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The trade and investment role of Argentina for U.S. firms seeking to establish operations in Mercosur

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THE TRADE AND INVESTMENT ROLE OF ARGENTINA FOR US FIRMS SEEKING TO ESTABLISH OPERATIONS IN MERCOSUR

by Ivanna Garibaldi ©

Submitted to the Committee on Undergraduate Honors at Baruch College of The City University of New York in partial fulfillment of the requirements for the degree of Bachelor of Business Administration in International Marketing with Honors.

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1. ABSTRACT

This thesis presents Argentina as a "trade bridge" to Mercosur. It was on March 26, 1991 that Argentina, Brazil, Paraguay, and Uruguay signed the agreement to enlarge their domestic markets through economic integration.

The concept of "trade bridge" depicts Argentina as a potential link for American firms seeking to invest in and trade with the rest of the Mercosur nations. Argentina can be the principal gateway into these other emerging markets and establish the first means by which this expansion can take place. This thesis attempts to answer key questions such as:

1. Is Argentina more suitable for trade with US companies than the other Mercosur countries? and if so, why?
2. Which US industries will benefit? How will specific industry participation affect Argentine-US trade and overall investment flows?
3. How can American companies benefit from trade and investment with Argentina, and through Argentina, trading with Mercosur countries?

As the countries within Mercosur consolidate their respective programs of modernization, regional economic integration will move forward even more rapidly, since the existence

of Mercosur will indeed ease the coordination of trade, exchange rate, fiscal, credit, and other macro-economic and sectoral policies. (Carlsson, 1997)

Within Mercosur, Argentina has not only reversed the poor economic performance evident during the past ten years, but during the 1990's its economic improvement has been of the most successful of Western nations. (Campbell, 1997).

Trade patterns and foreign investments volume has increased dramatically as a result of improved economic conditions, legislation reforms and privatization efforts. After Brazil, the US represents the most important trade partner for Argentina. Since 1989 activity between the two nations has evolved into a dynamic exchange of goods and services. The most notable evidence of this, are the increased establishments of operations by top American companies in Argentina. Another notable example are the innumerable privatization projects in which US firms have so far dominated.

There are vast opportunities in distinct industries including food, chemicals, automotive, mining, communications, petroleum and natural gas, computer services, insurance and banking, hotels and supermarkets.

The greatest opportunity for US firms exists in the technology-service industry including automation through computers, networking devices and other telecommunication products. Argentina represents a growing market which possesses a population whose purchasing power and consumer needs are increasing at record pace. It is necessary for these firms to realize the potential "link" that Argentina can establish for future expansion into the other Mercosur nations.

Argentina as a "trade bridge" will link these US companies to a region of vast economic growth and wondrous opportunities in terms of market size, future prospects in trade and investment and sustainable growing trends.

2. INTRODUCTION

Globalization of the world economy, enhancement of free trade frontiers together with the reduction of customs tariffs and the creation of a new organization known as the World Trade Organization (WTO: which is widely empowered to enforce international treaties) are extremely important aspects of today's global trade trends. These collectively reveal that the recent economic growth of countries is closely related to trade dynamization and expansion within increasingly wider geographic areas. (Herrera-Vegas, 1996).

Perhaps the most recent example of this has been last April 19th's Summit Meeting of The Americas in the city of Santiago, Chile. It was there that leaders of 34 countries in the Western Hemisphere took a first step toward creating the world's largest free trade zone, one that would span then Americas. In a joint declaration signed by President

Clinton and 21 other presidents and 12 prime ministers, the leaders said that talks on the subject would begin in September and they pledged to make "Concrete progress" toward a goal of signing an agreement by 2005. The Free Trade Area of the Americas (FTAA) would have 34 member nations (Cuba is not included) with 750 million people and a gross domestic product of more than US\$ 9 Trillion. The United States accounts for 85% of the region's economy. (Sims, 1998).

The important advances made in these trade expansion and integration agreements suggest that they are not only a necessity for growth, but also that isolation may threaten the subsistence of those nations that do not succeed in finding their way to enter these processes of trade frontier enhancements. (Hoopes, 1996)

Regional integration and participation in trade agreements is usually based on the reciprocal extension of trade privileges and as such these agreements serve to lower tariffs, eliminate quota restrictions, or otherwise remove protectionist barriers to cross-border trade between nationals of member countries. Global and regional trade agreements may contribute significantly to future prosperity and freedom of world markets and it is in this way that regional integration represents a crucial element for economic growth (de la Balze, 1996)

A most notable example of this is Argentina's current trade policy and how thoroughly it embraces the notion of free markets. To encourage foreign investment and open Argentina's markets to the forces of competition, the administration in power since 1989 has employed unilateral market liberalization and stabilization measures in combination with multinational and regional trade agreements like Mercosur. Such liberalization measures have boosted production and caused the domestic economy to expand greatly. In an effort to encourage export opportunities, the country has aggressively pursued membership in such agreements (Borner, 1994).

Regional Economic Integration

The processes of economic regional integration that have developed or are being developed in the world, may be classified according to their higher or lower degree of integration. (Cateora, 1996).

