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Trade Liberalization in Latin America's Southern Cone and Its Impact on Uruguay(1)

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1. Introduction

Different organizations with the aim of establishing varying degrees of economic integration have succeeded one another in post-war Latin America. In the short run, the results were often encouraging. Soon, however, there came set-backs in the form of cooperation difficulties, and the long-term positive results failed to appear.

Nevertheless, the issue of economic integration has received new attention during the last few years for several reasons. In the first place, Spain and Portugal, the former colonial powers of the continent, joined the European Community in 1986.

The EC is generally seen as a very successful model for Latin American attempts at integration, while at the same time there is widespread fear that Latin American exports to the EC will suffer after 1992. Secondly, considerable progress has been made in democracy, and a new feeling of solidarity has emerged between democratic governments forced to live up to high expectations of economic development in their respective countries.

At present, the most promising events regarding Latin American integration are the cooperation treaties signed by the two South American giants Argentina and Brazil. Uruguay has been invited to participate, which is natural considering its traditionally excellent trade relations with its neighbors, and it has also formally accepted.

It is the purpose of this paper to analyze the effects on Uruguay's development of a deepened economic cooperation with the larger and more industrialized countries Argentina and Brazil.

The disposition of the paper is as follows: The differing economic

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structures of the three countries involved are emphasized in section two. In section three, Uruguay's role in the regional integration process is discussed. Section four provides an analysis of the general welfare implications of trade liberalization in the Southern Cone, while section five is more specifically dedicated to the likely welfare impact on Uruguay. Finally, some of the conclusions drawn from the analysis are emphasized in section six.

2. The Countries of the Southern Cone

The most basic difference between the Southern Cone countries is their size. Uruguay has a population of only 3 million, while Argentina has 32 million, and Brazil is estimated to have 147 million. Although GDP per capita is highest in Uruguay and lowest in Brazil, the huge differences in population size are well reflected in their respective GDP. In 1988, Uruguay had a GDP of S8,641 million, Argentina's was $72,300 million, and Brazil's was $276,900 million. It is evident that Uruguay is of minor economic importance to its larger neighbors. In addition, the general conclusion must be that because of its very limited domestic market the Uruguayan industry is more dependent on international trade in order to achieve economies of scale.

There are also obvious differences in economic structure between the countries.

The figures from 1986 show that the industrial sector is relatively larger in Brazil (38.4% of GDP) and smaller in Uruguay (27.8%), with Argentina somewhere in between (34.8%).[2] The total agricultural influence on the three economies is also very different, as shown by the shares of agricultural products in total exports. We can clearly see the structural difference between Brazil, on the one hand, where the share of agricultural products in total exports has decreased steadily to only 38% in 1985, and Uruguay and Argentina, on the other, where it remains high at 70% and 68% respectively.

Apart from size and economic structure, another basic difference between the Southern Cone countries is the relative stability of the Uruguayan economy. Since 1985, Uruguay has managed to achieve positive growth every year. The development of GDP has been more irregular in Brazil and, above all, in Argentina. The rate of price increases has also varied much between, on the one hand, Uruguay, where inflation was 89% in 1989, and, on the other hand, Argentina and Brazil, where inflation rates were 4923% and 1764% respectively.[3] The inflation rate in Uruguay, which is relatively stable, does not really impede long-term planning. The hyperinflations in Argentina and Brazil have been an entirely different matter. After the failure of the Austral and

Cruzado plans, inflation rates increased rapidly in both countries and stabilizing the economies has subsequently proved to be difficult.

3. Uruguay's Role in the Regional Integration Process

Cooperation in the Southern Cone is based on a series of bilateral treaties. The present process, where Argentina and Brazil play the leading parts, started in November 1985, when the presidents of these two countries in an official document stated their "strong will to accelerate the bilateral integration process."[4] It was initiated as a response to the rapidly declining regional trade figures in the first half of the 1980's, and has consisted of a number of treaties regarding bilateral trade and cooperation in different areas.

Uruguay was soon invited to join its neighbors, and the country has also formally stated that it shares their aspiration for a stronger regional integration. Still, considering the relatively insignificant size of the Uruguayan economy, its participation probably has little more than symbolic value to Argentina and Brazil. Naturally, the opposite is true for Uruguay. Free access to the giant markets of its neighbors could give an immense impetus to its economy.

Uruguay's participation in the integration process actually started as early as 1974 and 1975, when bilateral trade treaties were signed with Argentina and with Brazil. The original treaties have later been replaced and extended by similar agreements. These treaties all have two things in common. First, they are entirely devoted to the removal of trade barriers and do not discuss other forms of cooperation. Secondly, they originate from Uruguay's consistent trade deficit vis-a-vis its neighbors and are consequently constructed to Uruguay's advantage.

The CAUCE (Argentine-Uruguayan Agreement on Economic Cooperation)[5] was signed in 1974. In its first four years of application, Argentina was to implement unilateral tariff cuts, but subsequently the cuts were to be reciprocal. Over the years, increasing numbers of products were negotiated within the treaty. In 1985, the Colonia Document[6] was signed in an effort to extend trade liberalization and get rid of the time consuming negotiations product-by-product. The principle for Argentine concessions according to this new agreement, which is still valid, is that all tariffs should be removed on a quota equivalent to 5% of total Argentine output of the product in question. However, the size of the quota can be smaller if production is considered to be of special national importance.[7] Uruguayan concessions have an altogether different basis. They are only concerned with goods that are not produced domestically and for which the Argentine share of Uruguayan imports is less than 30%. On such goods, however, the principle is that all tariffs should be removed without quotas.

