

# When Following Your Own Path Goes Wrong: LatAm, Dependency, and the Anti-Trade Mentality



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Europe and Latin America have a complex trajectory in terms of their integration processes, with dissimilar elements and other common ones as well. In Latin America, the ideas of protectionism and state interventionism have had a strong impact on the shaping of structures. These ideas truncated the economic growth of countries like Argentina. The sustained impact of protectionism over decades should serve as an experience for the CEEs to promote economic opening and trade agreements of regional blocs.

Three milestones mark the road of Argentina and Latin America (LatAm) to protectionism and fear of commerce. In a chronological order, these are:

1. the 1929 crisis, which fueled the so-called *Import Substitution Industrialization* in the region;
2. World War II, which drove LatAm to develop an economy able to satisfy (in part) the demand of the old continent, but it also meant a tendency towards autarky and protectionism that found in the state its lever for development;
3. the “Dependency Theory” and the anti-trade agenda set by the United Nations’s (UN) CEPAL (Economic Commission for Latin America and the Caribbean) in the 1950s<sup>1</sup>.

Argentina and the rest of Latin America followed the CEPAL guidelines to the letter – which under the inspiration of the Argentine Raúl Prebisch used protection to defend *infant* industries that reached senility without ever reaching competitive

maturity. Prebisch argued that the price of commodities (raw materials), the main exports of the area at the time, suffered a permanent deterioration compared to the prices of industrialized products, so that the only way out of backwardness was through industrialization forced by governments with obstacles to imports.

The results of the nefarious influence of Prebisch’s and CEPAL’s ideas led to planned economies across the region, thus making international commerce *suspicious* while strengthening the belief that the state should reactivate the economy through increased public spending financed by higher taxes, debt, and monetary printing. These three building blocks of the Latin-American protectionist mentality shall thus be examined with special emphasis on the impact of Prebisch and CEPAL.



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<sup>1</sup> Soto, Á. (2016) “CEPAL y la búsqueda del camino propio”, [in]: *El Cato*. Available [online]: <https://www.elcato.org/cepal-y-la-busqueda-del-camino-propio> [in Spanish]

## ARGENTINA AT THE FOREFRONT OF LATIN AMERICA'S PROTECTIONIST MENTALITY

The Latin American protectionist mentality was conditioned by its development in Argentina and Brazil. Of these two, the first country was particularly relevant considering the influence of who would become the most prominent school's intellectual: Raul Prebisch. Three clear periods divide Prebisch's fate in Argentina and Latin America.

### **IMPORT SUBSTITUTION INDUSTRIALIZATION AFTER THE 1929 CRISIS**

The First World War and the 1929 crisis produced a strong contraction of commerce in Latin-American countries. For example, Argentina's exports fell by 40%, whereas overall production decreased by 20%. This economic contraction not only impacted the general economy, but also hit the state's finances mostly dependent on import and export duty taxes, fueling social unrest and political instability that ended in several coups<sup>2</sup>. The social disruption was exemplified by the 1930s military coup in Argentina that ruled until 1943, implementing several protectionist and interventionist measures, among which, foreign trade controls were specially considered, imposing high import taxes and local industries subsidies.

Between 1933 and 1937, the national Action Plan would regulate almost every aspect of the country's economy. During this period, Raul Prebisch started working in the government for Federico Pinedo, the Finance Minister of the military regime, being then promoted as manager of the recently created Central Bank in 1935, occupying the position until 1943. In 1940, the Pinedo



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Plan, which he contributed to develop, was launched in order to promote industrial manufacturing and commerce integration with Brazil<sup>3</sup>.

Prebisch was an accountant that worked as professor in Political Economy in Buenos Aires University from 1923 until 1948. Around these years, he formed his thoughts and ideas in the protectionist

<sup>2</sup> Prebisch, R. (1949) *The Economic Development of Latin America and Its Principal Problems*, United Nations.

<sup>3</sup> Sztulwark, S. (2003) *El estructuralismo latinoamericano. Fundamentos y transformaciones del pensamiento económico de la periferia*, Buenos Aires: Prometeo Libros.

field as a local expression of the Keynesian ideological framework that justified state's broad intervention in the economy, but with a special twist – adding the need of trade barriers for industrial development as a strategy for local economic long-term growth.

**AUTARKY AND PROTECTIONISM  
IN LATIN AMERICA DURING  
THE SECOND POST-WAR PERIOD**

The military coup of 1943 imposed a political shift towards a different, more violent form of state interventionism that would derive into the authoritarian regime of general Peron's government between 1945 and 1955. Prebisch's support disappeared, forcing him out of the Central Bank in 1943 and out of the university in 1948.

In 1948, he entered the Economic Commission for Latin America and the Caribbean (ECLAC), an organization created by the United Nations, working as Executive Secretary between 1950 and 1963, becoming then Secretary-General of the United Nations Conference on Trade and Development (UNCTAD) from 1964 to 1969. Here, he would expand his ideas along Latin America as an alternative to the United States/USSR dichotomy and in accordance with the Non-Aligned Countries movement developed later in 1955 after the Afro-Asiatic conference. 1949 is thought as the year in which the structuralist school led by Prebisch was born, considering the publishing in that year of the text *Latin America's Economic Development and Some of Its Main Problems*, written by Prebisch for the ECLAC, as the cornerstone of the school.