They are as follows:

- 1. Free Trade Zone (or FTZ):** To facilitate export trade, countries designate areas within their borders as customs-privileged areas where manufacturers can assemble their products without paying tariffs on the imported parts until they enter a country and are for sale. Some countries designate a factory or a warehouse where goods can be stored or assembled; others designate an entire area as an FTZ.
- 2. Free Trade Area (or FTA):** It is an agreement between two or more nations to reduce or eliminate customs duties and non-tariff trade barriers among partner countries while members maintain individual tariff schedules for external countries. It provides its

members with a "mass market" without barriers that impede the flow of goods and services. (Ex: NAFTA)

3. **Customs Union:** It represents the next stage in economic cooperation. It enjoys the free-trade areas' reduced or eliminated internal tariffs and adds a common external tariff on products imported from countries outside the union. The Customs Union (as is Mercosur) is a logical step in the transition

4. **Common Market:** It eliminates all tariffs and other restrictions on internal trade, adopts a set of common external tariffs, and removes all restriction on the free flow of capital and labor among member nations. It is a "unified economy", but lacks "political unity" to become a Political Union (Economic Union)

5. **Economic Union:** This represents the most fully integrated form of regional cooperation. It involves complete political and economic integration; it may voluntary or enforced. At its ideal point it may involve the free flow between borders of all factors of productions (such as where the EU is evolving into). Another example is The Commonwealth of Nations which represents the loosest possible, voluntary relationship that can be classified as economic integration.

There is no question that during the last 15 years a new trend towards globalization of the economy has emerged world wide. Examples of the new trend include NAFTA, EU, APEC (Asian Pacific Economic Cooperation), and of course Mercosur. It was on March 26, 1991 that Argentina, Brazil, Paraguay, and Uruguay signed the agreement to enlarge their domestic markets through this economic integration. Mercosur is the most recent regional trade agreement which certainly appears to be drawing increasing attention from world investors. It represents an unavoidable actor in the field of global commerce and economy (Hoopes, 1996). Mercosur has evolved into the 4th largest economic group in the world and the second largest Customs Union after the EU.

Table 1

ECONOMIC INDICATORS OF THE MAJOR TRADING BLOCS

	GDP (\$Trillion)	POPULATION	GDP Per Capita	EXPORTS (\$Billion)
NAFTA	7.5	378	19988	712
EU	7.2	364	19781	1651
PACIFIC RIM *	5.8	470	12279	973
MERCOSUR	0.8	204	4327	62

* Comprised of Japan, Korea, Hong-Kong, Taiwan, Malaysia, Thailand, and Indonesia.

It is interesting to note that the members of NAFTA and Mercosur are the principal economic players of the Western Hemisphere. Combined they represent 96 percent of the hemisphere's total GDP. The importance of Mercosur for the United States is reflected by the fact that more than 55 percent of its exports to South America are currently concentrated in the four Mercosur countries, and 65 percent of the United States' foreign direct investment in South America is in the Mercosur member nations. (Carlsson, 1997)

3. RESEARCH METHODOLOGY

Argentina represents a positive business environment for firms through its market based economy, its favorable legal framework for investments, its efficient service infrastructure and its highly skilled human resources. For these reasons I will examine the role of Argentina within Mercosur and determine whether and how US firms can take advantage of this in terms of both investment and trade.

Argentina represents a "trade bridge" into Mercosur through its currently favorable socio-economic climate of growth and long-term stability. There are several industries which present great investment opportunities for American firms wishing to invest capital as well as those companies wishing to engage in exporting, joint ventures or other means of market penetration.

In order to illustrate the gateway that Argentina represents for US firms seeking to invest and engage in trade within Mercosur I examine several critical questions in this thesis. The first set of these, concerning Argentina's basic economic conditions, are:

- **How has Mercosur affected Argentina's economic growth?**
- **In which of the nation's economic variables is this growth most evident?**
- **How has this apparent "trade and investment drive" accelerated Argentine economic recovery?**

In order to answer these questions in depth, I analyzed Argentina's basic economic indicators conducting a Pre-Post study (1987-1997) of the figures prior to Mercosur's existence and after its signing into effect. I compare the changes in the major indicators before Mercosur and then the indicators following a few years after Mercosur. This will indicate the nature and degree of influence the regional agreement had on the nation's overall economic and trade environment.

Most of the figures researched are from The UN Statistical Abstract of the World (Third Edition) and the Statistical Yearbook (40th issue), recent publications, and current newspaper articles on the subject from The Wall Street Journal, New York Times, Business Week, Latin Trade, Financial Times, and some Argentine publications including Clarin and La Nacion.

The general economic variables I study are:

Economy:

- | | |
|------------------------------|---------------------------|
| 1) Real GDP | 7) Average Exchange Rate |
| 2) Fiscal Balance Ratio | 8) GDP Per Capita |
| 3) Foreign Exchange Reserves | 9) Unemployment Rate |
| 4) GDP Growth Rate | 10) Foreign Debt |
| 5) Inflation (% year end) | 11) Consumption |
| 6) Foreign Debt | 12) Investment (domestic) |

These economic indicators are closely observed to determine each one's behavior as a result of Mercosur's creation and I will attempt to measure the observable impact of Mercosur on them individually and then the impact on them within the framework of the whole economy.