In the period 1975-1985, Argentina implemented tariff exemptions within the agreement on 1042 products, whereas the corresponding figure for Uruguay was no more than 300 products.[8] As could be expected, those figures seem to indicate that the CAUCE primarily has favored Uruguayan exports. Uruguayan trade with Argentina has traditionally resulted in large deficits.

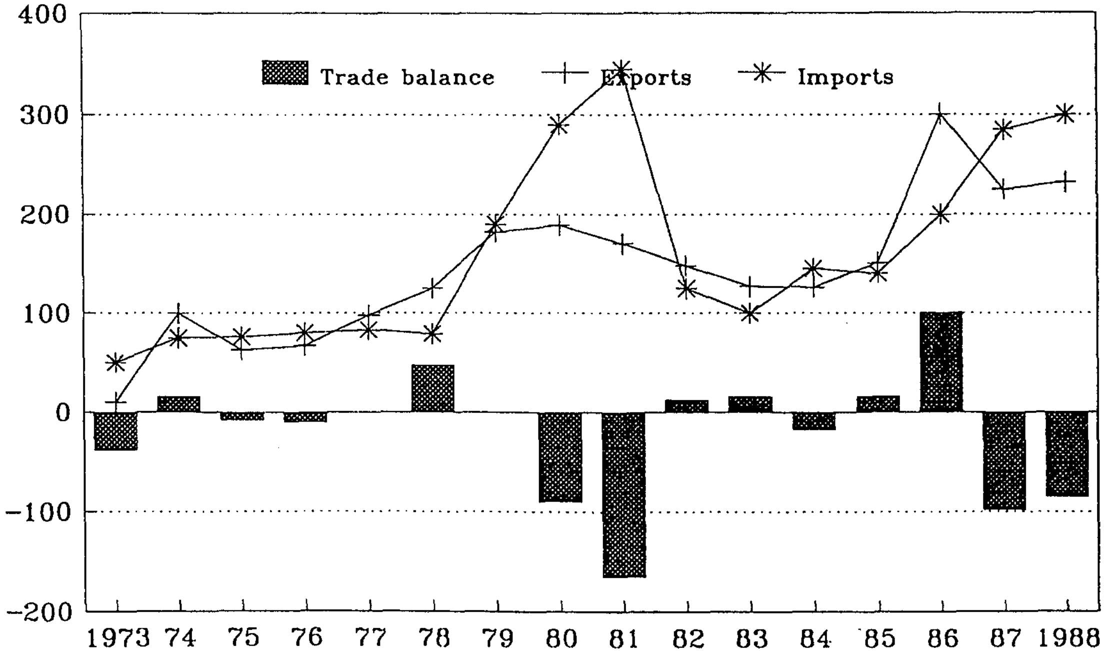
However, as we can see from Figure 1, Uruguay actually experienced surpluses twice in the beginning of the 1980's. The trend towards an increasing deficit during the last few years is of course disquieting, but it could be explained as a result of the Argentine economic crisis rather than as a structural imbalance.

The PEC (Protocol of Commercial Expansion)[9] was signed in 1975 by Uruguay and Brazil. Trade with Brazil has not traditionally been characterized by such consistent and large Uruguayan deficits as that with Argentina. As a result, the original PEC was not as favorable to Uruguay as the CAUCE. A smaller number of manufactured Uruguayan goods were given tariff exemption within the PEC, and the quotas were generally smaller as well.[10] Uruguayan concessions, however, had the same basis as in the CAUCE, in that they only included goods that were not produced domestically and were almost entirely free from restrictions in quantities. In the period 19751985, Brazil granted tariff exemptions on 1406 products, while the corresponding figure for Uruguay was 1009 products.[11] Nevertheless, those products only constituted 24.6% of total Uruguayan-Brazilian trade in 1986. That year, however, the PEC was extended by the Brasilia Agreements,[12] and the shares of tariff exempt products negotiated within the PEC increased drastically to 80.9% of Uruguayan exports and 44.9% of imports in 1988. What is more important, non-traditional manufactures, a previously rather unimportant feature of Uruguayan exports to Brazil, were given tariff exempt quotas.

As we can see from Figure 2, trade between the two countries, although generally increasing, has developed very irregularly. A good example is that in 1986, the year of the Cruzado plan and its excess demand, Uruguay was left with a surplus of $101 million. In 1987, however, that surplus had changed into a deficit of $85 million. Nevertheless, it seems that the structural Uruguayan deficits have been eliminated.