The main ideas behind this line of economic thought was that Latin America had a structural problem related to its position in the world economic stage as an agricultural producer, dependent on foreign

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manufactured goods<sup>4</sup>. The writings by Prebisch explained that there was a center-periphery international conditioning that mediated economic relations between states, leading to a dependency of underdeveloped countries. The rational was that cyclical crisis related to a deficit in trade were generated by a tendency of

<sup>4</sup> Sztulwark, S (2003) *El estructuralismo latinoamericano. Fundamentos y transformaciones del pensamiento económico de la periferia*, Buenos Aires: Prometeo Libros.

imports (mostly of the industrial kind) in less industrialized countries to exceed the value of its agricultural dominated exports. This process was, in theory, the result of the propensity manufactured goods to increase its value more strongly through technological improvements<sup>5</sup>.

World War II and the post-war period offered an excellent scenario for these ideas. During the war, most industrial trade ground to a halt or was redirected into the armed conflict, leaving war-excluded countries the opportunity to develop a local industry without competitive international pressure. In parallel, Europe and the United States presented a high demand for agricultural goods. This lasted until these countries were able to reinstate normal production and demand levels, reducing agricultural demand, and returning their industries to the international market. The economic boom in Argentina was used by the Peronist government to develop a subsidiary political system that crashed around the mid-1950s, when the external favorable conditions slowly stopped.

The state opted to use money printing and debt as a financial mechanism that eventually led to inflation and poverty, which – combined with social unrest from the opposing sectors, – permitted a coup in 1955<sup>6</sup>. With the new military regime, Prebisch then wrote the report known as Prebisch Plan, a diagnosis and action plan produced for the military government during his stay in Santiago de Chile, initiated in 1950 and extended until his brief return in 1984. The plan was highly criticized by the

left and Peronist leaders who were at the time in the outlawed opposition.

### **THE INFLUENCE OF THE STRUCTURALIST SCHOOL AND ITS INTERNAL DEBATES**

Even though the Prebisch's ideal reached a high level of acceptance in Latin America through the influence of CEPAL, the theory was not without critics. Beyond the broad classical liberal resistance to its interventionist approach, orthodox Marxists also opposed his mix-economy view that re-



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<sup>5</sup> Lillo, J.F. (2015) *La Escuela Estructuralista Latinoamericana*, Facultad de Ciencias Económicas Universidad Nacional de Cuyo.

<sup>6</sup> Soto, Á. (2016) "CEPAL y la búsqueda del camino propio", [in]: *El Cato*. Available [online]: <https://www.elcato.org/cepal-y-la-busqueda-del-camino-propio> [in Spanish]



## THE APPROACH BECAME MAINSTREAM IN LATIN-AMERICAN INTELLECTUAL GROUPS AND WAS TERMED *DEVELOPMENTALISM*

served a place for private enterprise in the economic structure that was to be guided by the state. This skepticism prompted Prebisch to devote at the end of the 1950s more attention to inflation, social inequality, and foreign interference as well as agricultural land reform.

In the 1960s, he left ECLAC, producing a great crisis inside the institution. During this whole period, the core idea in the structuralist school he led, was that socio-economic development was to be attained in poorer countries through an inside-directed growth focused in the internal market, and industrialization by imports substitution fomented by a protectionist and interventionist state policy<sup>7</sup>. The theoretical framework was first sketched by Hans Singer in his work for the United Nations<sup>8</sup> and then used by Prebisch on the Economic

<sup>7</sup> Lilloy, J.F. (2015) *La Escuela Estructuralista Latinoamericana*, Facultad de Ciencias Económicas Universidad Nacional de Cuyo.

<sup>8</sup> Singer, H. (1949) *Post-War Price Relations Between Under-Developed and Industrialized Countries*, Economic and Social Council, United Nations.

Survey of Latin America presented in 1950 for ECLAC.

What was then to be known as the Prebisch-Singer thesis, explained a process of trade terms cyclical deterioration linked to the fall of agricultural goods value in comparison to manufactured products as a result of industrial technological innovation and its added value (thus producing trade deficits and imbalances in a country's economy). The approach became mainstream in Latin-American intellectual groups and was termed *developmentalism*.

In order to summarize the key aspects of the Theory of the "Deterioration of the Terms of Trade", let us delve into it more deeply with the aid of Agustín Etchebarne's essay *Terms of Trade and Technological Change*. It defines the terms of trade as the relationship between the prices of imports and exports between two or more countries.

