Economic Cooperation and the Direction of Trade Between Brazil and Latin America, 1958-94

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I. Introduction: institutions and international relations

The interest in the role of institutions in the international political economy has steadily increased in recent years [*Snidal, 1996*]. In particular, economists and international relations theorists have tried to understand how institutions for cooperation emerge and how this affects international trade and investment [*Krasner, 1983; Keohane, 1984; Kindleberger, 1986*]. In this paper, it is adopted the definition of institutions suggested by Keohane [*1989: 3*]: "*persistent and connected set of rules (formal and informal) that prescribe behavioural roles, constraint activity and shape expectations*". From the so-called "modified realism" perspective, institutions are both a dependent (endogenous) and an intervening (exogenous) variable [*Krasner 1983; Keohane and Nye, 1989*]. As a dependent variable, they reflect the constraints posed by the domestic and international political economy[1] on actors' decisions. As an intervening variable, they play a relatively autonomous role in decision-making, a role which could not be deduced directly from systemic constraints[2].

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[1] These constraints are related to what Strange [*1988: 29-32*] calls "structural power", *i.e.*, the existence of asymmetries in the international system in terms of technological, financial and military capabilities, which imply a different ability of each country to shape or redefine the rules of the game. The relevant actors in the international system, in turn, are not just states. As observed by Katzenstein [*1983: 15-19*], governmental policies are the result of conflict and negotiations among various domestic and external interests, rather than a "rational" response to specific external conditions by a coherent, unique entity.

[2] In the words of Snidal [*1996: 127*], "(A)t the time of (constitutional) choice, institutions must not constrain states --that is, they must be preferred to the alternatives or else states will not enter voluntarily into them-- yet institutions are important precisely because they subsequently do constrain states --that is, states behave differently than they would in the absence of institutions. Thus, (...) institutions combine voluntary choice and

The relative autonomy of institutions stems from several factors: the influence of ideas on the actors' perceptions of their problems and interests [*Haas, 1989: chapter 2*][3]; bounded rationality, which makes it necessary to develop institutionalised patterns of behaviour to reduce uncertainty [*Nelson and Winter, 1982: 36-38; North, 1993; Hodgson, 1993*]; path-dependency phenomena in the process of human learning and institution-building [*Arthur, 1993: 27-28*]; the costs of reformulating institutions, as the latter represent a truce in the conflict for power among different actors[4]. As a result, the evolution of institutional arrangements play a role of their own in shaping outcomes in the international political economy[5].

This paper focuses on the factors that affected the emergence of institutions for economic integration in Latin America in the 1958-94 period. It also analyses the impact of cooperation on the direction of regional trade. Special attention will be given to cooperation between Brazil and Argentina, the two key actors in regional negotiations. The main argument to be presented is that economic integration in Latin America was an endogenous response to changing systemic conditions, related to the perception of increasing difficulties in the international economy and to rapid industrialisation in the largest countries. But once the institutions of economic integration were established, they contributed to enhance regional trade, even when the original systemic conditions that encouraged cooperation in the first place were no longer present [*Keohane, 1984*]. In this sense, the Latin American experience in cooperation gives credit to the hypothesis advanced by Keohane, namely

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subsequent constraint. They are, therefore, both endogenous and exogenous to state choice". Moreover, this comment should be extended to other international actors, not only states.

[3] Actors ' perceptions cannot be separated from dominant theories and beliefs on how the real world functions. Interests are only intelligible in the light of actors' past experiences and theoretical ideas - even when they are not explicitly articulated. Therefore, power is not enough to define systemic outcomes. As observed by Haas [*1989: p.12*], "*power is normally used to translate knowledge-informed interests into policy and program*s".

[4] Such a truce does not necessarily mean harmony. As Nelson and Winter point out [*1982: p. 110*]: "*conflict, both manifest and latent, persists, but manifest conflict follows largely predictable paths and stays within predictable bounds that are consistent with the ongoing routine*".

[5] The institutions that set a framework for negotiations and contribute to articulate the various interests of international actors are denominated by Krasner [*1983:1*] international regimes, defined as "*principles, norms, rules and decision-making procedures around which actors' expectations converge in a given issue-area"* in international relations. The institutions discussed in this paper can be seen as different international regimes in the field of regional trade in Latin America.

that cooperative institutions may persist in new, less favourable systemic conditions, as a result of both the ability of actors to learn from cooperation and the costs of reformulating the basis for cooperation. In addition, it will be argued that long term trends in regional trade suggest the existence of a positive association between economic integration agreements and the intensity of regional trade.

The paper is organised as follows. Section II presents the main hypothesis about how systemic variables influence regional cooperation. Section III summarises the evolution of the main institutional arrangements for cooperation in Latin America and their impact on trade through the "Intensity of Trade Index" (ITI). The following two sections discuss how regional cooperation and the ITI were related to changes in the international economy (section IV) and to industrial growth in Latin America (section V). In section VI we make a preliminary econometric test to analyse whether regional cooperation influenced regional trade. Finally, the main conclusions of the paper are summarised.

II. Structural Change and Regional Cooperation

In a pure Hecksher-Ohlin-Samuelson (HOS) world, there is in principle no reason to coordinate international economic policies, since each government will be doing its best by just letting the international market work. Cooperation then emerges spontaneously as each country unilaterally adopts the policy which conforms to an international Paretian optimum. As we move away from HOS conditions into the real world, however, there will be incentives to seek coordination/cooperation.

The literature suggests several reasons why governments may accept restrictions on their ability to adopt unilateral policies and move towards regional or international cooperation: (i) the production of international public goods and the associated "free-riding" problem [*Kindleberger, 1986*]; (ii) the existence of increasing returns and oligopoly rents in certain sectors [*Brander, 1986; Krugman, 1982: 46-52*], which generates conflicting interests as regards the desirable patterns of international specialisation; (iii) the prisoners' dilemma that arises when two countries attempt to increase exports while keeping at the same time their barriers to foreign goods [*Stein, 1983; Axelrod, 1984*]; (iv) the existence of externalities associated with the stability of the currency of the trading partners[6].

In the case of the Latin American economic integration in 1958-1994, conditions (i) and (ii)

[6] For a review of this topic see ECLAC [*1992*].

seem to have been especially important in explaining the different intensity of cooperation in different periods[7].

As regards point (i), a non-discriminatory multilateral trading system is an international public good that offers several advantages for countries that individually possess little bargaining power [*Bhagwati, 1992*]. First, multilateral negotiations make less apparent bilateral asymmetries in bargaining power. Second, they permit to extend to small countries trade advantages arising from negotiations among big countries - via the Most Favoured Nation (MFN) clause. Third, a multilateral setting allows global traders (*i.e.*, countries with a high degree of geographical diversification of exports and imports) to reach better access to world markets.

On the other hand, if a country believes that the international public good of an open, multilateral trading system is produced at a sub-optimal level, then it will have an incentive to look for preferential arrangements in order to compensate for (real or alleged) losses in trade due to "distortions" in the trading system. Thus, it can be expected a stronger stimulus for cooperation and for regional institution-building in Latin America in periods in which the regional actors believed that their position in the international economy was weakening or losing dynamism.

As regards point (ii) (the interest in promoting activities that generate external economies and oligopoly rents), it should be recalled that the region was the main destination for exports of manufactured goods, especially of those considered to produce technological spill-overs[8]. Thus, as industrialisation advanced and the need of new markets for industrial goods increased, then the interest in regional cooperation increased as well. The diversification of the industrial structure in Latin America opened up new opportunities for trade and thereby encouraged the interest in forming a regional market.