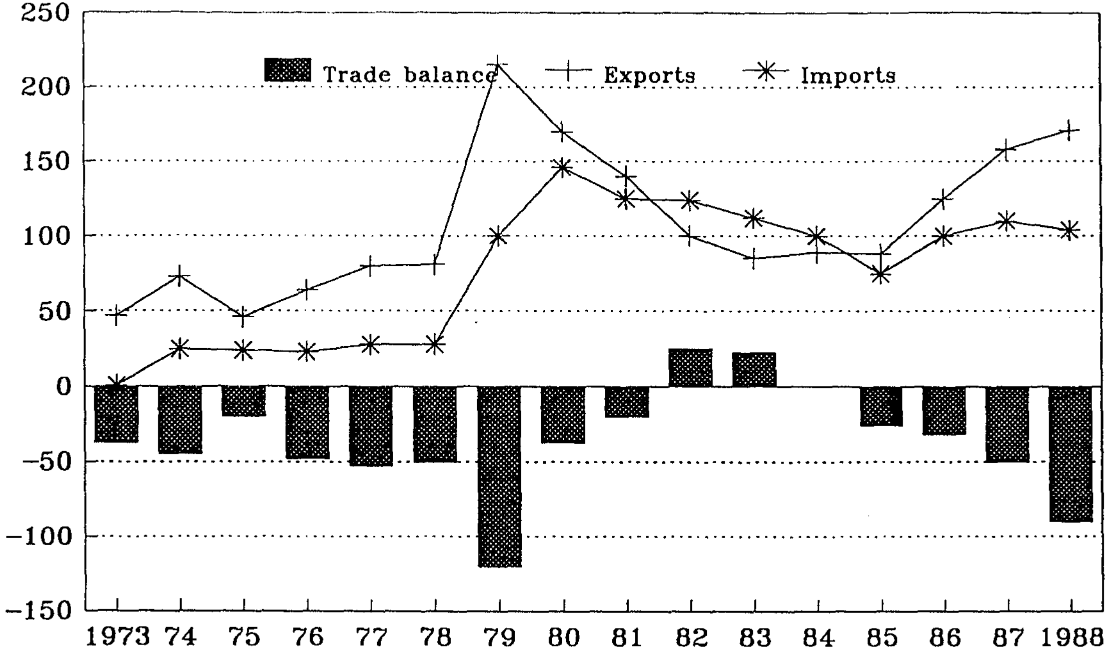
To sum up, the CAUCE and the PEC have been important in that they have helped increase regional trade and reduce Uruguay's traditional trade deficit vis-a-vis its larger neighbors. Table 1 illustrates how the shares of total Uruguayan exports that go to Argentina and Brazil have developed over the years 1973-1988. Although there is much variation, to say the least, the trend

Fig. 2: Uruguay's trade with Brazil
1973–1988
(millions of current dollars)



Sources: 1973–84 Zeballos, C.
1985–88 Banco de la
Republica Oriental del Uruguay

Fig. 1: Uruguay's trade with Argentina
1973–1988
(millions of current dollars)



Sources: 1973–84 Zeballos, C.
1985–88 Banco de la
Republica Oriental del Uruguay

seems to be that these shares are increasing. Table 1 quite clearly shows how regional trade has been affected by different events. The peaks in 1979 and 1980 are explained by the export promotion policies of the Uruguayan military government and the general tendency towards trade liberalization in the region at the time. The debt crisis, which forced the debtor countries to reduce imports drastically, accounts for the subsequent fall. The peak in 1986 can to a large extent be explained by the Cruzado Plan in Brazil, and probably to some extent by the Brasilia Agreements. The subsequent drop should be seen in the light of the troublesome economic situation in Argentina and Brazil. Nevertheless, as stated above, the general trend seems to be that these two countries are becoming increasingly important as receivers of Uruguayan exports.

Be that as it may, in an evaluation of the trade treaties and the effects on Uruguay of closer association to Argentina and Brazil, total export figures are not all that important. If, on the one hand, the increases are due to the fact that some of Uruguay's agricultural exports have been diverted from other parts of the world to Argentina and Brazil, then they are of less importance. Uruguay is already competitive on the international markets of its agricultural produce. The limiting factor in this field is not really international demand, but rather Uruguayan production. If, on the other hand, the increases can be explained by the fact that Uruguayan non-traditional manufacturing industries have found a market in the neighboring countries where their goods can be sold, then they are extremely important. The regional markets could then serve as "launching pads" for reaching extraregional markets in the long run. The launching pad argument will be elaborated in section 5. In that context, we will also try to establish the actual development of non-traditional manufactured exports to Argentina and Brazil in recent years.

4. General Welfare Implications of Trade Liberalization in the Southern Cone

Naturally, it is far beyond the limited scope of this paper to try to calculate the exact outcome of a comparative static welfare analysis of trade liberalization in the region. However, what we can do is to discuss some of the rough tests that have been proposed to determine whether the likely outcome of a customs union is positive or negative, i.e. whether trade creation (which must raise welfare) is likely to prevail over trade diversion (which may or may not). Trade creation is the replacement of the high-cost domestic production of one member country by the low-cost production from another, whereas trade diversion is the replacement of a low-cost third country producer by a high-cost

Table 1
Argentine and Brazilian shares of total Uruguayan exports 1973-1988
(percentages)

Year	Brazil	Argentina
1973	4.9	2.5
1974	24.1	8.1
1975	17.1	7.7
1976	10.9	4.0
1977	15.8	6.0
1978	18.7	5.6
1979	23.1	12.3
1980	18.1	13.5
1981	12.6	8.6
1982	14.1	10.6
1983	11.4	8.6
1984	11.9	9.1
1985	16.9	7.4
1986	27.3	8.2
1987	17.2	9.6
1988	16.3	7.1

Sources: 1973-1974 Zeballos C.
1975-1987 Statistical Abstract of Latin America. Vol. 20-27
1988 Latin American Economic Report, 1990-01 and Banco de la República Oriental del Uruguay

union producer.