When Prebisch-Singer speak of the "Deterioration of the Terms of Trade", they refer to the negative variation in the ratio between the prices of exports of less developed countries (*peripheral* in Prebisch's terminology) with respect to those of developed (or *central*) countries. In other words, they believed that the prices of natural resources, or raw materials, which made up the bulk of the sales of the *peripheral* countries, tend to fall more rapidly than the prices of industrialized goods exported by the *central* countries. According to these authors, they either rise or fall more slowly. In saying this, they relied on empirical research carried out by the UN's Department of Economic and Social Affairs which seemed to corroborate this trend<sup>9</sup>.

<sup>9</sup> Prebisch, R. (1949) *The Economic Development of Latin America and Its Principal Problems*, United Nations.



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Prebisch argued that the problem of the underdeveloped (*peripheral*) countries was not that they were lagging behind the developed countries, but that there was a structural problem that prevented them from developing. There would also be an additional issue due to the international trade cycle, given that the *peripheral* countries would be less resistant to recessions, which would also explain their tendency to generate large balances of payment deficits and their consequent recurrent crises. Prebisch argues that in contrast to

the productive structure of the periphery, which is specialized and heterogeneous, that of the centers is diversified and homogeneous. Diversified, because it produces different types of goods and services, and homogeneous because it has practically no informal sectors.

From there comes the formerly called “Dependency Theory”, according to which central countries exploit the *peripheral* ones. The authors propose for countries to develop a change in their productive structure through *import substitution*: establishing taxes on agricultural exports (withholding taxes), while protecting industry with high customs tariffs and encouraging infant industries with subsidies, tax breaks, “Buy National” laws, etc. All this requires a combination of free markets and government intervention. Later, Prebisch expanded the idea of *import substitution* with that of *export promotion* (industrial), following the success of Southeast Asian countries<sup>10</sup>. It is important to note that many of these ideas resemble Lenin’s and Rosa Luxemburg’s theories of capitalist imperialism, and were also heavily influential in intellectuals from other regions (among others, Africa).

In 1969, *Dependence and Development and Latin America* by the Brazilian Fernando Henrique Cardoso and the Chilean Enzo Faletto, introducing Marxist sociological perspectives supporting views of economic oppression as structuring forces of the international division of labor. The Theory of Dependence tried to explain that industrialization would not bring the consequences expected by the developmentalist or nationalist ideologues. Their arguments were that the process was conditioned by foreign investment, perpetuating the

<sup>10</sup> Sztulwark, S. (2003) *El estructuralismo latinoamericano. Fundamentos y transformaciones del pensamiento económico de la periferia*. Buenos Aires: Prometeo Libros.

international dependence, and that industrialization replicated concentrated, capitalist, and oppressive social structures inside each country to the detriment of the labor class and favoring skilled managerial positions instead of the workers. It also stated that imported technology displaced laborers from the market.

More extreme Marxist positions would arise around these basic ideas regarding economic oppression<sup>11</sup>. The central concept of technological dependence that instituted asymmetric relations between the center and the periphery of the international commerce system in favor of developed countries was only to be avoided by strong state action that appropriated and led the technical and economical process<sup>12</sup>.

This internal debate was then propagated by institutions related to ECLAC – like the Latin American Faculty of Social Sciences created in 1957 and the 1967 Latin American Council of Social Sciences, both under the United Nations Educational, Scientific, and Cultural Organization. These organizations would promote the discourse and fund the professionals that developed the structuralist school in the subcontinent. In parallel, the Alliance for Progress initiated by U.S. President John F. Kennedy in 1961, aimed to establish economic cooperation between the U.S. and Latin America after the Cuban revolution, was also promoting structuralist ideas, especially developmentalist ones, until its disbandment in 1973.

<sup>11</sup> Zeolla, N.H. and J.M. Telechea (2014) *El pensamiento económico latinoamericano del desarrollo y la industrialización: estructuralistas y neoestructuralistas ¿Giro o actualización?*, Centro Cultural de la Cooperación Floreal Gorini, 21<sup>st</sup> Edition. Available [online]: <https://www.centrocultural.coop/revista/21/el-pensamiento-economico-latinoamericano-del-desarrollo-y-la-industrializacion> [in Spanish]

<sup>12</sup> Etchebarne, A. (2008) “Los términos de intercambio y el cambio tecnológico”, [in]: *Revista de Instituciones, Ideas y Mercados*, Vol. 48.



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Back in Argentina, with the Peronist Party outlawed, the historic Unión Cívica Radical party governed from 1958 to 1962 under the Frondizi presidency. Aided by Rogelio Frigerio, he implemented a developmentalist policy in Argentina until they were ousted by yet another military coup. The interventionist economic policy would not change much, presenting a brief re-appearance as Economy Minister. With the return of the Unión Cívica Radical party to power from 1963 to 1966, developmentalist policies

continued with the military regime that followed until 1973, when the Peronist political movement returned.

The last military dictatorship that removed the Peronist government in 1976 diverged from the previous policies by implementing contractionary measures to intervene and free the economy without much result. The strong statist approach started in 1930 remained mostly undistorted, even after the definitive return of democracy in 1983.