Clearly, during 1995 and 1996, the economy has been accomplishing the principal criteria for sustained growth. (Fidler, 1997). It is interesting to dissect the major sectors of the economic environment to determine what the results have been and what future prospects can be predicted through trend analysis. For example, even though the nation's economy has flourished under the new stabilization, unemployment rates have not decreased dramatically and this represents a major area of concern for the nation's people. My objective is to examine these variables and closely study the current situation and how it all relates to Argentina's performance and participation within the framework of Mercosur.

Trade:

- 1) US Exports (FAS \$ million)
- 2) US Imports (C. V \$ million)
- 3) Total Country Exports (FOB \$ million)
- 4) Total Country Imports (CIF \$ million)
- 5) Trade Balance (\$ million)

After running a strong deficit in 1994, Argentina's trade balance moved solidly into surplus after the first quarter of 1995 as exports climbed sharply and imports declined slightly. The development of trade with Brazil under the protection of Mercosur has become an important element of Argentina's trade strategy. Mercosur is viewed as "the most effective" tool Argentina has to promote long-term economic growth. For example, in the agricultural sector alone, Argentina ran a US\$1.3 billion surplus in its trade with the other three Mercosur members. (Decker, 1997). I will examine impacts and results such as these for the major sectors of the economy.

I also describe the changes in the flow of investment before and after the implementation of Mercosur in 1991. It is important to note that as a result of the development of Mercosur, there has been not only a dramatic increase in trade, but also an even greater increase in the flow of foreign investment into the country. (Diaz, 1996).

In addition, I examine the trade impact both within the Mercosur (intra-regional trade) and between Argentina and other non-member nations paying particular attention to the United States, Japan, the EU nations, and other Latin American countries which are not currently Mercosur members. I compare the Argentine export and import figures and break the numbers down into total Argentine imports and exports to Mercosur, USA, EU and other countries (subdivided into Japan, Mexico, Canada, and other Latin American nations).

My contribution determines the reasons for these recent increases in trade activity and foreign investment. Most importantly I quantify Mercosur's observable impact on these recent developments.

-Does Argentina's membership in Mercosur guarantee the nation more active investment sectors? And if yes, why and how much?

• Is Argentina indeed more suitable for trade with American firms than other Mercosur nations?

-What are the Selection Criteria ?

Asking this question and attempting to answer it implicitly gives the notion that despite Mercosur (tending towards a market) each country is distinct as a trading partner and that a US firm, despite economic advantages offered by the region, common should focus on a single country to achieve greater results.

The question should be looked at from the point of view of a comparative analysis between the member nations. What socio-economic characteristics does Argentina have that the other member nations lack?

A comparison across the four nations (paying attention at basic data, historical background, as well recent trends in their business climates) enables the analysis of the information and interpretation of the reasons why Argentina presently represents the strongest market in terms of size, purchasing power, educational attainment and socio-political stability.

• What Are The Present Investment and Trade Opportunities Available for US Firms in Argentina?

-Which industries and sectors of the economy (products, services)?

-Privatization involving US firms' capital investments?

• How can these American firms take advantage of the opportunities in Argentina to trade and invest in other member nations?

To answer these questions I examine the current conditions existing in Argentina (within the framework of Mercosur) and what opportunities exist for American firms wishing to export there, make a foreign direct investment and some other form of market entry or invest intense capital or even engage in other means of market penetration (such as: strategic alliances, and other licensing agreements).

Indeed, the reduction --if not the removal-- of non tariff restrictions (through Mercosur) on the import of consumer goods has opened up the market to imports and increased the sales of many products. (Hinkelman, 1996). Improved economic conditions are increasing consumers' discretionary income. Since 1993 the demand for imported goods has slowed somewhat following the initial boom period in February of 1991, but a moderate to very strong demand continues to exist virtually across the board for capital, intermediate and consumer goods. In addition, even when domestic industries are filling most of the current demand in their particular markets, they are increasingly relying on imported materials and components, as well as on capital goods, creating additional markets for foreign suppliers. (Hinkelman, 1996).

I establish the particular industries in which both export and import opportunities exist for US firms and examine the future prospects in the coming few years and how Mercosur's growth will affect this. Some of the industries are: aerospace, computers and software, construction materials, electricity, industrial equipment, medical and scientific equipment, motor vehicles and vehicle parts, and telecommunications. These specific industries were selected as they are the sectors in which great opportunities for growth exist and where US firms can achieve the highest benefits if they decide to engage in trade in the above areas.

There have been many reasons for the current foreign investment boom in Argentina including new legislation (Argentine Foreign Investment Act of 1993), and political, social and economic stability. FDI continues its heated pace ever since the signing of Mercosur, remaining strong in the last few years. Cumulative, recorded, direct, non financial inflows of foreign investment (investments other than portfolio investment placed in securities that can be liquidated the initial boom period in February of 1991, but a moderate to very strong demand continues to exist virtually across the board for capital, intermediate and consumer goods. In addition, even when domestic industries are filling most of the current demand in their particular markets, they are increasingly relying on imported materials and components, as well as on capital goods, creating additional markets for foreign suppliers.(Hinkelman, 1996).