The most basic generalization in this area is the one stating that the chances of net increases of economic welfare are greater if the economies involved are actually competitive (because of the protective tariffs), but potentially complementary (because of dissimilar cost ratios).

In a general discussion of this kind it is natural to contrast Argentina and Uruguay on the one hand with Brazil on the other. Uruguay is still basically an agricultural economy and Argentina, though industrialized, has failed to achieve competitiveness in its industrial production, whereas Brazil has developed into an important industrial economy. This difference is also clearly reflected in the structure of regional trade: Argentine and Uruguayan exports to Brazil consist essentially of primary products, while trade in the reverse direction primarily comprises manufactured products. In addition, as regards capital goods, Brazil's strength lies in massproduction, while Argentina to a higher degree takes up specialized, high unit value production.

On this basis, we might conjecture that because of dissimilar cost ratios the countries of the region are highly complementary. Furthermore, they are considered to be among the World's most efficient producers in their respective fields. Consequently, a drastic reduction or total abolishment of tariffs and other trade barriers would not cause much diversion of trade (i.e. replacement of imports from more efficient extra-regional producers), but then again one would suspect that it would not cause extreme amounts of trade creation either, since the economic structures of the countries already differ so markedly.

However, facts tell us that the value of trade between Argentina and Brazil increased from $750 million in 1985 to $1700 million in 1988.[13] Obviously, the tariff walls that existed in 1985 were high enough to prevent much of the trade that takes place today between the two countries.

The general conclusion of a traditional comparative static approach is that trade liberalization would not cause any fundamental changes, but it would tend to strengthen the regional division of labor and the existing trade patterns. The net welfare effect is likely to be positive, especially if the future aim of a customs union can be reached, i.e. if a common external tariff can be established. Then the new common tariff may be lower than the previous individual ones and, additionally, it may show less variation among different groups of imported commodities, thus causing less distortion of domestic prices.

The dynamic gains are often regarded as the most important ones. Since we will later analyze Uruguay's role specifically, we will now only conclude that the achievement of economies of scale is not likely to be a major argument for economic integration for Brazil, a country which is the world's tenth largest economy. On the other hand, Argentine industries would certainly prosper if they could extend their protected domestic markets to the Brazilian market. However, the gains from achievement of economies of scale for some industries are based on the costs of either shut-downs of other regional industries or trade diversion. The Latin American experience of economic integration has shown, not unexpectedly, that the shut-downs are most likely to occur in the least industrialized countries. Consequently, given that the free market forces are left to determine the allocation results of trade liberalization, primarily Argentine and Uruguayan industries will be forced to discontinue production.

The gains from forced efficiency are closely linked to the discussion above where increased competition is regarded as a price to be paid for the possibility of reaching a significantly larger market. Naturally, it is a very different viewpoint to consider increased competition as an important source of dynamic gains. Nevertheless, this factor is believed to cause very significant gains in the form of forced increases of efficiency. This is specially true in the developing countries, where markets often tend to be uncompetitive. The countries of the Southern Cone are no exception to this rule. Inefficiencies have flourished behind the barriers raised by the traditional Latin American policy of import-substitution. In addition, primarily in Brazil, huge subsidies encourage inefficiencies in monopolistic, state-owned enterprises, and in Uruguay the market is often too small to prevent the development of monopolistic practices. Hence, we must conclude that the gains from forced increases of efficiency would be quite significant if a system of free trade was established in the region.

Characteristic of development thinking in most Third World countries is a preference for industrial production. Regardless of its reasons, this preference must be taken into account when an evaluation is made of a specific attempt at economic integration. Economic integration with countries which are at a similar level of industrial development enables the developing country to protect its infant industry at a lower cost. Traditionally, however, the unequal distribution of costs and benefits (basically the varying rates of industrial growth) has been the major stumbling-block in the earlier efforts at Latin American economic integration.

On the basis of our knowledge of the fundamental differences in economic structure between, on the one hand, Brazil and, on the other hand, Argentina and Uruguay, we can therefore safely assume that these differences will constitute a significant obstacle in the continued process of economic integration between the countries. The natural outcome is that Argentina and Uruguay, whose industries are bound to suffer most from economic integration, will counteract the Brazilian efforts to accomplish a general trade liberalization. This is why Brazil has been most inclined to speed up the process and initiate annual tariff cuts across the board, whereas Argentina and Uruguay have preferred time-consuming negotiations product-by-product, which enable them to protect those industries which are perceived to be of special national interest.

Cooper and Massell's conclusion is that both the comparative static and the dynamic analyses are basically arguments for free trade.[14] According to these approaches a global union would be the optimal arrangement for every individual country. Therefore, it should come as no surprise that those parts of the above evaluation are essentially very positive to trade liberalization in the region. The development approach, however, is more attached to the welfare views of local politicians than to those of international economists. Consequently, we must look seriously upon the assumption of that analysis that the integration process will be hampered by the different levels of industrial development of the Southern Cone countries.

5. The Impact on Uruguay of Trade Liberalization in the Southern Cone

5.1 General Considerations

This section is dedicated to a specific analysis of the likely impact on Uruguay, as a small and less industrialized country, if it is integrated into a customs union with Argentina and Brazil. As before, traditional comparative static, dynamic, and development approaches will be used.