Another form in which industrialisation in Latin America affected regional cooperation was through the increase of intra-industry trade. The political economy of trade liberalisation depends on whether intra-industry trade or inter-industry trade prevails [*Greenaway and Hine, 1991*]. When intra-

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[7]Condition (iii) was significant too but its influence was probably more or less constant through time. Condition (iv) has become more apparent recently, while its role in past cooperation was probably negligible.

[8] There is of course a debate about whteher a desirable pattern of specialisation exists. What is relevant for this work, however, is that governments do consider some industries more desirable and take decisions based on this idea.

industry trade prevails, the reallocation of factors brought about by import competition would be less costly, and therefore the resistance to trade would be lower. On the contrary, the predominance of inter-industry trade heightens the disruptive impact of imports and mobilise political forces against regional economic integration.

In sum, two set of variables are identified as shaping the evolution of regional cooperation: the "imperfection" of the international system (from the perspective of Latin America) and the gradual process of industrialisation and industrial learning in Latin America. These variables will be analysed in more detail in the following sections. In the next section we briefly present the main institutional arrangements for economic cooperation in Latin America between 1958-1994. Subsequently, we analyse how these arrangements were related to the intensity of regional trade. In sections IV and V, institutions and trade will be discussed in the light of systemic transformations in the international economy and in industrial learning.

III. Institutions as an Intervening Variable: Regional Cooperation and Trade

(a) The Evolution of the Institutional Framework, 1958-94

By the mid-fifties, trade in the Southern Cone of Latin America (including Argentina, Brazil, Chile and Uruguay) was regulated by bilateral agreements which granted import and exchange rate preferences to other Latin American countries [*ECLA, 1958: 106-111*][9]. In the case of Argentina and Brazil, the backbone of the bilateral trade regime was the 1940 Treaty of Commerce and Navigation, complemented by the 1941 Payments Agreement. Basically, these agreements provided for (i) preferential access to import permits and reduced tariffs; (ii) more favourable exchange rates for regional imports; (iii) payments in goods and/or soft currencies of bilateral net trade balances; (iv) soft credits for the financing of bilateral trade[10]. These agreements were devised to obtain imports that Latin America could not buy in the international economy during World War II and to save hard currency in the "dollar shortage" era.

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[9] During the period 1946-51, 83 % of inter-Latin American trade (excluding oil) took place through compensatory agreements. This percentage increased to 90.7 % in 1953. Including oil, compensatory trade represented 73.4 % and 70.5 %, respectively, of total inter-Latin American trade [*ECLA, 1953: 120*].

[10] FO 371 24167, 26 January 1940.

Import and exchange preferences were negotiated on a product-by-product basis and covered a relatively reduced set of goods --most frequently complementary primary goods. In addition, they were only valid for short periods, which implied the need of frequent renegotiations, giving rise to considerable uncertainty as regards the conditions of bilateral trade.

From the late fifties and culminating with the creation of the Latin American Free Trade Association (LAFTA) in 1960, the regional trade regime was reformulated [*ECLA, 1959: 106-7*]. The LAFTA regime displayed significant differences with respect to the former bilateral regime. First, the agreements were expected to include most of the Latin American countries. Although key negotiations continued to occur at a bilateral level, trade concessions had to be extended to all the other members of LAFTA through a regional MFN clause. Secondly, the reduction of trade barriers could not be reverted. Moreover, they should gradually include most of regional trade, leading to the formation of a free trade area in a period of twelve years. Finally, special complementary agreements were accepted during the transition towards the free trade area, with a view to encouraging regional industrial specialisation by multinational firms [*Wyonczek, 1964: 84-104*][11].

At variance with the previous regime, the objective of LAFTA was principally to foster trade in manufactured goods. It was aimed at providing a long term, stable institutional framework, curbing the uncertainty that had characterised the fifties. LAFTA, however, achieved only limited success in promoting regional trade liberalisation. Although significant trade concessions were granted within the LAFTA regime until the late sixties, cooperation receded thereafter. Tariff preferences achieved a maximum in 1968 and stagnated from them on. The preferences granted by LAFTA increased at a fast rate until 1966, then grew at a slower rate until 1969 (the data for 1968 were in fact inflated by the accession to LAFTA of Bolivia and Venezuela) and stagnated thereafter. The cumulative number of concessions granted by LAFTA increased from 4268 in 1962 to 10869 in 1969 (an increase higher than 100 %). But in 1970 this figure was just 11242. The concessions granted by Argentina and Brazil followed the same pattern as LAFTA total concessions and the margins of preference actually fell in

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[11] Originally, the Economic Commission for Latin America (ECLA) had suggested to create along with LAFTA a regional system of payments providing for compensatory payments of net trade balances among LAFTA members [*ECLA, 1960*]. The idea was strongly resisted by the IMF and had to be abandoned to avoid losing external support to LAFTA. See on this FO 371 147678 A 1123/2, 27 January 1961. Still, the proposal gained momentum a few years later, and was eventually implemented through the 1965 Santo Domingo agreement, working quite successfully until nowadays.

1970 [BID-*INTAL, 1972*].

The stagnation of the process of economic integration in Latin America led to the replacement of LAFTA by the Latin American Integration Association (LAIA) in 1980, which was intended to reinvigorate trade liberalisation[12]. Still, the achievements of LAIA in this field were especially modest, and the new institution was basically circumscribed to preserve the concessions formerly granted by LAFTA. However, the creation of LAIA was not inconsequential. A key institutional innovation introduced by LAIA was the possibility of bilateral or sub-regional agreements within LAFTA. Countries were therefore freed from having to extend trade concessions to all LAFTA partners. This allowed those countries which were more similar from the point of view of industrial development, and which displayed a stronger interest in economic integration, to set their own pace for trade liberalisation. It is in this context that Argentina and Brazil signed several bilateral agreements gathered in the 1986 Protocol for Integration and Economic Cooperation (PICE)[13]. This ample bilateral arrangement was succeeded by others, in a process which culminated with the creation of the Southern Common Market (MERCOSUR) in March1991. Paraguay and Uruguay joined Argentina and Brazil in the formation of the MERCOSUR.

The MERCOSUR represented a significant change in the institutional framework for regional trade. First, trade concessions were negotiated on an across-the-board basis, and no longer by means of the sluggish product-by-product pattern --which were especially sensitive to protectionist pressures. Secondly, the common external barrier adopted by MERCOSUR was significantly lower than the unilateral barriers that had been applied by each country just a few years before. This process of economic integration in a context of openness has been called of "open regionalism" by ECLA [*1993*],

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[12] In 1969 the LAFTA timetable was reformulated and the deadline for the formation of a free trade zone extended until December 1980. Yet by the mid-seventies it was clear that the new deadline could not be reached and that it would be necessary to reformulate LAFTA [*French-Davis, 1989; Barbosa, 1993*].

[13] Argentina and Brazil signed at the beginning bilateral agreements on several specific sectors - capital goods, wheat, steel and iron, and nuclear energy, among others. In the case of capital goods emphasis was given to the expansion of intra-industry trade in order to avoid serious disruptions for the Argentine industry, which was recovering from a long recession. The Argentine metal-mechanical industry was in a very weak position in the eighties as a result of the process of de-industrialisation of the seventies [*Katz and Kosacoff, 1989; Kosacoff, 1992*]. The original set of bilateral agreements subsequently evolved towards a programme of faster, across-the-board trade liberalisation with a view to forming a common market, a process partially accomplished by the MERCOSUR [*Barbosa, 1991: chapter 4*].

in contrast with the closed pattern of the LAFTA era. It should also be observed that while LAFTA sought to create a free trade area, the MERCOSUR adopted the form of a (yet incomplete) customs union. Finally, during the transition towards the customs union exemptions to regional free trade were accepted. But these exemptions take the form of a "negative list" of products which should gradually disappear.

