely a pre-Uruguay Round phenomenon which is now being moderated. "People are now beginning to walk away from the negative reasons for going regional and are looking much more at the positive reasons for going regional."

Mistry also agreed that coordinating mechanisms and surveillance at the multilateral level were critical. He thought that this would be an issue of concern not only for the World Trade Organisation (WTO) but also for the other multilateral economic organisations. "I think that the way in which the WTO interacts with the Fund and the World Bank and the regional development banks will be as critical if not more critical," Mistry said.

Ricardo Ffrench-Davis observed that since non-traditional exports are a target of regionalism they will tend to be a building block rather than a stumbling block to multilateralism.

"If regional cooperation is relevant for some sorts of commodities but there are other commodities that are very crucial in the traditional exports of member countries, one may have there an additional source of complemen-

tarity or non-conflict between regional integration and integration into the global markets. I think that we should pay more attention to the fact that we are talking of different baskets of products when we are talking of trade with the world economy and trade with members of an integration group. Usually integration groups are trading in somewhat different sorts of commodities and that is tremendously significant in the case of Latin America.”

Roberto Bouzas said there are usually two arguments made in favour of multilateralism. One is that multilateralism serves to balance the interests of consumers and exporting firms and workers against the interests of import-competing firms and workers. Second, multilateralism contributes to foster a cooperative environment among nations. Bouzas said he believed that the first argument – the balancing of interests – could be appropriately met by regionalism as long as the region was large enough. The second argument, however, could not be met adequately by a regional approach alone, he said.

“So I think this is a matter that becomes crucial, not in the debate about multilateralism or regionalism, which I don’t think that any of us sees as a contradiction or as alternatives, but in the discussion about how to live with multilateralism and regionalism at the same time.”

Bouzas further believed that the issues of convergence and inclusiveness raised by Percy Mistry in his paper should be taken as objectives or aims rather than as something which the integration process would naturally lead to.

“Why do I think convergence is not granted? Partly because regionalism does not foster a cooperative environment among nations globally, quite on the contrary. One of the main shortcomings of regionalism is precisely the increase in resentment which it may give rise to, not necessarily but it may give rise to. And the other reason is because when we speak about regionalism we are speaking about very different animals. For example, the European Union – which is very inclusive in terms of issues, ranging from the economic sphere to even the security matter – is very different from the US-Canada agreement which is purely trade. And as regards the inclusiveness issue, I would not take it for granted that inclusiveness is a feature of the present process of regionalisation. What the present process has shown, at least in the Western Hemisphere, is the difficulty of widening the regional agreements, and this creates a very serious political and policy problem for those who are left out of the agreement, particularly in an environment of uncertainty on how that agreement will be expanded in the future.”

Shahen Abrahamian, officer-in-charge of the Global Interdependence Division at UNCTAD, thought that neither multilateralism nor regionalism had been the main force behind the liberalisation of trade.

“It seems to me that the main impetus is basically unilateralism,” Abrahamian observed. “Not unilateralism in terms of imposing restrictions

on your trade partner but a sort of voluntarily disarming on the trade side. This has been the main line that Latin America has followed. It is being driven by macroeconomic financial considerations. I think that the IMF and World Bank have had much more to do with the trade liberalisation of Latin America than the GATT.”

Percy Mistry fully agreed with Abrahamian and added: “The new regionalism has only become possible in an ethos of unilateral trade liberalisation, and if that ethos had not occurred, then we wouldn’t even be talking about the new regionalism. In fact we wouldn’t even be talking about the potential for a new multilateralism. If that ethos had not existed, I think we would still be negotiating the Uruguay Round.”