### **LIVING WITH WHAT IS OURS: THE CONSTANT RETURN OF ECONOMIC NATIONALISM IN THE ARGENTINE POLITICAL DISCOURSE**

During the 1970s and the beginning of the 1980s, Latin-American countries experienced a strong debt and inflation crisis with slow or negative growth, with large portions of their population living in poverty<sup>13</sup>. This forced a review in structuralist ideas like the one presented in his 1990 book *Productive Transformation with Equality* by Fernando Fajnzylber, proposing greater trade liberalization and lower monetary interventions in order to attain a more durable industrial development under competitive forces instead of forced opportunities reached with artificially low currency exchange rates and closed markets.

These ideas were then termed *neo-structuralism* and reigned the school until 1998, when authors like José Antonio Ocampo started the current theoretical framework<sup>14</sup>. The entire transformation was pushed by

<sup>13</sup> Nicolini, J.P. (2011) "Mitos Argentinos sobre la Industrialización", [in]: *Foco económico: un blog latinoamericano de economía y política*. Available [online]: <https://focoeconomico.org/2011/10/10/mitos-argentinos-sobre-la-industrializacion/> [in Spanish]

<sup>14</sup> Ocampo, J.A. and M.A. Parra (2003) "Los términos de intercambio de los productos básicos en el siglo XX", [in]: *CEPAL Review*, Vol 79.



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the strong critics in the classical liberal and Marxist ideologies that pointed to the lack of results shown by the developmentalists policies after decades of implementation.

Some explained that by 1970, Brazil was even more unequal than before the structuralist policies were put in place. Two big branches were born – one that stuck closer to the origins, as previously described, demanding a more truthful technological and competitive economy, and another one that broke its ties and stated that there was no successful alternative for a reform inside the variations of a mixed economy. The intellectuals like Osvaldo Sunkel, who stuck with Fajnzylber's perspective, understood that the key aspect of industrialization was the capacity of the economic environment to allow for entrepreneurial innovation. It

was fundamental for this innovation to be capable of sustaining technological transformations that ultimately permit international competition and survival for attaining global integration<sup>15</sup>.

The critical process was also fomented by a theoretical crisis that originated in the lack of explanatory capacity of the framework against the evidence from the economical process developed since the 1970s until present day. But before analyzing these problems, for which we will dedicate the next section, we could review what was happening in Argentina during these years. With the return to power of the Unión Cívica Radical under the democratic government of Raúl Alfonsín in 1983, many developmentalist ideas found ground again.

Prebisch traveled back to the country in 1984 to advise the newly elected government for a year, passing away in 1986 in Chile. The figure that was going to lead the policies was Aldo Ferrer, who wrote in 1983 the book titled *Living with What Is Ours*, a revival of developmentalist and protectionist ideas. Ferrer, a Unión Cívica Radical's affiliate and founding member of the Latin American Social Science Council, had served as the Minister of Economy of Argentina from 1970 to 1971 under the military government of president Levingston, and was a main influence for the Alfonsín government.

The failure of the policies aimed at solving the crisis using subsidies funded by state loans and money printing ended in hyperinflation and an early call to election in

1989, in order to hand the power to a Peronist government under Carlos Menem. President Menem, who won promising left-leaning policies, drifted for almost two years until he decided to reform his course and introduce a large package of reforms that involved privatizations, deregulations, and a moderate opening of the economy. The context of the fall of the Berlin wall and the dissolution of the Soviet Union helped create the ideological environment needed to support the policies, promoting economic growth and recovering from the crisis.

By the mid-1990s, Menem started dismantling some of his policies in order to instate a populist system, continuing an artificially fixed exchange rate between the peso and the dollar and fueling an economic



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situation with high unemployment and poverty levels that fomented a return for the Unión Cívica Radical until 2001, when the situation exploded in a crisis that forced five presidents to renounce in less than two weeks and ended with a two-year austerity government under a Peronist president.

In 2003, Kirchner, a newly elected Peronist president started a period of three consecutive terms alternated with his wife. Kirchners' governments were aided by a strong increase in agricultural export goods produced by Argentina and permitted large subsidiary and populist policies until 2015. The post-2001-crisis era was marked by a revival of developmentalist ideas that found in Kirchners' rule large support. After a short interruption during the 1990s, interventionist and protectionist policies were again put in place, when the state was able to support them with funds from taxes to agricultural exports that were feeding Asian markets.

In 2008, Aldo Ferrer reviewed and re-published his 1983 book; minor contributions – like Marcelo Gullo's *Insubordinate Foundation* – also saw the light. Many former

Unión Cívica Radical politicians and intellectuals, as well as many other left-leaning ones, integrated the Peronist coalition in power and occupied many government and university positions. The Kirchners' policies were a clear example of developmentalist ideas, ranging from high import taxes and restrictions, increasing regulation, high general taxes, social and corporate subsidies, and high export taxes for agricultural goods. By 2015, the internalization of these ideas into the political scheme was so broad that the two main electoral coalitions (the Peronist-Kirchnerist alliance and the Liberal-Unión Cívica Radical) presented similar platforms, diverging more in judiciary and corruption case positions, as well as geopolitical alignments, than in economic proposals.