Trade creation means that production is carried out more efficiently and that the combined output of the countries involved will increase. The question of how this gain is divided among the countries has of course received much attention over the years. The solution is by no means self-evident, but it includes varying exchange-rates as a determinant.[15]

A more general answer is that the respective sizes of the countries involved are an important determining force. We have earlier seen that Uruguay has an economy 1/8 the size of Argentina's and 1/32 the size of Brazil's. Naturally, the adjustments would be greater in Uruguay than in Brazil if all trade barriers between the countries were abolished and the relative prices became identical in the region.

Reallocation of resources would of course occur in all three countries, but those in Uruguay would be the proportionally largest ones and, consequently, that country would be the biggest potential gainer.

There have been several attempts to calculate the potential gains from economies of scale for the different Latin American countries. Theoretically, Uruguay has much to gain because of the limited size of its economy, and this is of course reflected in the resulting figures. Cline, for example, has estimated that the production costs of operating at inefficiently low levels in Uruguay are equivalent to 8.4% of GDP (the figures for Argentina and Brazil are 1.7% and 0.1% respectively).[16] However, by looking at the potential gains as current costs instead, we illustrate the initial lack of competitiveness of the Uruguayan industry.

As we stated above, the gains from achievement of economies of scale in some industries are based on the costs of either shut-downs of other regional industries or trade diversion. If absolutely free trade was introduced in the Southern Cone, those shut-downs would most likely occur in Uruguay, as it is the least industrialized and smallest country of the region.

The potential gains from forced increases of efficiency can also be expected to be greater in Uruguay than in the neighboring countries. Apart from a short period in the mid-1970's, high import barriers on industrial products have virtually excluded foreign competitors from the Uruguayan market.

The same is true for Argentina and Brazil, but Uruguay has had to deal with an additional source of inefficiencies in that its small market has a restrictive influence on the emergence of domestic competition as well.

Policy-makers in Uruguay do not differ from their counterparts in other countries. Consequently, they have a preference for industrial production. Above, we discussed the increased competition and the subsequently increased risk of shut-downs which the Uruguayan industry would have to face if it were fully integrated with the neighboring economies.

The development approach explains why Uruguay, as a smaller and less industrialized country, is not likely to accept the consequences of free trade.

As before, we conclude that both the comparative static and the dynamic analyses are basically arguments for free trade. The reasoning behind these approaches is that restrictions on trade cause distortions. *Ceteris paribus*, trade is more restricted in a small economy than in a big one and, consequently, the cost of protectionism is bigger in Uruguay than in Brazil; so of course are the potential benefits from trade liberalization. The conclusion that Uruguay is the biggest gainer by free trade is changed, however, when the preference for industrial production of the development approach is taken into account. This preference indicates that the structural adjustments which are necessary to get rid of regional distortions are likely to generate strong resistance.

5.2. The Pros and Cons of Deepened Economic Integration

5.2.1. Argentina and Brazil as Launching Pads for New International Markets

Some economists believe that selectively reduced trade barriers within the region will entail increased Uruguayan exports of nontraditional manufactured goods to the neighboring economies. This would be beneficial for economies of scale and, what is more important, result in a learning effect in the export area. The Uruguayan industry is then in a second step expected to use this enhanced competitiveness to gain extraregional market shares.[17] The general agreement among economists studying the bilateral treaties with Argentina and Brazil seems to be that they in fact have had a substantial impact on the size of non-traditional exports to Argentina and Brazil.

Even economists who are partly critical of the treaties do not deny these achievements. They concentrate instead on the fact that the treaties fail to encourage intra-industrial regional specialization.[18] Furthermore, the assumedly enhanced competitiveness is called into question. Critics contend that Argentine and Brazilian markets are just as protected from international competition as the domestic markets are and, subsequently, that the tariff exempt quotas received by the Uruguayan industry together with the fiscal stimulation of exports only create windfall gains and do not stimulate higher industrial efficiency.[19]

We believe, however, that neither of these points of criticism are relevant. It is true that the existing treaties do not encourage intra-industrial regional specialization, but then again the only way to encourage such specialization is to agree in advance on a specific distribution of industrial production. Such schemes were tried in the Andean Group with very limited results; there is always a significant risk that such potential decisions are based on political rather than economic considerations. As regards the second point of criticism, we must conclude that the objection is highly questionable.

The fact that the neighboring markets are just as protected from extraregional competition as the domestic market does not really prevent the Uruguayan industry from gaining in competitiveness. As we have discussed earlier, the enhanced competitiveness does not only originate from increased competition, which is naturally more restricted within the region than on the international markets, but also from the achievement of economies of scale and from the export experience itself.

In conclusion, there are no econometric studies that have succeeded in estimating the applicability in Uruguay's case of the assumed causal relations behind using Argentina and Brazil as launching pads. Nor will we try to make such an evaluation in this paper. We will, however, try to establish whether or not there exist certain circumstances that could render this theory credible. In the first place, we have already stated that the share of total Uruguayan exports that goes to Argentina and Brazil has tended to rise since the treaties were signed (see section 3). Secondly, we must examine these increases to see whether or not non-traditional manufactured exports have played an important part. In order to do that, we have picked out the four groups of non-traditional manufactured exports that represented the largest shares of total Uruguayan exports in 1988 as well as in 1979.

They are: chemical products (6.0% of total exports in 1988), plastics (2.2%), transport material (1.8%), and machines and electric equipment (1.0%). Tables 2 and 3 illustrate how the shares of those four groups have developed in the period 1979 to 1988 in exports to Argentina and Brazil respectively.