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industries were selected as they are the sectors in which great opportunities for growth exist and where US firms can achieve the highest benefits if they decide to engage in trade in the above areas.

There have been many reasons for the current foreign investment boom in Argentina including new legislation (Argentine Foreign Investment Act of 1993), and political, social and economic stability. FDI continues its heated pace ever since the signing of Mercosur, remaining strong in the last few years. Cumulative, recorded, direct, non financial inflows of foreign investment (investments other than portfolio investment placed in securities that can be liquidated rapidly --the so called "hot money") in Argentina as of year end 1993 amounted to approximately US\$ 28 billion between 1990-93; the third largest inflow among emerging markets worldwide. (Hinkelman, 1996)

Private capital inflow in 1992 almost reached US\$ 8 billion and was slightly more than US\$5 billion for 1993. With privatization largely completed, the massive capital inflows of the early 1990's are expected to subside somewhat. However, assuming continued growth and stability, foreign investment should remain in a surplus position for the remainder of the decade, although observers expect annual flows to level off at figure around US\$ 2 billion (Hoopes, 1996)

I examine FDI's past history in Argentina and the trends that were evident prior to Mercosur (perhaps dating back to 1987) and then compare with the current booming situation in Argentina. I explain the extent of Mercosur's impact on the changes in FDI patterns in Argentina in the last five to ten years.

I collect both historical data as well as administering a mail survey/ questionnaire to managers of major US firms based in Argentina. Companies to be surveyed include: General Motors, Lockheed Aircrafts, Lone Star Industries, NL Industries, telecom Ventures, Unisys, Nortel, Mattel, just to name a few.

The above were selected because they are the particular ones in which American firms have a substantial direct capital investment and which have been identified by the parent firm as a wholly or partially owned subsidiary, affiliate, or branch. Franchises, representatives and non-commercial enterprises or institutions, such as hospitals, schools, etc. financed or operated by American philanthropic or religious organizations are not included.

The primary source of primary data is the mail surveys / questionnaires completed by the parent corporations and annual reports provided by them. Direct telephone contact and personal interviews will be used extensively for verification and clarification of the functions of subsidiaries in Argentina. Ideally, the personal interview will be a follow-up to the completed mail questionnaire in order to clarify major points of interest not covered previously.

Questionnaire Design ([Please refer to Appendix C for a sample of the questionnaire; PDF file 167 KB](#))

Questionnaire consists of 26 detailed questions (open ended, multiple choice, and rating through scales) covering numerous aspects of the firm's operations in Argentina:

Questions 1-5: cover the location of operations (what major cities), date of establishment in Argentina, the particular industry in which the company competes, the relationship with the US headquarters, and the reasons why the company decided to take operations to Argentina.

Questions 6-8: ask about the current business climate in the Argentine operations such as whether there has been recent expansion or contraction and the reasons why, ratings of firm's performance in comparison to worldwide operations, competitive strength within local industry.

Questions 9-11: introduces Mercosur within framework of the company's operations in Argentina. These questions ask about Mercosur's influence on operations, its potential strengths and weaknesses as it relates to the particular industry in which the firm is competing.

Questions 12-16: ask about Argentina's overall economic and business environment, focusing on the factors that have led to US companies' success or lack of success in the country. The firm is asked to respond to a series of scale-design questions as to whether they agree or not agree with statements regarding privatization efforts and the conditions existing for such projects.

Questions 17-18: focus on Argentina's restructured legal framework. Companies are asked to rate the level of influence of this new legislation on their level of investment within the past years and the overall impact it has or no has had on the firm and industry as a whole.

Questions 19-21: describe the future outlook of the company's operations in Argentina as well as the possibilities for movement into neighboring Mercosur nations (Brazil, Paraguay and Uruguay). Respondents are also asked to describe the most dramatic changes that the firm has experienced as a result of Mercosur's implementation.

Questions 22-26: illustrate the company's future strategic plans as Mercosur eventually grows into a true common market (both long term and short term prospects and goals). Respondents are also asked to point out their most important competitive advantages and benefits derived from having established operations in Argentina and other comments and opinions they may have regarding the subject.

- **What has been the social impact of the economic reform in Argentina?**
- **in particular, relating to the major socio-demographic segments of the population?**
- **How has Mercosur contributed to the overall social climate?**

In my research I address the impact that Argentina's economic advance has had on Argentine society as a whole. I undertake a closer analysis of population perceptions, attitudes, and opinions on the reforms undertaken, privatization efforts as well as Mercosur itself. This will enable a better in depth look into the trade agreements role within the dynamically evolving Argentine economy.

What this question poses is the issue of the current economic reforms' impact on employment rates, consumer spending, education levels and the country's literacy rate. By comparing the major trends existing today in Argentina and those figures prior to 1989 (beginning of the economic restructuring period) I can infer the effects (both the positive and the negative) evident in the lives of the Argentine population

Another aspect of the "social implications" on the agreement which cannot be quantified, but are indeed observed and studied, are the general attitude changes and reactions of the people: How they feel about the economic reforms and Mercosur and how the implementation of these has benefited them in their everyday life, and how it has altered their perspective on the current economic situation of the country. In order to achieve this, I conduct an examination of the recent polls in the last elections, recent articles and publications in both American and US magazines and newspapers.