The discourse in Argentina remains strongly attached to the myths of structuralism. Even after almost a century of protectionist policies, high agricultural export taxes, import restrictions and duties, those are presented as the solutions for economic growth. Meanwhile, a lack of trade barriers is still used as an excuse for greater industrial development.

### PROTECTIONISM VERSUS FREE TRADE

By the 21<sup>st</sup> century, most mainstream economists maintain that the phenomenon of deterioration of the terms of trade is a topic that has lost its relevance. This is due to the fact that, in recent years, there has been substantial improvement in these prices in favor of the emerging countries as a result of the joint movement of rising prices of primary products. The process ran at the pace of the demand for mineral and agricultural goods in Asia. In parallel, falling prices of manufactured products appeared as the result of the accelerated industrialization process in which Asian countries have been involved. In the context of the 2008 international crisis, prices



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had suffered a sudden and substantial drop, but they have since recovered<sup>16</sup>.

The fact that, since the 1970s, there has been evidence against the core idea behind the protectionist viewpoint was crucial to erode its reputations and explanatory power. Although the oil crisis that raised this commodity price was artificially generated by the OPEC cartel, former price increases in commodities, especially after the beginning of the new century, confirmed that the theory was primarily wrong.

Econometric studies regarding twenty-four commodity prices and eight commodity price indexes between 1900 and 2000 showed no statistical evidence of a secular or continuous trend in the deterioration of the terms of trade<sup>17</sup>. Beyond this issue, the economic science has come to agree with the interpretation that when poor economies grow, the manufacturing sector increases its share of output, but there comes a time when per capita income is sufficiently high that the manufacturing sector loses relative importance. This very same process was experienced by Argentina, reaching an increasing growth in the service sector after the 1980s, without any specific or sharper increase in the reduction of the industrial sector's relevance in the economy during the 1990s liberalization, nor a special recovery after the 2000s<sup>18</sup>.

One key aspect that encouraged this situation was the stronger capacity for

<sup>16</sup> Boudreaux, D.J. and N. Ghei (2017) *The Benefits of Free Trade: Addressing Key Myths*, Mercatus Center, George Mason University.

<sup>17</sup> Etchebarne, A. (2008) "Los términos de intercambio y el cambio tecnológico", [in]: *Revista de Instituciones, Ideas y Mercados*, Vol. 48.

<sup>18</sup> Nicolini, J.P. (2011) *Mitos Argentinos sobre la Industrialización, Foco económico: un blog latinoamericano de economía y política*. Available [online]: <https://foco-economico.org/2011/10/10/mitos-argentinos-sobre-la-industrializacion/> [in Spanish]



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innovation, and quantity and quality outputs experienced in the industrial sector. The phenomenon was observed especially in areas like computers and other electronics, in comparison with the same metrics in agricultural and mineral goods production. This has led to a greater growth of the supply/demand ratio accompanied by the capacity to locate factories in virtually any place, something harder to achieve in the production of commodities, more tightly locked to natural resources unevenly distributed over the planet<sup>19</sup>.

<sup>19</sup> Bianco, C. (2011) "¿Automóviles o vacas? ¿Acero o caramelos? Una discusión teórica sobre especialización productiva y términos de intercambio", [in]: *Revista de Ciencias Sociales. Segunda época*, Vol. 20.



GLOBALIZATION,  
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On top of this problem for agricultural exports countries, until the beginning of the 21<sup>st</sup> century, the lag in population growth was still under the initial stages of economic development in the largest countries, almost all located in Asia and experiencing the first steps of development. At this level, most gains in income are still devoted to basic needs and demands and have not yet allowed for the complex and upper levels of luxury consumption of goods present in North America and Europe. The previous process could pose a challenge for non-industrialized countries by increasing industrialized goods demand relatively in comparison with agricultural products, thus rising manufactured good prices strongly.

Although, empirically, the theory of trade terms deterioration has been refuted, there have always been enough arguments against it. Protectionist theories have been around since the 15<sup>th</sup> century, with the first examples being Mercantilist ideas promoting imperialism, high tariffs, and subsidies on traded goods in order to maximize the

exports and minimize the imports for an economy, thus reducing as much as possible the current account deficit or reaching a current account surplus. Among the most common protectionist measures, one can find accumulating monetary reserves by a positive balance of trade, with detailed attention to finished goods.

Historically, such policies have led to war and promoted harmful colonial expansion. In this sense, nationalism and protectionism at the end of the 19<sup>th</sup> and beginning of the 20<sup>th</sup> century led to scattered armed conflicts, World War I and II, as well as to a deterioration in the economies of most involved countries. Globalization, as the extension of free trade and economic international integration, correlates with democracy and peace<sup>20</sup>.