In sum, between 1958-1994 at least three regional trade regimes can be found in Latin America, and in particular in the case of Argentina and Brazil: the bilateral trade regime of the fifties, the regional LAFTA-LAIA regime of 1960-85 and the PICE-MERCOSUR regime negotiated in 1986-1991. Although the process was far from linear, each phase represented a gradual strengthening of economic integration, at least at a sub-regional level.

(b) The Evolution of the Index of Trade Intensity

To see how institutional change and the direction of trade were related, we calculated the Trade Intensity Index (ITI) for the period 1958-1994[14]. The advantage of this index is that it permits to control for the influence of factors like the size of the country or the effect of devaluations on the direction of trade.

In the case of exports, ITI(x) = x_{ij}/m_j, where x_{ij} is the share of country i's exports going to country j and m_j is the share of country j in world imports (net of country i's imports). If there is no regional bias in trade, the participation of country j in country i's exports will be equal to the participation of country j in world imports (and then ITI(x) = 1). A similar index can be calculated for imports (ITI(m)), as the ratio between the share of country j in total country i's imports and the participation of j in world exports (net of country i's exports).

There are two reasons why the ITI between two countries, say i and j, may be higher than the unity. The first is economic complementarity [15]. The second is related to the existence of cooperative

[14] For a detailed discussion of the ITI, see Anderson and Norheim (1993)

[15] For instance, the ITI between Argentina and Brazil will tend to be higher than the ITI between Argentina and the USA because Argentina and Brazil have complementary agricultural production. Clearly, transport costs are important as well, leading to a higher ITI between neighbouring countries. The influence of transport costs is not addressed in this paper.

agreements reducing transaction costs and/or giving a margin of preference to the region. In order to know whether economic integration had an impact on trade, it is necessary to separate the effect of economic complementarity from the effect of trade preferences and lower transaction costs on the ITI. In effect, the ITI can be considered as composed by the product of two other indexes, B_{ij} and C_{ij}, where B_{ij} is a residual transaction costs index and C_{ij} is a complementarity index[16]. If C_{ij} does not vary or its influence is controlled, then the ITI will only reflect B_{ij}, which (assuming constant transport costs) is a function of policy induced bias in the direction of trade. Hence, the evolution of the ITI can give an idea of the evolution of cooperation in regional trade.

Graphs I and II display the ITI for exports (ITI(x)), imports (ITI(m)) and the average ITI (ITI(a)) for trade between Brazil and Latin America and Brazil and Argentina, respectively (see also Appendix I). In the long term, the ITI tended to increase (albeit irregularly) stemming from the cumulative process of learning at both the institutional and industrial level.

Two aspects of the evolution of the ITI Brazil-Argentina and Brazil-Latin America are particularly apparent: the high absolute values of the ITI Brazil-Argentina; and changes in the time trend in different periods.

In effect, the ITI Brazil-Argentina began at much higher levels, and increased at faster rates in the early sixties, than the ITI Brazil-Latin America. This was related to two factors. First, the Southern Cone countries had already developed a network of preferential agreements in the mid-fifties, which excluded other Latin American countries. This contributed to raise the intensity of trade between Argentina and Brazil as compared with that between Brazil and Latin America. Secondly, there existed a natural economic complementarity between Argentina and Brazil, two large neighbouring countries specialised in different primary goods – Brazil in coffee and Argentina in wheat. Argentina was the main supplier of wheat to Brazil, while Brazil exported coffee, tropical fruits, and iron and rubber manufactures to Argentina[17].

In turn, the increase in the ITI accelerated in certain periods. It can be seen that in the case of

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[16] C_{ij} is defined as $\Sigma(x_{ki}.m_{kj}/t_{kw})$, where x_{ki} is the share of commodity k in country i's exports, m_{kj} is the share of commodity k in country j's imports and t_{kw} is the share of commodity k in world trade. Cf. Anderson and Norheim *[1993: 82-3]*.

[17] For an early account of trade complementarity between Argentina and Brazil see Magalhães [*1945*]. See also Fonseca[*1989*].

the ITI Brazil-Latin America, the ITI always increased, although at a relatively lower rates in the seventies. In the case of the Brazil-Argentina, the ITI grew until the mid-sixties and subsequently stagnated. The ITI experienced a substantial (and surprisingly fast) recovering after the PICE and MERCOSUL agreements of 1986 and 1991, which reinvigorated regional cooperation[18]. These data is broadly consistent with the hypothesis that the institutional arrangements for cooperation did influence the intensity of regional trade. In the following section we will analyse the specific conditions faced by Brazil and Argentina in the seventies, which contribute to explain the stronger fluctuations observed in the ITI between these two countries.

IV. Institutions as a Dependent Variable: Systemic Constraints and Industrial Transformation

The previous section discussed how institutional change affected the intensity of regional trade. This corresponds to the role that institutions play as an intervening, relatively autonomous variable. However, as mentioned, institutions are as well endogenous variables, shaped by systemic conditions in the international economy and industrial transformation. To this aspect of institutions we now turn our attention.

(a) The International Economy and Regional Cooperation

1. E*arly developments*. It was suggested that regional cooperation increased when international conditions were seen in Latin America as less favourable for trade and growth. In the case of Argentina and Brazil, the cooperation process began in the context of the collapse of the international trading system during World War Second, which severely impaired the supply of imports to these countries [*Porcile, 1995*]. Although in 1946-48 these agreements were temporarily abandoned, they began to be used intensively again in the early post-war period [*ECLA, 1956*]. At that time, the key problems were related to recurrent deficits with the dollar area --the so-called "dollar shortage". The favourable trade balance obtained by Brazil and Argentina with the European countries could not be used to pay for

[18] The average ITI between Argentina and Brazil in 1986-90 almost doubled the figure of 1974-81, expressing the impact of the 1986 PICE agreements. Under the MERCOSUL the ITI(a) continued to growth, reaching a value which was in 1991-94 more than 30 % higher than in 1986-90.

imports from the dollar area, since Europe only returned to full convertibility in 1958 [*Malan et al, 1977*]. Thus, the mechanisms of cooperation developed during the war --trade and exchange preferences-- were preserved as a means of saving scarce dollars in the fifties.

The move towards closer cooperation further accelerated in the late fifties, leading to the creation of LAFTA in 1960. This move was a response to the constraints that the international system seemed to pose on Latin American development in the heydays of her major industrialisation effort. In effect, since the mid-fifties the "developmentalist" governments of Brazil and Argentina sought to dramatically accelerate the process of industrialisation by implanting new capital- and technology-intensive industries. In order to succeed in this effort, the region demanded higher levels of international support in terms of financing and technology transfer. But from the perspective of the governments of Argentina and Brazil, this support failed to come at a critical moment of the development process.

Firstly, it was considered that after the war the USA had unduly neglected Latin America in the distribution of international financial assistance. The Latin American countries demanded special arrangements for the stabilisation of commodity prices, and soft financing for their industrial projects[19]. Still, as the new hegemonic power, the USA faced urgent commitments in other parts of the globe in the context of the Cold War, and was therefore reluctant to comply with Latin American demands. This led the governments of Argentina and Brazil to conclude that more regional cooperation would be required to both compensate for the lack of international support and strengthen their bargaining power in the international economy[20].

Secondly, it was considered that the international trading system that had emerged from

[19] The opposite Latin American and US views on international support for economic development in the late fifties was a persistent source of friction in hemispheric relations. Commenting on the 1957 Economic Conference of American States in Buenos Aires (15 August - 4 September), US Assistant Secretary Rubottom observed that while Latin America advanced its "*customary proposals*" in Buenos Aires for export and financial support, the USA had to insist on her "*traditional and thoroughly justifiable view*" that "*foreign and domestic private capital (...) should carry the main burden of financing and promoting economic development, and the Governments should seek to create investment climates conducive to a higher rate of private investment*". Cf. letter from the Assistant of State for Inter-American Affairs, 23 October 1957, *FRUS* [*1985, pp.140-43*]. The Latin American demands would emerge again in a more coordinated fashion in the so-called "Pan-American Operation", launched by President Kubitschek of Brazil in May 1958 [*Kubitschek, 1963*].