- **What have been the recent criticisms on Mercosur?**
- **Counter arguments?**
- **What is Trade Diversion vs. Trade Creation?**
- **Has Mercosur erected barriers to foreign (non- Mercosur) competition?**

Here I analyze the views presented in a very stimulating and well-publicized academic critique on the South Cone Common Market (Mercosur). I discuss and interpret perhaps the strongest case written against Mercosur and attempt to refute each point made by the author: Alexander J. Yeats (the principal economist from the International Trade Division of the World Bank, Washington DC).

By gathering supporting data I summarize my findings on the agreement and enhance its benefits while at the same time counter-arguing Mr. Yeat's attempts to undermine all that Mercosur has achieved. I focus on his "key points of attack". It is essential to define the concepts presented and what exactly is mean by "trade diversion" and "trade creation". Also, of great importance is measuring the extent of the influence that this criticism may have on future investment and trade between Mercosur nations and the rest of the world.

During the last decade, the formation and development of Mercosur have undoubtedly been two of the main achievements of Argentina and its partners in a process largely exceeding the "mere" economic and business arena. Overcoming chronic difficulties and

leaving historical regional antagonism behind, around 1985 the nations of the region took up an ambitious challenge.

Contrary to many predictions, Mercosur has punctually and strictly complied with each and every schedule agreed. It has even grown to include some new "associate members" such as Chile and Bolivia (which was discussed earlier on in the proposal).

In concrete terms, the marked increase in Argentine participation in international trade has been accompanied by significant growth in "world" trade with the country, not only for other Mercosur nations, but also for external economies, such as East Asian countries, the United States and the European Union. **But is it all as it seems?**

In other words, *is it clear that as a consequence of the creation of Mercosur, trade volume generated is higher than trade diverted?*

How will American firms seeking to become involved in substantial trade with the Mercosur bloc benefit greatly from viewing Argentina as this "trade bridge"?

In my research I answer the questions above and prove that regional integration agreements are not means of protecting members, rather they are a means of liberalizing trade worldwide and enhancing the emergence of global, interdependent economies.

4. A CLOSER LOOK AT MERCOSUR

Latin America is widely considered the fastest growing area of the world (alongside South East Asia) and within it, Mercosur is the fastest growing region representing a single market of 230 million people; more than 58 percent of Latin America's GDP; 59 percent of its total area; slightly more than 51 percent of its industrial production and inter-regional trade and 33% of total Latin American foreign trade. "Mercosur will develop faster in the next few years than NAFTA," predicted former US Secretary of State Henry Kissinger at a meeting of the Latin America Business Council last year. (Silva, 1997)

Combined GDP of its member nations (Argentina, Uruguay, Paraguay, and Brazil) is just below US\$ 900 billion. Its total trade (exports plus imports) reached 124.4 billion dollars in 1995. In other words, Mercosur is an integrated market which accounts for more than half the value of Latin America's main economic indicators, and has an unmistakable potential and drawing power.

Table 2

MERCOSUR IN NUMBERS 1996

COUNTRY

AREA (mill. miles 2) (mill) REAL GDP (\$ bn.)

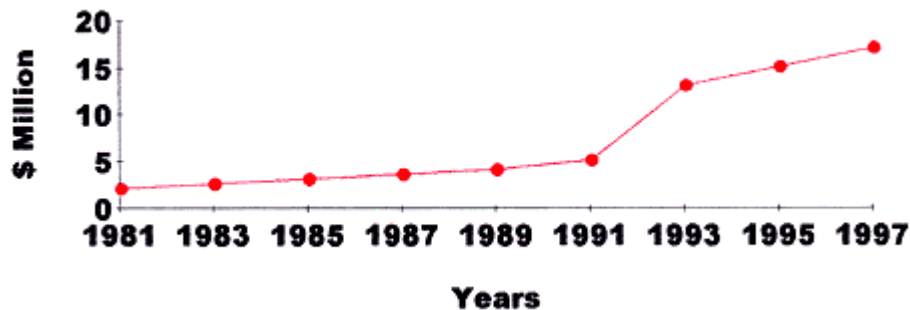
ARGENTINA	1.08	34.1	279.4
BRAZIL	3.28	162.2	581.3
PARAGUAY	0.15	4.7	7.6
URUGUAY	0.07	3.3	15.6
TOTAL (Mercosur Nations)	4.58	204.3	883.9
UNITED STATES	3.78	260	4885

Source: Hinkelman, 1996.

Judging by recent developments, the integration process in Mercosur has made enormous strides and has reached a level of interrelationship that provides a solid foundation for future, additional progress. (Herrera-Vegas,1996). Mercosur has created an impressively dynamic market of US\$ 1 trillion. This dynamism is based primarily on bilateral trade between the two largest economies of South America, Brazil and Argentina. From 1990 to 1994, trade among Mercosur economies of South America, Brazil and Argentina. From 1990 to 1994, trade among Mercosur countries increased by 181 percent (roughly 30 percent per year) (Hinkelman, 1996). Without a doubt Mercosur's greatest impact has been the extraordinary growth in trade and investment among the member nations.