In addition, there is strong evidence that globalization has mitigated rising inequality between participating nations, and that the nations that gained the most are those poor ones that changed their policies to become involved in the said process, instead of remaining isolated. The effect of globalization on inequality within nations also shows that those who have lost the most from globalizations typically have been the non-participants<sup>21</sup>. On the other hand, protectionist policies have proven profoundly negative, as Licomme explains,

*“When researchers at the International Monetary Fund recently examined tariff increases in 151 different countries between 1963 and 2014, they found that correlated with such policies were significant declines in domestic output and productivity, more unemployment,*

<sup>20</sup> Lindert, P.H. and J.G. Williamson (2001) *Does Globalization Make the World More Unequal?*, National Bureau of Economic Research, Working Paper No. 8228.

<sup>21</sup> Ibid.

*and higher inequality... a dramatic increase in developing-country participation in trade has coincided with an equally sharp decline in extreme poverty worldwide*<sup>22</sup>.

The benefits of free international trade are harder to see, while the benefits of shielding specific groups from foreign competition are often immediate and visible, thus paving the way for protectionist rhetoric. But free trade increases access to higher-quality, lower-priced goods by providing cheaper imports, thus allowing people and businesses to use the saved money in acquiring more goods or saving it, favoring investment by easing loans backed by real savings.

Free trade also means improving efficiency and innovation because it helps shift workers and resources to more productive uses, allowing more efficient industries to thrive. The results are higher wages, investment in things such as infrastructure, and a more dynamic economy that continues to create new jobs and opportunities.

The same mechanism drives competitiveness because it requires businesses and workers to adapt to the shifting demands of the worldwide marketplace, as well as to the local demand, which could otherwise obtain products from abroad if the national production does not satisfy them. However, these adjustments are critical to remaining competitive, and competition is what fuels long-term growth.

Free trade may reduce jobs in inefficient industries, but it also frees up resources to create jobs in more efficient ones, thus increasing overall wages and improving



THE BENEFITS OF FREE INTERNATIONAL TRADE ARE HARDER TO SEE, WHILE THE BENEFITS OF SHIELDING SPECIFIC GROUPS FROM FOREIGN COMPETITION ARE OFTEN IMMEDIATE AND VISIBLE, THUS PAVING THE WAY FOR PROTECTIONIST RHETORIC

living standards. In contrast, protectionist policies attempt to protect jobs that the market will eventually not sustain at the expense of more innovative industries, higher prices, and lower qualities and quantities of products for the consumers<sup>23</sup>.

At the global scale, free trade allows for increases in productivity by international specialization over comparative advantages,

<sup>22</sup> Lincicome, S. (2019) "The Case for Free Trade", [in]: *National Review*. Available [online]: <https://www.nationalreview.com/magazine/2019/05/20/the-case-for-free-trade/>

<sup>23</sup> Boudreaux, D.J. and N. Ghei (2017) *The Benefits of Free Trade: Addressing Key Myths*, Mercatus Center, George Mason University.

allowing for each country to dedicate their human and natural resources to produce what they are best at. This becomes especially important in a planet-wide context, where natural-resources efficient use is highly estimated because of environmental concerns. On the other hand, specialization also allows for greater overall production, which is critical in order to sustain the welfare of the vast majority of the population, particularly the poorer part.

One of the main problems with protectionism constitutes the proven incapacity of countries to develop true competitive productive industries. The initial protections over arbitrary sectors do not allow for the creative destruction process fueled by competition to take place, thus wasting resources and inhibiting innovation. In the long term, these sectors take advantage of the lack of competition to avoid improving or are plainly not able to transform, being highly vulnerable to opening the economy, thus using their influence over the political power to push for the maintenance of the *status quo* in detriment of the general welfare.

In general terms, countries have two ways of industrializing. One is spontaneous and linked to processes of comparative advantages in industrial sectors resulting from the capacity for innovation and specialization to manufacture higher qualities and quantities of products, serving the domestic and foreign markets at the same time and without hindrance. The other one, when focused on the external market, is a forced version in which, in the absence of specialization and advantages, competition is based on the price of the products.

To achieve forced competitive advantages strategies of low wages or currency devaluation by means of monetary emission and

its consequent inflation are chosen, which seriously affects workers in order to allow the industrial export policy abroad. This strategy poses the problem of being forced to keep wages low or the currency devalued indefinitely. Such an approach is harmful and, in many cases, unsustainable, since it fails to replace the real development of sectors resulting from existing comparative advantages, as well as from an innovative competitive process.

Ultimately, while devaluation through monetary emission is necessarily linked to a higher inflationary level paid for by the pockets of the entire population, the focus on low wages not only poses a problem for workers. Currently, this strategy has become vulnerable to advances in robotization and automation that displace labor as a relevant factor in the productive process and the formation of the cost of a product.



AT THE GLOBAL SCALE, FREE TRADE ALLOWS FOR INCREASES IN PRODUCTIVITY BY INTERNATIONAL SPECIALIZATION OVER COMPARATIVE ADVANTAGES



WHILE ARGENTINA'S OFFICIAL POSITION IS TO MAINTAIN THE PROTECTIONIST BARRIERS UNAFFECTED, THE REST OF THE COUNTRIES INTEND TO LOWER THE COMMON EXTERNAL TARIFF TO 10%

### LATIN AMERICA AND THE STRUGGLE FOR TRADE BORDERS

Almost a century after the beginning of the protectionist movement in the 1930s, many Latin-American countries remain under tight trade restrictions. The 2021 World Trade Organization World Tariff Profiles Report, written jointly with the United Nations Conference on Trade and Development, details that Argentina ranks 15<sup>th</sup> among 135 countries regarding strong trade barriers for the entry of products. Brazil occupies the 16<sup>th</sup> position<sup>24</sup>.