[20] Cf. FO 371 126224 AB1042/1, 6 December 1957.

Bretton Woods placed Latin America in a disadvantageous position[21]. Such a perception was heightened by the "Haberler Report", which argued that Latin American exports were hampered by protectionism in the industrialised countries [*GATT, 1958*]. Both Argentina and Brazil were concerned with having been "set aside" from the most dynamic currents in international trade and investments [*Lanús, 1984*].

Finally, the new democratic governments of Kubitschek (1956-61) and Frondizi (1958-1962) in Brazil and Argentina, respectively, abandoned the pattern of geopolitical rivalry that had dominated the relations between the two countries in the 1942-1955 period. The main objective of the external policy of the two presidents was furthering economic development and industrialisation. This made it easier for them to agree to integrate more closely their economies and to accept higher levels of regional interdependence[22].

2. *The golden age.* The global economic conditions of the 1960-73 period resembled the ideal type of world envisaged in Bretton Woods, based on multilateral institutions promoting rapid growth and trade liberalisation. This period combined full employment policies with high rates of productivity growth stemming from the international diffusion of US technology [*Gilpin, 1987: chapter 9*]. The favourable international conditions of the golden era of the Bretton Woods regime challenged the "marginalisation" idea that had characterised the late fifties in Latin America. This may have contributed to the decline in the interest of the Latin America governments in LAFTA from the mid-sixties, as reflected in the stagnation of the process of regional trade liberalisation. The stimulus to surrender sovereignty was lessened as the international economy grew at high rates on multilateral basis[23].

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[21] On the perception that Latin America was in great disadvantage in the emerging post-war order, see Simonsen [*1947*]. For a careful assessment of the influence of post-war conditions on Latin American industrial policies, see Thorp [*1992*].

[22] The geopolitical rivalries that prevailed in the Perón-Vargas and Perón-Dutra eras began to erode from 1955 on. The rapprochement between Argentina and Brazil achieved its highest point during the meeting of Presidents Frondizi (Argentina) and Quadros (Brazil) at the border city of Uruguaiana by the end of April 1961, when they signed a formal agreement to coordinate their external economic policies [*Lanús, 1984: pp.289-296*]. Cooperation continued after the resignation of Quadros in October 1961 and his substitution by João Goulart. See on this FO 371 155829 AA 10310612, 3 May 1961.

[23] It should be observed, however, that the benefits of the multilateral GATT system were to some extent less

In addition, a critical factor in the decline of LAFTA was the consolidation of protectionist interests in the industrial sector. Industry developed in the fifties protected by high trade barriers which were difficult to reduce in the sixties. History matters, and the fact that the largest Latin American countries had established their heavy industries (chemical and metal-mechanical) in the fifties, redefined the political economy of international and regional trade [*Haggard, 1990: pp.180-182*]. Clearly, industrial firms, and especially multinational firms that operated in several Latin American countries, welcomed some degree of trade liberalisation in order to specialise their subsidiaries and rationalise production. But unrestricted regional competition would receive much less support, especially by medium and small industrial firms [*Haas and Schmitter, 1965: pp.18-22*].

3. *The rise of the international debt*. In the 1973-1982 period the ITI Brazil-Latin America and the ITI Brazil-Argentina grew at very slow rates --and even fell in the latter case. Does the slower rate of growth of the ITI in the seventies conform to what can be expected from the theoretical review of section II --namely, that regional cooperation tends to increase when there exists a perception that the international economy is in trouble?

In principle, the seventies were years of widespread economic recession, marked by two oil shocks and the fall of the Bretton Woods regime, which unleashed a period of high instability in international trade and exchange rates [*Gilpin, 1987*]. Thus, given the international conditions, it should be expected that the ITI between the neighbours (especially the bigger ones) increased at a faster rate than what was actually observed. However, this sombre picture of the international economy is incomplete as it fails to take into account the impact of the flow of international financing on growth and economic policies in Latin America.

In effect, the impact of the crisis would only be fully felt in the region in the eighties. The

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significant to Latin America than to the industrialized countries. From one hand, key sectors for the Latin American exports (agriculture goods and some simpler manufactures, like textiles) remained outside the GATT system [*Tussie, 1987*]. This clearly implied an asymmetry as regards the benefits that this process could bring for countries specialized in agricultural goods that were highly protected in Europe and the USA. On the other hand, the attempt of the Latin American governments to promote rapid industrialization, in relation with the dynamics of the political economy of protectionism, led the region to keep high protectionist barriers in the industrial sector. By arguing that protection was necessary to avoid external disequilibrium (an exception to GATT rules allowed by Article XIX), the Latin American countries maintained significant tariff and non-tariff trade barriers during all this period.

seventies gave to the Latin American governments the transitory --and misleading-- impression that they had *more and no less* room for manoeuvre in the international economy. During the seventies, the inflow of private foreign capital conveyed the idea that the private sector was successfully recycling the "petro-dollars" and that national governments possessed more autonomy to implement their preferred economic policies, freed from the conditions usually attached to official lending [*Evans, 1992: pp. 150-55*]. Abundant international financing in the seventies promised a safe transition through the oil crisis and even allowed some Latin American governments to implement bold experiments in economic policy. The neglect of regional cooperation, already visible in the late sixties, became still more pronounced in the seventies [*Ffrench-Davis, 1989, pp.36-37*].

It is interesting to observe more carefully the behaviour of the ITI between Brazil and Latin America, and between Brazil and Argentina.

The ITI Brazil-Argentina experienced a significant setback in the seventies. This represented a period in which conflict prevailed again --as in the forties-- in the relations between the two countries[24]. National objectives about industrialisation and trade clearly diverged, making cooperation more difficult. In effect, both Brazil and Argentina set out in this period to promote significant structural change in their economies, but the desired direction of change was the opposite. Brazil moved towards further import-substitution while Argentina made a bold attempt at trade and financial liberalisation after 1976 Both policies had in common that they gave little attention to regional integration. As mentioned, external conditions seemed to be favourable enough to go alone and regional integration was not deemed necessary for promoting structural change.

In the case of Brazil, the Second National Development Plan (II PND, 1974-78) represented a further effort for import-substituting industrialisation (ISI), aimed at "deepening" the industrial structure towards new intermediate and capital goods [*Castro and Souza, 1985; Becker and Egler, 1992: pp.92-98*]. Spurred by the disequilibrium provoked by the first oil crisis, a severe system of non tariff protection was set up and managed by the National Bureau of External Trade (Portuguese

[24] Conflict was in part related to the revival of geopolitical rivalry between the military governments installed in Argentina (1966-71; since 1976) and Brazil (since 1964). In effect, the bilateral agenda was dominated from the late sixties by the conflict about the construction of the Itaipu dam, which represented a stumbling block for regional economic diplomacy until 1979 [*Moneta, 1988; Hirst, 1994*].

acronym CACEX), while generous subsidies were granted to priority sectors[25]. Clearly, the new Brazilian policy left no place for regional specialisation, stretching ISI to its limits. Only the most essential primary goods or complex capital goods, which could not be substituted, were imported[26]. The objective of furthering ISI was not softened by the opportunities offered by regional trade to avoid costs and inefficiency. This was the period of the *diplomacia da gaveta*[27], when CACEX controlled intra- and extra-regional imports with equal zeal.