Figure 1

**MERCOSUR INTRAREGIONAL TRADE
1981-1997**



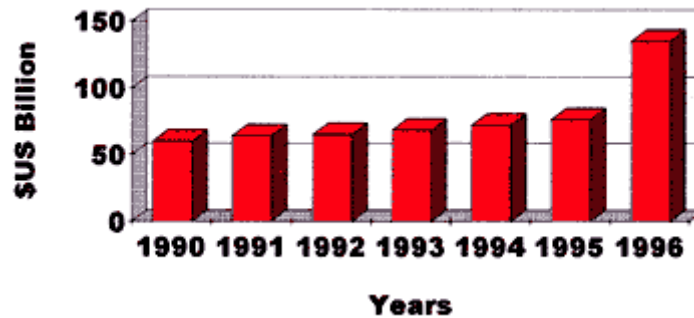
Source: *The Economist*, 1998

As shown in the graph above, intra-regional trade (within member nations) increased dramatically after 1991, the time around which Mercosur took an important role in the region's trade patterns. It must be pointed out that the larger figures have been the result of the two larger nations: Argentina and Brazil. Estimated total trade at mid 1997 was US\$ 17 million and projected numbers for 1998 may reach the 20 million mark. (Warn, 1998). However, "intra-regional" trade has not been the only area in which great increases have taken place. Interestingly enough, Mercosur's overall "global trade" in

1996 increased approximately 43,5% over the 1995 figures. Total trade (exports + imports) reached US\$ 135 billion in 1996.

Figure 2

MERCOSUR GLOBAL TRADE 1996

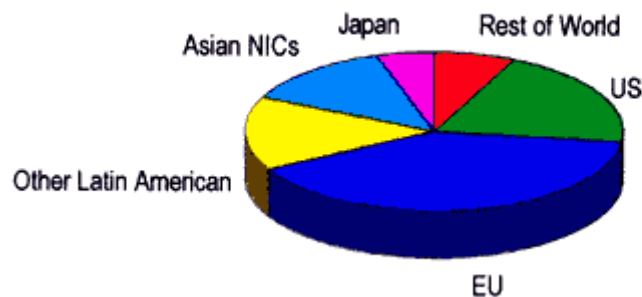


Source: Bannister, 1997

If one takes a closer look at how this global trade pattern is broken down among the different areas of the world, we see that United States is the number one trade partner of the Mercosur nations collectively. Even though, the EU has a greater amount as a whole entity, none of the other individual nations in the world come close to the US- Mercosur Trade numbers.

Figure 3

MERCOSUR GLOBAL TRADE 1996 (Segmented into regions)



Source: Ministry of Economy Report, 1997

Table 3

MERCOSUR GLOBAL TRADE

United States	20%	27 US\$ Billion (rounded off from 26.8)
European Union	40%	54 US\$ Billion
Great Britain	12%	6.48 US\$ Billion
Germany	10%	5.4 US\$ Billion
France	9%	4.86 US\$ Billion
Italy	6%	3.24 US\$ Billion
Spain	3%	1.62 US\$ Billion
Other Latin American nations	15%	20.25 US\$ Billion
Asian NICs	13%	17.55 US\$ Billion
Japan	5%	6.75 US\$ Billion
Rest of World	7%	9.45 US\$ Billion
TOTAL	100%	135 US\$ Billion

Source: Ministry of Economy Report, 1997

Table 4

MERCOSUR'S TRADE WITH U.S *(Mercosur's exports and imports to the U.S)*

(Billion Dollars)	1995	1996
EXPORTS	13.7	16
IMPORTS	10.7	10.8
TOTAL	24.4	26.8
BALANCE	plus 3	plus 5.2

Ministry of Economy Report: 1997

Note: Mercosur is the 8th largest export market in the world and the 12th largest supplier overall.

What is worth mentioning from the US perspective is that eighty percent of the major American companies in Latin America are settled in Mercosur and even though the principal trade and investment partner is by far the EU (with which Mercosur has a "bilateral trade agreement"), the US represents the most important individual country in terms of trade volume with Mercosur.

An older agreement with the United States called the "Four Plus One" has grown substantially in the last five years. Also referred to as "The Rose Garden", "Four Plus One" agreements was originally signed in 1991 to provide the US and Mercosur members with a structures within which to negotiate reciprocal trade and investment arrangements. Specifically, it provides the US with the means to negotiate with Mercosur members collectively rather than having to negotiate with each country individually, while it also allows the members of Mercosur to speak with a more powerful united voice. (Hinkelman, 1996)

It is in this south American region that the US companies will have the greatest opportunities for both investment and wider trade relations. (Campbell, 1998)

Mercosur's long term goals are as follows:

- * Harmonization of legislation, tax structure, commercial practices, tariff structure, and standards for quality and production.
- * Disappearance of protection for certain companies, subsidies, monopolies and market shares.
- * Increase of market potential, competition, employment, productivity, consumer demands, regional enterprise initiations and extra-territory investment flows.