These barriers are put in place via tariff and import duties, as well as special permits

that delay the entry of goods and produce complex problems in supply and manufacturing chains inside the nation. Added to all these complications are the high competitive costs of local companies. A policy originally intended to protect national industries from competition ended up being used as a mechanism to allow the national state to retain as many U.S. dollars as possible from the agricultural export.

While the national Argentine government keeps the export income dollars and pays the exporters in pesos, at the same time tries to avoid selling importers U.S. dollars in a broad context of a series of restrictions to currency exchange that effectively ends up banning the sale and buying of foreign money. This situation revives the debate inside the regional trading block called MERCOSUR, inside which Brazil, Argentina, Uruguay, and Paraguay are discussing new trading policies that could reduce foreign trade restrictions. While Argentina's official position is to maintain the protectionist barriers unaffected, the rest of the countries intend to lower the Common External Tariff to 10%.

MERCOSUR was created in 1991 in order to allow for greater trade exchange and a unified tariff policy between the countries in accordance with the revised ECLAC recommendations for regional integration. After the economic crises in the late 1990s and again in 2008, Argentina, followed by Brazil, reinstated protectionist measures unilaterally in violation of the accords. These measures remain in place until now and could, eventually, lead to the dissolution of the block. While MERCOSUR is probably a failed example of closed economies unable to restructure their trade policies, the Pacific Alliance shows a different case, comprising Chile, Colombia, Mexico, and Peru. The agreement started in 2011 between the more open economies of the

<sup>24</sup> WTO, ITC, and UNCTAD (2021) *World Tariff Profiles 2021*.



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Pacific Latin-American coast has proven more effective.

Moreover, MERCOSUR shows, in comparison to the Pacific Alliance, a deeper and more volatile fall in GDP as well as higher inflation, lower economic freedom, lower competitiveness in their economies and higher business barriers and trade restrictions<sup>25</sup>. In addition, MERCOSUR depends on a few products and geographical markets for their exports, has a larger proportion of its international commerce dedicated to its neighboring countries, and a lower

high-tech exports ratio in comparison with the Pacific Alliance. This produces the problem of vulnerability that affects the export portfolio of the block, presenting a worse condition from a risk-return perspective when compared to the Pacific Alliance, something that is a problem not only for national enterprises and governments, but also for any foreign investor<sup>26</sup>.

The range of interventionist measures in Latin-American countries (especially in nations like Argentina that have strongly applied them) build up a complex network that conspire against production. Let us imagine a company that is trying to manufacture goods and find problems importing products used in their production chain that cannot be found inside the country. Or think of an enterprise that employs thousands of employees, but has grown out of protectionist barriers and faces a new government wishing to open the economy. We can even think of a corporation that has to compete with the import of goods from countries with extremely low taxes, and artificially inflated labor costs – like the ones in Argentina.

While the final objective of any trade policy should be to open and free the economy, the exact path towards that goal needs to handle a complex dismantling of the protectionist economic structure built after decades of trade barriers. The political and social short-term consequences should be addressed if the long-term benefits are to be achieved. High taxes, high import and export duties, complex regulations, currency controls, trade restrictions, bureaucracy, artificial unions, and labor costs, debt, inflations, and a lack of infrastructure conspire together with a poor legal track

<sup>25</sup> de Gouvea, R. et al. (2014) "An Export Portfolio Assessment of Regional Free Trade Agreements: A Mercosur and Pacific Alliance Perspective", [in]: *Modern Economy*, Vol. 5.

<sup>26</sup> Martínez Castillo, A. (2016) "The Pacific Alliance and Mercosur: Two Approaches to Economic Regional Integration", [in]: *Papel Político*, Vol. 21(2). Available [online]: <https://www.redalyc.org/articulo.oa?id=77751033007>

record against opening a company, foreign investment, and wealth generation. Each intervention created a problem that prompted other interventions, until the whole economic structure flourishes in inadequate policies hard to disband and with special interest groups fighting for their maintenance.

The myth of an Argentina in need of a commanded industrialization does not hold against the facts of a moderately industrialized country before the 1930s and that

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clearly has experienced a failed forced industrial intervention since then. Nevertheless, beyond the pessimistic impulses we could have, there is a clear path to follow: we could structure a transition using our comparative advantages. The re-opening of the economy must be structured so that existing companies can transform, and labor supply trained and relocated into competitive sectors of the economy.