Conversely, Argentina used the abundance of international financial capital to implement a comprehensive programme of trade and financial liberalisation since 1977. The objective was to move away from the dominant ISI pattern of growth and achieve unrestricted integration to the world economy[28]. With this objective, trade barriers were reduced (slowly in 1976-78, faster since early 1979) and full financial liberalisation implemented[29]. As in the Brazilian case, regional integration had no role to play in this policy, since trade liberalisation should not distinguish between regional and extra-regional producers. In fact, the new policy was supposed to rest on the neutrality of the government incentives with respect to different sectors and trade partners[30]. As unilateral liberalisation in Argentina progressed, regional preferences were eroded.

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[25] On the policies of the II PND see also Batiste [*1992: pp. 36-5*1].

[26] For an analysis of how the structure of effective protection operated in favour of these imports see Malan [*1981: part III*].

[27] The expression *diplomacia da gaveta* ("diplomacy of draws") refers to the delays with which CACEX considered the concession of import permits, even for regional imports.

[28] The then Economic Minister, Alfredo Martínez de Hoz [*1990: p. 151*], emphasized that "(*O)ur program intended to implement a structural reform of the economy and not only to overcome a crisis. We had to reinsert Argentina within the framework of the international economy*". This strategy marked the economic policy of the military government until the early eighties.

[29] The maximum nominal tariff protection in Argentina was 210 % in 1976, with an average of 55. Firstly, the maximum was reduced to 100 % with an average of 41 %. In January 1979 a program for quarterly reductions of tariffs was adopted, with the aim of achieving a maximum of 20 % and an average of 18 % in five years [*Kosacoff, 1992*].

[30] The sources of the Argentine problems, according to Martínez de Hoz, were '*statization and regulations (which) had stifled individual initiative, pushing private enterprises into wooing public officials for their favours*' (ibid.), p. 152. Despite the official discourse of elimination of public subsidies and protection, some sectors continued to receive special treatment, especially capital- and resource- intensive intermediate industries (steel, paper, and petrochemicals). See on this Aspiazu (1989).

Therefore, bilateral cooperation between Argentina and Brazil in the seventies went through its lowest point since 1955. The ITI reflected this lack of interest in regional cooperation, as well as the diverging strategies of development adopted by these countries.

The ITI between Brazil and Latin America, on the other hand, experienced a desacceleration, but it did not fall. The average behaviour of the ITI resulted from different trends in the ITI for exports and imports. As part of the II PND, Brazil adopted an active policy for diversifying markets and exports, targeting less developed countries for her exports of manufactures [*Ricupero, 1991*]. This led to an especially high increase in the ITI for exports (ITI(x)) between Brazil and Latin America. But the ITI(m) only experienced a modest increase. This suggests that the Brazilian efforts to control imports affected the region as strongly as it affected the rest of the world. On average, the ITI between Brazil and Latin America grew moderately, spurred by the ITI(x).

At least two factors may have contributed to the poor performance of the ITI (m) between Brazil and Latin America. First, the advance of the import-substitution process in Brazil demanded growing imports of equipment and intermediate goods, which the region could not supply. This naturally implied a lower priority to imports from the region within the system of quantitative restrictions managed by CACEX. Secondly, Brazil became more dependent on oil supplies. The direction of trade moved in favour of the Middle East out of a change in the terms of trade, amounting to a loss of economic complementarity (a fall in C_{ij}) between Latin America and Brazil.

4. *After the debt crisis*. The 1982-90 period was dominated by the consequences of the external debt crisis of 1982, which led to economic recession and instability, with a few short periods of positive growth. Sustained recovery would only begin in the nineties. The international position of Latin America reached its worst moment in terms of external vulnerability in the aftermath of the debt crisis. The room for manoeuvre of national governments was sharply curtailed, as economic policies were almost completely driven by the need to service the debt [*Cline, 1989*]. Heavy external obligations, aggravated by a fall in the terms of trade, reduced the rates of investment in the region and compromised growth.

In addition, regionalist policies gained momentum in the international system, as reflected in the decision of Canada and the USA of forming a free trade area in 1988 (CUSTA) and the European decision to transform the common market into an economic union [*Bhagwati, 1992*]. This, along with the so-called "aggressive unilateralism" of the USA, and the yet uncertain results of the Montevideo Round of the GATT, heightened concerns in Latin America about trade discrimination in the international system [*Barbosa, 1993; Baldwin, 1994*].

Finally, the external crisis of the eighties obliged Argentina and Brazil to review their former economic policies and adopt new strategies to foster trade and specialisation. These new strategies implied a reduction of trade barriers and a stronger emphasis on international competitiveness [*Araújo Jr., 1990; Suzigan and Villela, 1997: 61-70*]. Regional trade liberalisation was then facilitated by the commitment to a multilateral reduction of trade barriers.

Thus, the reformulation of the regional economic policies in the eighties took place in a context in which the position of Latin America was especially fragile both in terms of growth prospects and bargaining power in the international economy. As in the fifties, the Latin American governments perceived that the world was going through a transitional period, in which bargaining power and the rules of the game were in a process of redefinition. Concurrently, there was a consensus in both countries that the previous pattern of growth had gone for good and they would have to find new avenues for growth. The result was an impressive revival of regional cooperation as a response to this challenge. This was in turn reflected in the rapid increase of the intensity of regional trade.

V. Cooperation and Industrial Learning

The diversification of the industry of Argentina and Brazil and gains in industrial productivity redefined the costs and benefits of regional integration. The so-called "second phase" of import-substituting industrialisation (ISI-2) began in the late fifties with the implantation of several new metal-mechanical and chemical industries in both Brazil and Argentina [*Sikkink, 1991*]. At variance with the simpler industrial activities that formed the "easy" or "first" phase of import-substituting industrialisation (ISI-1), the new industries were more intensive in capital and technology, and displayed significant dynamic and static economies of scale. This raised the costs of industrialisation in isolated markets and stimulated the interest in the regional market.

Several pieces of evidence confirm the significance of increasing returns for industrial growth in the late fifties. The main industries of the fifties, like automobiles, showed a clear unbalance between the size of the internal market and the efficient scales of production for international standards[31]. This implied lower productivity, higher costs and excess of capacity, which had to be compensated through subsidies and protection, giving rise to macroeconomic disequilibrium[32]. This clearly heightened the potential benefits of the enlargement of the market by forming a free trade area, - assuming that this process would include a regional distribution of industrial activities[33].

The new role of increasing returns in the fifties can also be tested more formally by estimating a conventional Cobb-Douglas production function for the periods 1945-1955 and 1955-1965 (see Appendix II) for Argentina and Brazil[34]. Chow tests of structural break show that in both cases the production functions of 1945-1955 were different from those of the subsequent period, reflecting the impact of the ISI-2 on the economic structure. In addition, the hypotheses of increasing returns cannot be rejected for the production function of 1955-65 in these countries[35].

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[31] The combined market of Argentina, Brazil, Mexico, Chile, Colombia, Peru and Venezuela could only absorb 300,000 automobiles per year in the mid-sixties. This was less than the annual production of Ford in Britain [*Dell, 1966: 23-24*]. In the case of the automobile sector in Argentina, twenty-six firms asked to be included in the Regime of Promotion of the Automobile Industry between 1959-60. All of them obtained a favourable reply from the government. Three of these firms gave up before beginning production, ten closed their facilities by 1964 and another four firms left the market in 1967. Only eight firms (all of them multinational firms) remained, along with DINFIA, the producer of vehicles operated by the armed forces. This was a still relatively high number of firms, given the size of the Argentine market for transport equipment [*Sourrouille et al, 1985: pp.27-29*]. In Brazil, ten firms were allowed to establish by Kubitschek's Executive Groups for the Automobile Industry, of which eight were multinationals, one a public enterprise (FNM) and one a private Brazilian firm (VEMAG) [*Leopoldi: 1991: pp.86-87*].