The agreement will allow for free movement of goods, services, and factors of production (including capital, labor and natural resources) among member countries upon fulfillment of the long-term goals of the agreement. Currently it establishes a CET (Common External Tariff) to third countries. Mercosur's governing body is the Common Market Council, composed by the Ministers of Foreign Affairs and Economy of each member state. The Executive Body of Mercosur is the Common Market Group composed of sixteen members representing Ministers of Foreign Affairs; of Economy and Central Banks. The Common Market Group has a permanent Secretariat based in Montevideo (Uruguay) and eleven working groups dealing with sectarian policies. The Mercosur Trade Commission overlooks the implementation of the CET and Mercosur Trade Policy. (Decker, 1997)

It is imperative to point out that Mercosur is still far from being a "true common market", but the members have managed to achieve a customs union and continue negotiations aimed at full common market status by 2006.

The current priorities of Mercosur are as follows: first, to maintain what was already arranged; second, to deepen the agreements in terms of new economic sectors, third: to advance in the external front at a regional level; and fourth to participate in hemispheric and international initiatives with similar regional trade markets.

To maintain the agreements already obtained is a daily exercise. Frequently new restrictions appear that have to be discussed and overcome. This appears to reflect that increasing commerce and at greater trade volume can lead to a greater quantity of possible conflicts.

Originally, in the case of Mercosur, a period of transition was established, as from the date of the execution of the agreement (December 31st 1994), in which the member countries set up a *Program of Trade Liberalization*, whereby tariffs levied on trade within the bloc would be linearly and automatically reduced. In this way, as of December 31, 1994, **all goods that originated in Mercosur would be free from tariffs with non-tariff restrictions upon them, and presumably if they were traded within Mercosur.**

In practice, the first stage of economic integration was an imperfect free trade association. The four countries made lists of goods, which were not affected by tariff preferences because they were being considered sensitive to competition. Year by year, those lists were reduced and, on January 1, 1995 a 100 percent of liberalization was obtained for the whole universe of tariffs that affected the goods originated in Mercosur. The only exception was a list of products filed by each country within the system of final adequacy to customs union (Decker, 1997)

The concepts of inter-zone and extra-zone trade must be differentiated to distinguish the first stage of trade liberalization from the second. **Inter-zone** trade means trade developed exclusively within the limits of the bloc, that is to say, trade which involves the member countries only. On the other hand, **Extra-Zone** trade refers to that between the bloc and the rest of the world, that is to say, commercial transactions performed between any of the member countries and the rest of the world (Carlsson, 1997)

Therefore, the first stage of integration, the free trade association, involved only inter-zone trade, without affecting the tariff level that each country in the Mercosur maintains with the rest of the world. In order to reach the Customs Union stage in Mercosur as of 1995, each of the member countries had to replace their own particular tariff structure.

An extra-zone common tariff structure was adopted by the four countries, which meant that the protection level upon the imports from the rest of the world would be the same for all the countries in the Mercosur. The existence of a CET (Common External Tariff) would prevent leakage of products that could be imported through the country that offered the lower tariff protection, this becoming a place for goods in transit to be sent to a further destination.

During 1994, a variety of events took place which led to greater regional economic integration across the world. On January 1, NAFTA (North American Free Trade Agreement) signed by Mexico, US and Canada was put into force. Also, the agreements reached by the Summit of Presidents -held in Miami on December 1994- which put negotiations into motion to set up a continental free trade zone in the year 2005, represented a new step towards Inter-American integration.

A regional undertaking of major importance blossomed in 1994: the leaders of the main countries adjacent to the Pacific Ocean created APEC (Asian Pacific Economic Cooperation). This group included several economically powerful countries led by the US, Japan and China. In South America, the process of **Mercosur** was consolidated by the agreements reached in Ouro Preto on December 1994, which ensured the enforcement of a Free Trade Zone (FTZ) and a Customs Union among Argentina, Brazil, Paraguay and Uruguay as of January 1, 1995.

Although this is a matter of considerable debate, "regional agreements" (like NAFTA, and Mercosur) generally are not devised to foster internal free trade on the one hand and protectionism towards the rest of the world on the other. On the contrary, agreements among blocs tend to be achieved, which then accelerate the globalization of the world trade. In other words, "open" regionalism may be understood as a "non-multilateral" means of advancing towards a more open international trade system. (Ribeiro, 1997)

Basically, this view of regionalism may be construed as an integration process which neither builds walls nor intends to become a fortress, isolated from the rest of the world. This is the concept which inspired the "founders" of Mercosur and continues to inspire those concerned with its further development. (Decker, 1997)

A clear indication of this is the fact that only eighteen months after the setting up of the Customs Union, Mercosur concluded its first NonMercosur free trade agreement, in this case with Chile. This country and Bolivia have since signed free trade association agreements with Mercosur. Negotiations aimed at achieving a similar agreement with the Andean Pact countries (Venezuela, Colombia, Ecuador, Peru) will soon follow. Mercosur is also participating as a bloc in the Free Trade Area of the Americas hemispheric integration negotiations (FTAA).