Tables 2 and 3 make it clear that non-traditional manufactures have in fact played an immensely important part in the increased exports to Argentina and Brazil. These four groups have not only defended their shares of total exports; in the case of Argentina, the shares show an increasing trend, whereas in Brazil's case, under the influence of the Brasilia Agreements, they almost doubled between 1986 and 1987 (from 19.9% to 36.7%). It is difficult to estimate exactly what influence the bilateral trade treaties have had on this increase, but it seems evident that it has been substantial. This is specially true in the case of Brazil, where the signing of the Brasilia Agreements in 1986 was followed by a drastic increase of Uruguayan non-traditional exports.

However, as we know, Uruguay is in a second phase expected to use its enhanced competitiveness to gain extraregional market shares. There are no signs that this has been the case. A possible interpretation of this is that Uruguay has not yet reached phase two. Another, and more pessimistic, interpretation is that the competitiveness that can be achieved on the Argentine and Brazilian markets is not enough to be able to compete on the World markets. Nevertheless, even if one does believe that phase two will not materialize automatically, because of a remaining lack of competitive-ness, the increased non-traditional manufactured exports to Argentina and Brazil must be regarded as something positive.

Uruguayan competitiveness is bound to have increased through the achievement of economies of scale, increased efficiency from having to compete with other companies and, perhaps most important, experience from exportation. This will of course facilitate a future opening to the world markets, which will require less of export promotion policies.

Is there scope for a deepening of the process, i.e. will further tariff reductions in Argentina and Brazil *vis-à-vis* Uruguay lead to increased Uruguayan exports to these countries and, in the long run, to the rest of the world? The answer to that question is not self-evident. However, there are many factors which give cause for a certain caution in an assessment of the potential dynamic effects on Uruguay of an improved preferential treatment of its exports to Argentina and Brazil. One such factor is the risk that an improvement might be neutralized by new bilateral trade treaties between Argentina and Brazil.[20] Uruguayan goods would then possibly have to compete on equal terms with Argentinian goods on the Brazilian market and with Brazilian goods on the Argentine market.

Another factor is of course the sluggish economic growth in Argentina and Brazil, which is generally expected to continue, at least into the near future.[21] Nevertheless, neither of these two factors contradicts the need for further improvements of the treatment of Uruguayan exports. Still, they do suggest that the impact of such improvements may be less substantial than they have been earlier.

In contrast, there exists a factor that actually calls into question the need for improvements. It seems that most economists point to the export experience as the single most important result of the earlier increases of non-traditional exports to Argentina and Brazil.[22] This effect, however, is bound to be far less important in the future than it was in the mid-1970's. Uruguay virtually had no non-traditional exports prior to that period and the initial learning effects from trade must have been quite substantial. Today, on the other hand, we cannot expect the same outcome for two reasons. The first reason is that the items presently included in the trade treaties cover practically the whole line of exportable Uruguayan goods. Subsequently, there is little scope for the creation of entirely new trade currents. An improved preferential treatment of Uruguayan exports would primarily consist in extended quotas. This is where the second reason comes in. This is the limited size of the Uruguayan market, which has impeded the emergence of domestic competition. Consequently, there is an apparent risk that the extended quotas would mainly affect the already existing export firms and would not result in much new learning from trade.

To sum up, our conclusion is that the first stage of the launching pad argument has certainly had a great validity in the past. However, as a result of the restrictions discussed above, its impact on Uruguayan competitiveness regarding non-traditional industry can be expected to be considerably less important in the future.

Table 2
Shares of four groups of non-traditional manufactures in total Uruguayan exports to Argentina 1979-1988 (percentages)

Year	Chemical products	Plastics	Transport material	Machines, electr. equip
1979	8.4	6.8	13.2	8.0
1980	8.9	4.9	13.8	6.3
1981	11.6	6.3	6.3	3.8
1982	19.2	9.4	1.6	1.7
1983	9.0	7.4	0.1	1.3
1984	11.2	5.6	1.8	4.4
1985	15.4	6.8	4.2	6.4
1986	14.4	7..1	9.1	6.6
1987	13.5	6.2	15.8	4.8
1988	18.2	6.6	22.1	2.7

Source: Centro de Estadísticas Nacionales y Comercio Internacional del Uruguay.

Table 3
Shares of four groups of non-traditional manufactures in total Uruguayan exports to Brazil 1979-1988 (percentages)

Year	Chemical products	Plastics	Transport material	Machines: electr. equip.
1979	6.1	7.1	0.5	3.3
1980	5.2	6.9	0.4	3.3
1981	6.1	10.6	0.3	3.4
1982	7.8	5.3	0.4	2.6
1983	5.4	3.8	0.1	1.6
1984	8.4	3.5	0.0	1.8
1985	9.4	5.5	0.0	3.1
1986	8.5	8.5	0.0	2.9
1987	23.7	10.6	0.0	2.4
1988	23.3	9.6	0.0	3.5

Source: Centro de Estadísticas Nacionales y Comercio Internacional del Uruguay.

5.2.2. Enhanced Dependence on the Volatile Economies of Argentina and Brazil

Looking at the increasing Argentine and Brazilian shares of total Uruguayan exports and at the likewise increasing shares of non-traditional manufactured exports out of total exports to these countries, there is no doubt that Uruguay's dependence on the two neighboring economies is great and, furthermore, that it has increased substantially over the last fifteen years. Considering the fact that Argentina and Brazil are both exceedingly unstable economies with soaring inflation rates and fluctuating growth rates, it is only natural that this dependence to some extent could be regarded as a threat to the Uruguayan economy.