[32] For an analysis of fiscal and trade disequilibria during the ISI-2 in Brazil and Argentina, see respectively Orenstein and Sochaczewsky [*1990: pp.171-195*] and Petrecolla [*1989: pp.109-114*].

[33] ECLA [*1959*] regarded the free trade area as form of achieving economies of scale and industrial efficiency in Latin America.

[34] For a discussion of econometric tests for increasing returns see McCombie and Thirlwall [*1994: pp. 177-80*].

[35] A test for the linear restriction $a + b = 1$ was performed - where a and b represent the coefficients of capital and labour, respectively, in the production function. In the case of Argentina, this test showed that $a + b$ did not significantly differ from the unity in 1946-55. Conversely, increasing returns could not be rejected at a 1 % level of significance in 1956-65 (cf. Appendix II) Therefore, the evidence for Argentina confirms the hypothesis that increasing returns became significant in the ISI-2 phase of industrialization, while in the ISI-1 phase prevailed constant returns to scale. The evidence for Brazil is less conclusive. Increasing returns could not be rejected in both periods. However, as in the ISI-2 phase industrial production for the internal market increased its participation in total product, then it can be expected that the size of the market posed more severe constraints to productivity gains after 1955. Previous estimations of the production functions, consistent with these results,

Since the late fifties, the ISI-2 industries began a process of "maturation", a sluggish but persistent process of learning by which productivity and competitiveness increased in the industrial sector, giving rise to a stream of new manufactured exports [*Katz, 1982; Araújo Jr., 1982*]. The regional market became a key destination of regional industrial exports[36]. Latin America absorbed 49% and 59.5% of total manufactured exports from Argentina and Brazil, respectively, in 1965. Ten years later, these percentages were 52 % and 38 %. The participation of machinery and transport equipment in Argentina's total intra-regional exports increased from 16 % to 18 % between 1970 and 1987. In the case of Brazil, these figures were 22 % and 35 %, respectively [Baumann, 1990: pp. 52-53]. In 1989-90, Brazil destined 20 % of its machinery and transport equipment exports to Latin America, while this figure reached 61 % in the case of Argentina [*LAIA, 1992*]. Thus, the region displayed a very significant role as an outlet for manufactured exports, especially of those which were more intensive in technology and skilled labour. Moreover, Argentina and Brazil also began to export technology, engineering and construction services to other Latin American countries [*Dahlman and Sercovich, 1984; Wells, 1983*].

This stream of manufactured and technology exports were particularly appreciated by the governments of Argentina and Brazil, which were committed to industrial development[37]. BID-INTAL [1976, pp. 1-3] recalled the "hidden benefits" that economic integration had produced: "*the products exchanged* (within Latin America) *present a much higher value added and incorporate more qualified workforce and entrepreneurial activities*" than extra-regional trade. This was in turn consistent with the measures taken to foster "non-traditional" exports in the mid-sixties [*Mallon and Sourrouille,*

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are offered by Katz and Kosaccoff [*1989: pp. 67-77*] for the case of Argentina.

[36] The role of the regional market for manufactured exports can in part be explained by the preferences provided by LAFTA. Empirical evidence in favour of this hypothesis is provided by BID-INTAL [*1972*]. In addition, the incremental innovations developed by firms in Argentina and Brazil, with a view to adapting foreign technology for the specific features of their domestic markets, represented competitive advantages of those firms in other Latin American countries [*Katz, 1982; Lall et al, 1983].*

[37] In a late recollection, R. Alemann, former Economic Minister of the Frondizi government in Argentina, observed that "*the emergence of LAFTA (was) a suitable instrument for encouraging Argentine industrial exports (...) About half of Argentina's industrial exports went to LAFTA countries for many years --our critics are not justified in alleging that the policies begun in 1958 had an anti-export bias*" [*Alemann, 1990: p. 67*].

1976: pp. 79-82][38].

Finally, a higher proportion of total regional trade was carried on an intra-industry basis as compared with total extra-regional trade. As mentioned, intra-industry trade tends to be less disruptive of existing production than inter-industry trade, and it is therefore politically more acceptable. Balassa [*1979*] already pointed out this in the mid-seventies, when he observed that the highest levels of intra-industry trade occurred within the region. A subsequent study of the Inter-American Development Bank [*IDB, 1992*] showed that, in the case of Argentina, the Grubel-LLoyd index of intra-industry trade (unweighted average) increased from 23 % in 1970 to 52.1 % in 1990. In the case of Brazil, these figures were 20 % and 50 %, respectively. This increase was particularly impressive in industries intensive in human capital: from 25 % to 52 % in Argentina and from 20 % to 52 % in Brazil [*Baumann, 1992: pp.87-99*].

Thus, structural change in the domestic economy, in the shape of growing industrial exports, technology exports and intra-industry trade, contributed to sustain the interest in the regional market. This long term trend of industrial learning introduced another component of path-dependency (along with the endurance of institutions) in the evolution of regional cooperation, which sustained the ITI(a) despite the change in perceptions by the national governments regarding the need of sharing sovereignty.

VI. Institutions and Cooperation: A Preliminary Test

The perception of external vulnerability acted principally as a strong impetus towards cooperation in specific short sub-periods of time, out of which new institutions (new international regimes, in the sense of Krasner) were devised. This was the case of the three most significant experiences in cooperation in the period analysed, namely the creation of LAFTA, PICE and MERCOSUL. Once created, these institutions could not be easily modified as they crystallised a truce among the regional partners. Breaking an agreement would entail a certain (present and prospective) cost for countries that are long-term trade partners, including a higher uncertainty as regards trade matters during the period of renegotiation of the agreement.

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[38] These authors also present regressions showing a significant association between manufactured exports and LAFTA preferences in the sixties.

With a view to obtaining a preliminary assessment of the influence of institutional change on regional trade, a simple econometric test was performed, which is aimed to complement the analysis presented in section III. A regression was run in which the dependent variable was the average ITI between Brazil and Argentina and the exogenous variables were the institutional framework, the intensity of the external constraints and the process of industrial learning - in accordance with the theoretical argument developed in the previous sections.

Firstly, the impact of different institutional arrangements - LAFTA, PICE and MERCOSUL - on the direction of trade was "captured" through "dummy" variables associated with a "once and for all" increase in the ITI. Secondly, a time trend was included as a proxy for the incremental process of industrial learning, which sustained the diversification of exports and trade partners. Finally, the ratio exports/imports was used as a proxy for balance of payments conditions. It was expected that a deterioration of these conditions should lead to an increase of the ITI(a) among countries linked by payments agreements.

The results of the regression are as follows:

LITI(a) = 4.37 + 0.49.LAFTA*** + 0.45.PICE** + 0.36.MERCOSUL* + 0.05.TREND* - 0.63.LEXIM**

LITI (a) = natural logarithm of the average ITI(a) between Argentina and Brazil
LAFTA = dummy variable that takes the value 1 from 1964[39]
PICE = dummy variable that takes the value 1 from 1986
MERCOSUR = dummy variable that takes the value 1 from 1991
TREND = time trend
LEXIM = natural logarithm of the ratio exports/imports in Brazil.

*Significant at 10% level

[39] As the first regional experience for cooperation, the negotiations of LAFTA were sluggish and complex, and trade liberalisation gradual. For this reason, it was assumed a lag of four years between the signature of the agreement and the changes in the direction of trade.