Even after having to pay around 70% in total taxes, the Argentine agricultural sector remains strong after two decades of high international commodity prices pushed by the economic boom of Asia. If allowed through a tax and labor cost reduction in combination with a bureaucratic and trade easing, it could help finance the expansion of the agricultural-related industrial sector. Here, the country has been able to develop, again against the load of the state, an industry that produces a wide range of machines and equipment for food production, as well as agricultural genetic technology, competing in international markets for its quality. These sectors combined can provide jobs for a wide range of low-, medium-, and high-skilled workers, thus absorbing the vacant supply from uncompetitive industries.

The opportunity must be taken as quickly as it can be. Food production is experiencing a transformational process that could be soon increased up to levels that would revolutionize its technology, thus increasing production capacity far beyond population demand. The world is reaching a point of slow population growth that would be mainly focused in African poor and non-developing conflictive countries, a different process than the one experienced in Asia during the last decades.

Another threat appears on the horizon with increasing demands for dietary changes

in order to reduce food consumption because of moral and environmental complaints. Most agricultural production is used for animal feeding, and if these new demands are met in combinations with artificial meat production, regular agricultural demand could sharply decrease.

The 2020 COVID-19 pandemic poses another threat similar to the one experienced after the two World Wars, when trade restriction fomented economic barriers processes. The disruptions in supply chains generated by the pandemic over international trade can eventually foment production of ersatz goods in order to replace the ones hard or impossible to find in the market.

An example of supply chain disruption consequences is the increase in delivery of chips that has been multiplied in a range of around three to six times the usual waiting time<sup>27</sup>. This generates problems in many factories – from agricultural machines to home appliances, fomenting fast investment for local production of alternatives of dubious quality. When the international scenario returns to business as usual, these new companies and producers will not be able to compete globally against the regular manufacturers and will probably push for protectionist measures in detriment of the efficiency and welfare of the whole economic system.

### **CONCLUSIONS: ARGENTINA'S ANTI-TRADE LESSONS FOR THE EU**

The main lesson Central and Eastern Europeans may take from Argentina's pro-autarky mentality is twofold. On the one hand, the level of destruction produced by

anti-trade, protectionist policies are paramount. Once among the richest countries of the world, the South American country, nowadays, it cannot keep up with its neighbors. On the other hand, the Latin-American state shows how pervasive and difficult to eradicate these beliefs are.

Most Central and Eastern European, as well as Baltic states, have gone through a spectacular economic revival thanks to the opportunities offered by the European Union regarding trade *within* the bloc. This is because regional trade agreements have a dark side – by their very nature, they are discriminatory. The conditions of relative openness that they bring are only enjoyed by the members. To the outsiders, the situation can be much more complicated. Thus, the EU can be quite open to the inside, but it can also be a fortress on the outside. Definitely not a solution to this discriminatory feature, but a step forward to more openness, was the treaty signed by the EU and MERCOSUR in 2019. The agreement, however, is currently under attack by an unholy alliance between protectionist politicians, agricultural lobbyists, and environmentalists.



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<sup>27</sup> Li, L. and C. Ting-Fang (2021) "How the Chip Shortage Got So Bad - And Why It's So Hard to Fix", [in]: *Nikkei Asia*. Available [online]: <https://asia.nikkei.com/Business/Business-Spotlight/How-the-chip-shortage-got-so-bad-and-why-it-s-so-hard-to-fix>



## CRIES ABOUT SUSTAINABILITY AND ENVIRONMENTAL PROTECTION MAY VERY WELL BE MERE SIREN CALLS THAT HIDE GOOD OLD PROTECTIONIST LOBBIES

Both the civil societies and political leaderships of Central and Eastern European and Baltic countries should spearhead the defense of the MERCOSUR/EU trade agreement. Not only because these countries are examples of the benefits of trade openness, but also because the opening for trade of a combined population of 260 million with a gross national income (GNI) per capita of approximately EUR 9,500 will help all of them to diversify and become more resilient to shocks or sudden changes. Nowadays, 60% of EU exports go to EU countries, for instance<sup>28</sup>.

In the same way that structuralism became almost a mental disorder at the base of Argentina's trade policies, the concept of sustainability is dangerously playing a similar role within European elites. Cries about

sustainability and environmental protection may very well be mere siren calls that hide good old protectionist lobbies. Be that as it may, the sustainability flock seems to ignore one of the most positive and obvious impacts of the trade agreement between MERCOSUR and the EU. Namely, the treaty would facilitate the purchase of EU technology that would lead to more efficient production and lower emissions. More trade will make MERCOSUR's economic growth more sustainable<sup>29</sup>.

<sup>29</sup> Fernández, F. N. (2019) *The EU-Mercosur Trade Deal and the Lunacy of Protectionism*, Austrian Economics Center Daily. Available [online]: <https://www.austrian-center.com/eu-mercotur-trade-deal-protectionism/>



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<sup>28</sup> Guinea, O. and I. Pérez del Puerto (2021) "Don't Allow Doubts to Stop the EU-Mercosur Deal", [in]: *Diario El País*, April 19. Available [online]: <https://english.elpais.com/usa/2021-04-21/dont-allow-doubts-to-stop-the-eu-mercotur-deal.html>