However, total Uruguayan exports appear to have been quite unaffected by past fluctuations in the neighboring countries. An explanation could be that non-traditional manufactured exports to Argentina and Brazil are not as easily affected by varying levels of economic activity in those countries as traditional exports. Consequently, when the Brazilian demand suddenly was sharply reduced in 1987, this mainly affected the traditional exports of unprocessed animal products, which - because of Uruguay's international competitiveness in this area of production - could quite easily be diverted to other countries.

In an effort to corroborate this theory, we have again utilized the four categories of non-traditional manufactured exports presented in the previous section. Figures 3 and 4 give a somewhat simplified but very informative picture of Uruguayan exports. Chemical products, plastics, transport material, and machines and electric equipment have been called "non-traditional exports", while all the rest of Uruguayan exports has been called "traditional". When studying in Figure 3 how the value of these four categories of non-traditional manufactures has developed in exports to Argentina, we see that growth has been quite steady, apart from two years at the beginning of the 1980's. For the period we study, the two most recent years of negative GDP growth in Argentina occurred in 1985 and 1988, with -4.5% and -3.1% respectively. In both cases this is clearly reflected by large decreases of "traditional" exports. The impact on "non-traditional" exports in the same years was nowhere near as substantial. The value of these exports was stable in 1985 and grew, perhaps at a more moderate pace, in 1988.

In the case of Brazil, which is illustrated in Figure 4, there is a rather steady decline of the value of both "traditional" and "non-traditional" exports during the first years of the 1980's. That decline was subsequently replaced by a steady increasing trend in the later years of the decade. There are, however, a few remarkable deviations from that pattern of stability. The first one occurred in 1986, when the value of "traditional" exports suddenly more than doubled, from $118 million in 1985 to $254 million in 1986. Then, the following year, when the Cruzado Plan crashed, "traditional" exports fell again to $130 million. That same year, however, under the influence of the Brasilia Agreements, "non-traditional" exports increased by more than 80% (from S42 million in 1986 to $76 million in 1987).

Accordingly, both the Argentine and the Brazilian cases confirm the theory that Uruguayan non-traditional exports are not as easily affected as traditional exports by varying economic growth rates in the receiving countries.

6. Conclusion

According to the comparative static as well as the dynamic approach, Uruguay has the most to gain by free trade. This outcome is changed, however, when we also consider the preference for industrial production of the development approach. Therefore, the structural adjustments that would follow from the implementation of absolutely free trade in the region are likely to generate strong resistance.

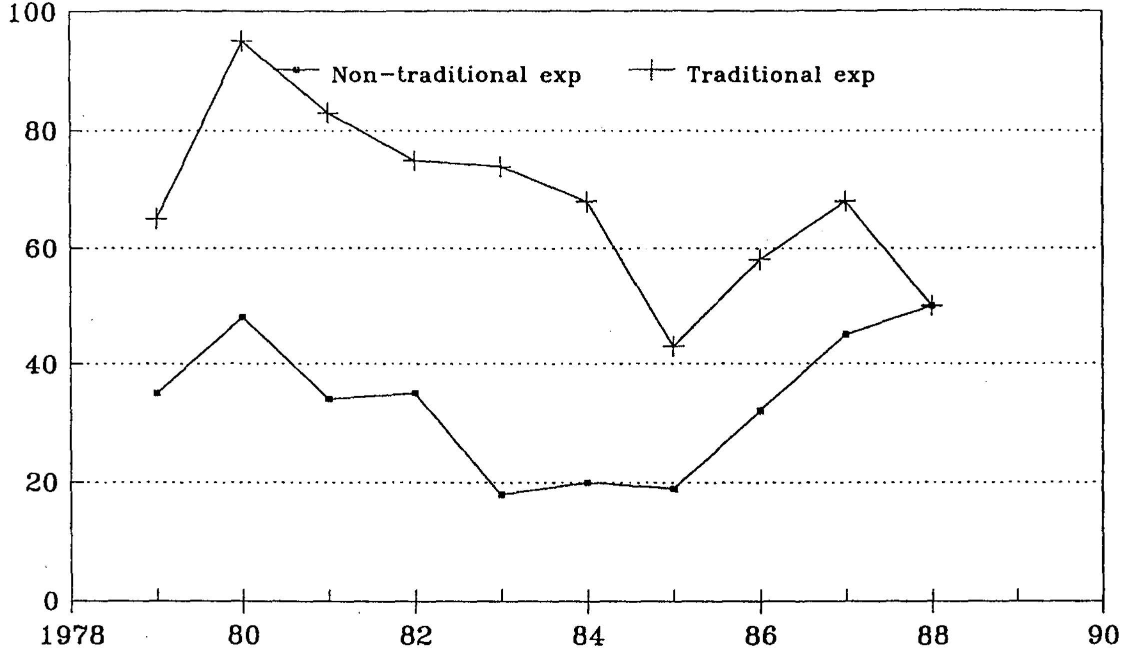
As regards selectively reduced or abolished trade barriers within the region, two arguments have been discussed, one in favor of and one against such a development.