**Significant at 5% level

***Significant at 1% level

Specification Tests	
Durbin Watson Test:	F= 1.6102 DL= 1.591 DU= 0.954
Breuch Godfrey Test:	F= 0.404 Probability = 0.8030
Reset Test:	F= 0.2925 Probability = 0.8304
White Test (with Cross Terms):	F= 0.8671 Probability = 0.6008

All the coefficients have the expected signs and are significant at least at a 10 % level. The regression successfully "passed" a battery of specification tests, like the Q-test and the LM test for serial correlation, the RESET test for misspecification and the recursive tests for structural stability of the parameters (CUSUM and CUSUMS tests).

The main result of the test is that the institutional variables seem to have played a role in sustaining cooperation. If one assumes that the time trend captured the gradual increase in economic complementarity related to long term, cumulative learning in the industrial sector and that the export/import ratio captured the effect of short term difficulties in the balance of payments, then the dummy variables will get the impact of institutions on transaction costs and policy-induced bias in the direction of trade.

It is worthwhile noting that the impact of LAFTA on the ITI(a) was significant. This result is somewhat surprising as LAFTA has always been pointed out as a rather unsuccessful experience in economic integration. Clearly, LAFTA could not be considered a success when appraised from the point of view of its highly ambitious objectives. But it did set up a new threshold upon which cooperation was exercised in the region and which permitted a modest (but still significant) expansion of regional trade.

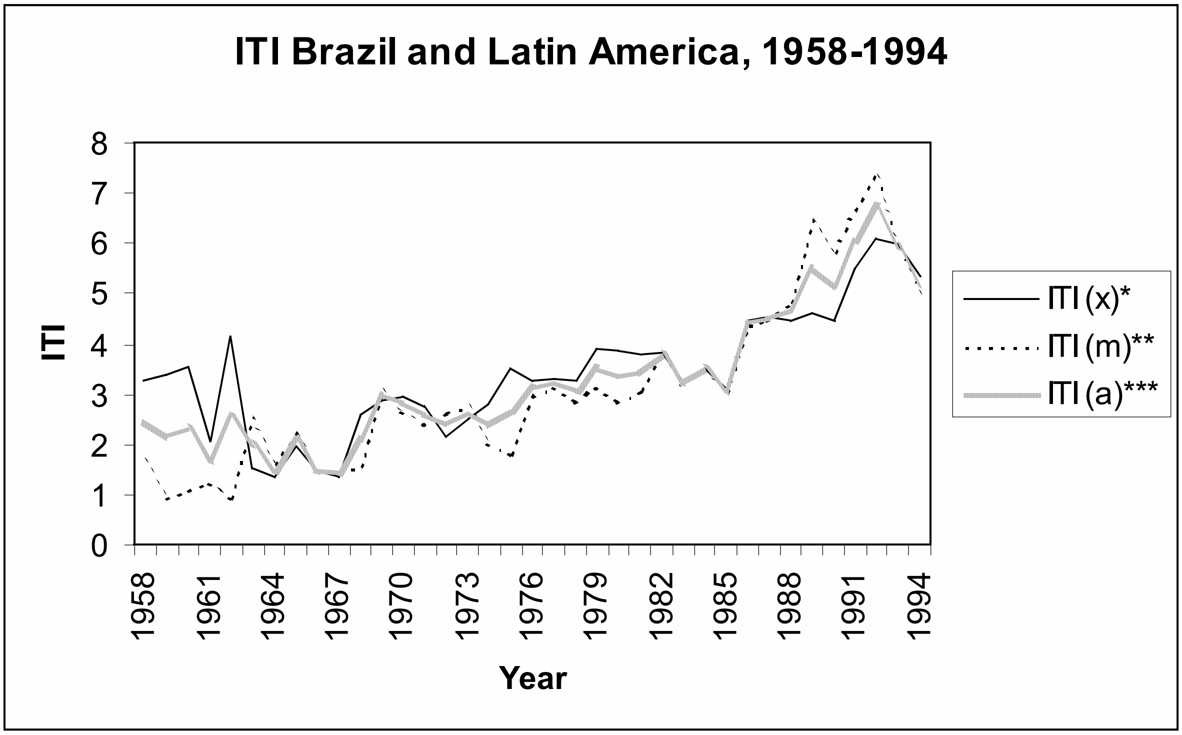
A similar conclusion can be reached regarding the more recent cooperative agreements of the eighties and nineties. These institutions seem to have had a relevant effect on the direction of trade.

VII. Conclusions

The perception of external vulnerability and the importance of the regional market for industrial exports shaped the region's interest in the process of economic integration. The aftermath of external crisis represented moments of intense reformulation of the institutional basis of cooperation. The creation of LAFTA, the PICE agreements and MERCOSUL were, in part, a response to periods of remarkable external difficulties that favoured cooperative responses at a regional level. In addition, the cumulative process of industrial learning raised the ITI(a) in the long term, by increasing the export basis of the countries of the region.

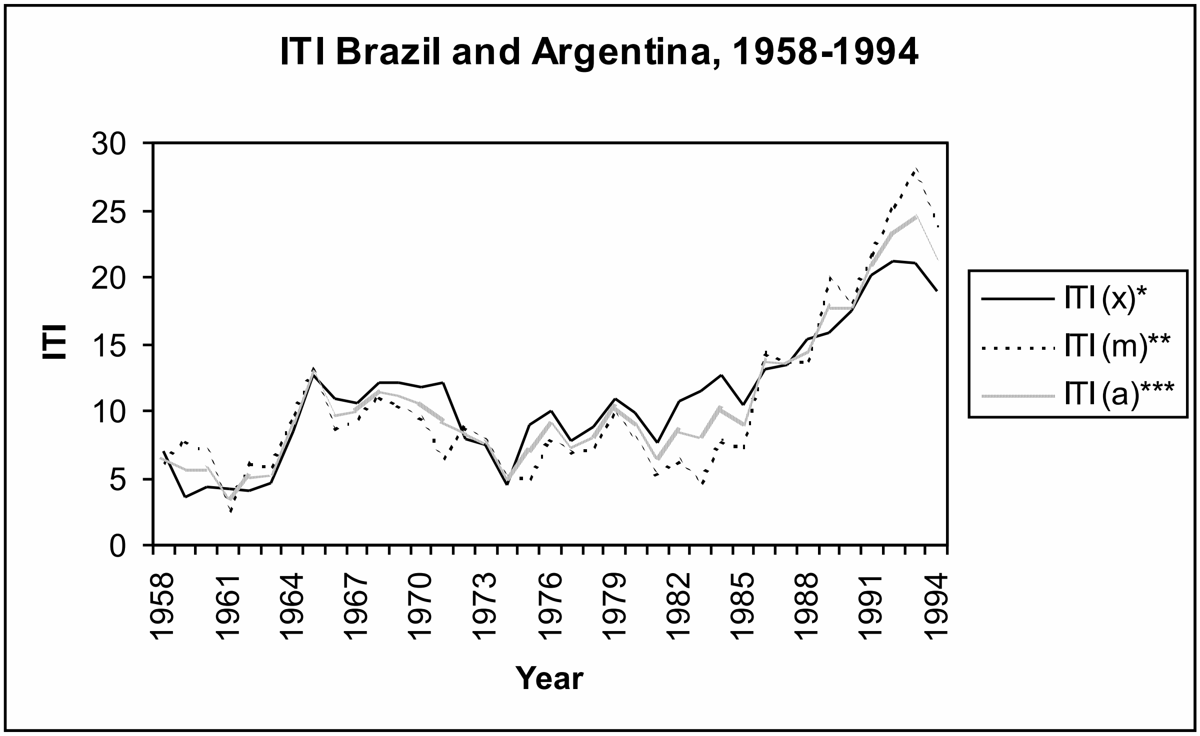
Institutions, in turn, played a role of their own in sustaining cooperation. The accumulated experience, the benefits brought about by past cooperation and the inertia inherent to institutions --as they embody a set of rules, laboriously developed, aimed at conciliating interests and creating confidence among private and public actors in different countries-- introduced a path-dependent component to the evolution of regional trade. This result is consistent with the perception of authors like Keohane, North and Nelson and Winter on the relatively autonomous role of institutions in shaping economic behaviour and performance.

GRAPHIC 1



Source: Table I, Appendix I

GRAPHIC 2



Source: Table II, Appendix I

APPENDIX I. EVOLUTION OF THE TRADE INTENSITY INDEX

TABLE I - ITI Brazil and Latin America, 1958 -1994.

Year	ITI (x)*	ITI (m)**	ITI (a)***
1958	3,257783	1,683090	2,470436
1959	3,372795	0,919064	2,145930
1960	3,559166	1,064371	2,311768
1961	2,085408	1,225446	1,655427
1962	4,149464	0,913578	2,531521
1963	1,496785	2,511550	2,004168
1964	1,366517	1,606584	1,486551
1965	1,955184	2,185450	2,070317
1966	1,476931	1,476041	1,476486
1967	1,370429	1,463811	1,417120
1968	2,571176	1,561968	2,066572
1969	2,856863	3,084188	2,970525
1970	2,950367	2,677507	2,813937
1971	2,762395	2,392591	2,577493
1972	2,147108	2,618661	2,382885
1973	2,518182	2,743219	2,630700
1974	2,787535	2,014581	2,401058
1975	3,506054	1,793186	2,649620
1976	3,264071	2,956058	3,110065
1977	3,313612	3,139777	3,226694
1978	3,276760	2,820787	3,048774
1979	3,889544	3,150338	3,519941
1980	3,854856	2,833744	3,344300
1981	3,778485	3,062957	3,420721
1982	3,839779	3,739577	3,789678
1983	3,257325	3,176369	3,216847
1984	3,514627	3,463496	3,489062
1985	3,106070	3,022014	3,064042
1986	4,443729	4,390653	4,417191
1987	4,551207	4,467411	4,509309
1988	4,461570	4,817122	4,639346
1989	4,631919	6,464037	5,547978
1990	4,458427	5,799474	5,128951
1991	5,473212	6,655311	6,064261
1992	6,105956	7,340620	6,723288
1993	5,954624	5,903391	5,929008
1994	5,331651	5,009986	5,170819

Source: Direction of Trade (FMI).

* ITI Brazil - Latin America Exports.

** ITI Brazil - Latin America Imports.

*** Average between ITI Brazil - Latin America, Imports and Exports.

TABLE II - ITI Brazil and Argentina, 1958 - 1994

Year	ITI (x)*	ITI (m)**	ITI (a)***
1958	7,028903	6,187652	6,608277
1959	3,612731	7,693523	5,653127
1960	4,368752	7,031224	5,699988
1961	4,221994	2,566968	3,394481
1962	4,046709	6,082184	5,064446
1963	4,684584	5,752161	5,218373
1964	8,536410	9,735769	9,136090
1965	12,63904	13,05662	12,84783
1966	10,84203	8,702555	9,772296
1967	10,65897	9,383823	10,02139
1968	12,03984	11,04465	11,54224
1969	12,02513	10,42043	11,22278
1970	11,86055	9,474837	10,66769
1971	12,11460	6,411812	9,263207
1972	7,940115	8,737017	8,338566
1973	7,525922	7,775793	7,650857
1974	4,445347	5,278526	4,861936
1975	9,011584	4,989994	7,000789
1976	9,939413	7,952777	8,946095
1977	7,816911	6,923301	7,370106
1978	8,870346	7,346842	8,108594
1979	10,86786	9,674414	10,27114
1980	9,887457	7,873834	8,880646
1981	7,595787	5,271744	6,433766
1982	10,69480	6,283329	8,489066
1983	11,53421	4,699020	8,116617
1984	12,68233	7,707398	10,19486
1985	10,51211	7,319990	8,916051
1986	13,19615	14,28456	13,74035
1987	13,42895	13,77725	13,60310
1988	15,30421	13,65913	14,48167
1989	15,80989	19,84977	17,82983
1990	17,49215	18,09130	17,79172
1991	20,09723	21,70382	20,90052
1992	21,13535	25,26671	23,20103
1993	21,01650	27,93369	24,47509
1994	18,91652	23,88947	21,40300

Source: Direction of Trade (FMI).

* ITI Brazil - Argentina Exports.

** ITI Brazil - Argentina Imports.

*** Average between ITI Brazil - Argentina, Imports and Exports.

APPENDIX II. ESTIMATION OF COBB-DOUGLAS PRODUCTION FUNCTIONS

A Cobb-Douglas production function was estimated for the ISI-1 and ISI-2 periods for both Argentina and Brazil, on the basis of data provided by Elías (1992).

Log (GDP/L) = A + b_1.(K/L) + b_2.(+ - 1)L
Dependent Variable: GDP/L (in constant Argentine pesos of 1960)

TABLE A.1.
ARGENTINA: PRODUCTION FUNCTIONS, ISI-1 AND ISI-2 PERIODS

Period: 1946-54

Regressor	Coefficient	t-statistic	Probability*
C	-0.1268	-0.3216	(0.756)
K/L	-0.0116	-0.0239	(0.982)
L	0.3414	1.0609	(0.320)

R-squared = 21.62 % F(2,8) = 1.1032 (0.377)
Durbin-Watson = 1.2252

Period: 1955-65

Regressor	Coefficient	t-statistic	Probability
C	-2.6487	-6.3296	(0.000)
K/L	-0.0116	11.891	(0.000)
L	0.3414	5.3474	(0.000)

R-squared = 96.92 % F(2,8) = 114.55 (0.000)
Durbin-Watson = 1.2710

* Figures between brackets are probabilities

Key for the Independent Variables

C = Constant
K/L = Ratio of the Stock of Capital to Employment
L = Employment (thousands of people)

Note: The regression uses the logs of the dependent and independent variables. If b_2 is statistically higher than zero, then the production function shows increasing returns to scale; if b_2 does not differ from zero, then the production function shows constant returns to scale; if b_2 is negative and

significantly different from zero the production function presents decreasing returns to scale.
Source: Data obtained from Elías (1992).

TABLE A.2
BRAZIL: PRODUCTION FUNCTIONS, ISI-1 AND ISI-2 PERIODS

Dependent Variable: GDP/L (in constant cruzeiros of 1949)

Period: 1945-55

Regressor	Coefficient	t-statistic	Probability*
C	-0.70461	-0.1794	(0.000)
K/L	-0.09858	-0.9989	(0.927)
L	1.3189	8.7023	(0.003)

R-squared = 96.27 % F(2,3) = 38.69 (0.007)
DW = 3.1365

Period: 1955-65

Regressor	Coefficient	t-statistic	Probability
C	-12.9874	-8.0267	(0.000)
K/L	3.7516	8.5091	(0.000)
L	0.4355	7.2927	(0.000)

R-squared = 97.34 % F(2,8) = 146.23 (0.000)
Durbin-Watson = 1.6204

* Figures between brackets are probabilities

Key for the Independent Variables

C = Constant
K/L = Ratio of the Stock of Capital to Employment
L = Employment (thousands of people)

Source: Data obtained from Elías (1992), Appendix 20.

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Abstract: This paper discusses the role of institutions in promoting regional trade between Brazil and the rest of Latin America (especially Argentina) in the 1958-94 period, focusing the conditions in which cooperative institutions emerged and contributed to the expansion of intra-Latin American trade. The analysis is based on the calculation of an Index of Trade Intensity. It is suggested that the creation of LAFTA, the PICE agreements and MERCOSUL were, in part, a response to periods of remarkable external difficulties that favoured cooperative responses at a regional level. (JEL: F15; N76)