On the one hand, we were partly able to verify the so-called launching pad argument, the belief that such measures will improve the competitiveness of the Uruguayan industry and subsequently enable extraregional exportation. We showed that the value of Uruguayan exports of non-traditional manufactures to Argentina and Brazil has increased considerably over the last few years. So far, however, it seems as though the Uruguayan industry has not been able to use its assumedly improved competitiveness to gain extraregional market shares. The discussion was concluded with the presumption that in the future the impact on Uruguayan competitiveness will for several reasons not be as important as it has been in the past few years.

On the other hand, we were partly able to refute the argument that continued trade liberalization would lead to a dangerous dependence on the unstable neighboring economies.

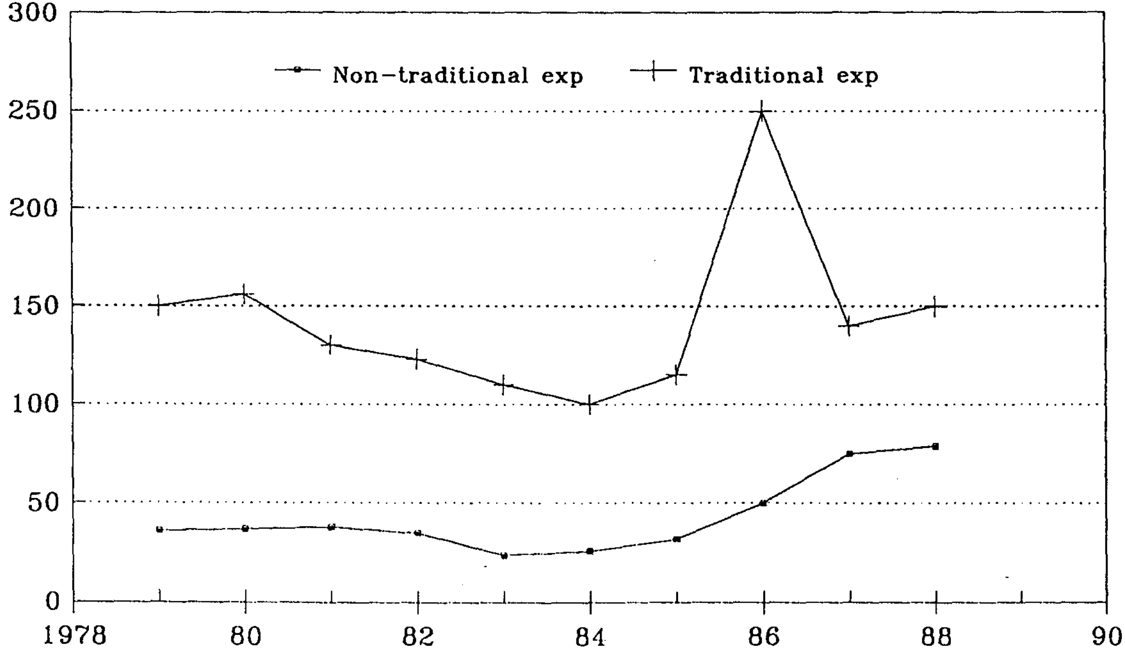
Our conclusion was that it is true that the Uruguayan dependence on Argentina and Brazil has increased with the constantly larger shares of total Uruguayan non-traditional manufactured exports that go to these two countries. However, subsequently we showed that these exports are not much affected by temporary variations in the level of economic activity of those countries.

Fig. 3: The Development of Uruguayan "Traditional" vs "Non-traditional" Exports to Argentina 1979-88 (mill. Dls)



Source: Centro de Estadisticas Nacionales y Comercio Internacional del Uruguay

Fig. 4: The Development of Uruguayan "Traditional" vs "Non-traditional" Exports to Brazil 1979-88 (mill. Dls)



Source: Centro de Estadisticas Nacionales y Comercio Internacional del Uruguay

NOTES

1. We are indebted to the Economic Research Institute, University of Montevideo, Uruguay for the help received in our field work. Westander's work was supported by a Minor Field Study grant from SIDA, Sweden and the Stock holm School of Economics, and Zejan's participation by grants from HSFR and SAREC, Sweden.
2. World Bank, 1989.
3. Statistical Abstract of Latin America, Vol. 27.
4. Latin American Economic Report, 1990-01.
5. Integración Latinoamericana, April 1987, p 1.
6. Convenio Argentino-Uruguayo de Cooperación Económica.
7. Acta de Colonia.
8. The exact terms are "sensitive", which should lead to a quota equivalent to 2.5 %, and "critical", which enables even smaller quotas.
9. Zeballos, C., 1986, p 1.
10. Protocolo de Expansión Comercial.
11. Beretta, N., Lorenzo, F., 1988, p 152.
12. Zeballos, C., 1986, p 9.
13. Acuerdos de Brasilia.
14. Ambito Financiero, August 23, 1989, p 2.
15. Cooper, C.A., Massell, B.F., 1965, p 462.
16. Machlup, F., 1977, pp 49-51, 84-85.
17. Cline, W. R., 1982, p 28.
18. Saráchaga, D., 1989, pp 156, 161.
19 Kaplan, M., Saráchaga, D., Vera, T., 1988, p 115.
20 Ibid., p. 115.
21 Saráchaga, D., 1989, p 142.
22 Ibid., pp 156-157.
23 See for example Saráchaga, D., 1989, p 161.

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