In a very significant step, on December 22nd 1994 a Joint Declaration between the EU Council and the Mercosur member countries was made known, in which the interest in establishing an inter-regional political and economic association was remarked. Two negotiations carried out in September, in Brussels, and in October, in Montevideo, ended up with the signing in Madrid on December 15th 1995, of the inter-regional Framework Agreement of Cooperation between the EU and Mercosur. This model for negotiation of a trade pact became this way the first agreement entered into by two regional systems of integration, opening doors to the future creation of an economic space with 580 million consumers, and as an answer to the importance of the trading exchange between both

blocs and to the great amount of European investments in Mercosur. When the pact becomes officially signed in 1999, it will establish joint cooperation mechanisms with regards to customs for the inter-regional trade with the aim of completely freeing it by the year 2008. (Hoke, 1997)

In this respect, it is important to point out that, in addition to any trade benefits which may be derived from regional trade agreements, the latter imply (to a greater or lesser degree) the partial or total elimination of tariff preferences received at a given time within the Mercosur framework. This phenomenon would not be imaginable in the case of a regional trade agreement which aimed at the discrimination of third parties or in which the development of the regional market were "a purpose in itself" (Devlin, 1997)

The proliferation of preferential trade agreements clearly in evidence in the international economy in recent years is putting the old ideal of multilateral liberalization in international trade to the test. However, the idea that attempting to achieve an open international economy does not necessarily exclude integration agreements which could even facilitate its attainment has recently become accepted in both academic and government circles. (Devlin, 1997)

It is important to understand that, although the interest of those American firms striving to get into these new markets will be concentrated on the commercial possibilities of the bloc or region, they, nevertheless, should specifically take into account the strategic framework offered by the country that will constitute their basis. Special attention must be paid to relevant factors such as economic deregulation, legal certainty, low tax cost and the establishment of clear and simple non-economic governmental regulations that fit in with international trade dynamics.

Mercosur has a vision of "open regionalism" meaning that it has no apparent walls (except for CET) and the member nations do not want to be isolated from the rest of the world. Despite the fact that a significant portion of Mercosur trade occurs within its boundaries, the agreement was **not** conceived primarily as an intra-regional one, nor does it aim to satisfy the needs of its own population. Rather, Mercosur is designed to serve two main purposes: opening bigger markets for large companies operating within the bloc, and creating increased competitiveness in order to reach markets outside the region. (Ribeiro, 1997)

A clear example of this is that Mercosur, after one and a half years of the creation of the customs union, concluded its first agreement of free trade with Chile, hoping to arrive at a similar one with Bolivia and with the countries of the "Andean Pact". Mercosur also actively participated in the initiative towards hemispheric integration (ALCA) and even Mexico (that forms together with the US and Canada in NAFTA) expressed an interest in being part of Mercosur. The formula to be applied would be that of "4+1", creating this way a free trade area with a potential market that would cover almost the whole American continent.

Likewise, Mercosur has begun dialogues with Japan, and India, and with other countries of the world. Judging by the recent developments (i.e.: with Chile, Bolivia mentioned previously), the integration process in Mercosur has made enormous strides and has reached a level of interrelationship that provides a solid foundation for additional progress in the years to come. (Omega, 1997).

One of the most interesting phenomena of the Mercosur process is the fact that from its creation, as an area of preferential trade from 1991 and a customs union from 1995, the volume of its commerce with the world has increased. That is for the partner countries, Mercosur is not an "end in itself", but on the contrary it is a tool to be inserted in world trade. (Hinkelman, 1996). This notion of Mercosur as a useful pathway for increased international trade is a question I will address more specifically in my research. Mercosur's regional trade with the rest of the world has increased by 74.3% (from 1990-1995) in comparison to the NAFTA's 21% and EU's 31.7% growth rate during that same five year period.

Mercosur's ever growing role in global trade is evident by the recent October 1997 signing of the Mercosur-Chile Free Trade Zone Agreement between Mercosur and Chile was created. This implies the institutionalization of an economic trade relation that was naturally growing since the beginning of the decade at a rate of over 4.6% annually. (Decker, 1997). Because the Chilean economy has an important international prestige, its incorporation into Mercosur as an associate member can be considered as a "quality seal" and a positive sign. Chile may indeed represent Mercosur's gateway into the Pacific markets due to its geographic location (which makes it a natural bridge to the Pacific Rim) and its close trade ties and past commitment in commerce with Southeast Asia.

The importance of Mercosur for the United States is reflected by the fact that more than 55 percent of its exports to South America are concentrated in the four Mercosur countries. But without a doubt Mercosur's greatest impact has been the extraordinary growth in trade and investment for its two biggest members, Argentina and Brazil. Between 1986 and 1990 the region's share of Argentina's total trade remained around 14.3%. Regional trade began to grow rapidly in 1991 with an increase of its share in total Argentine trade from 18.7% in 1991 to 26.5% in 1994 and to 28% during the first six months of 1995. (Hoopes, 1996).

5. ARGENTINA WITHIN MERCOSUR

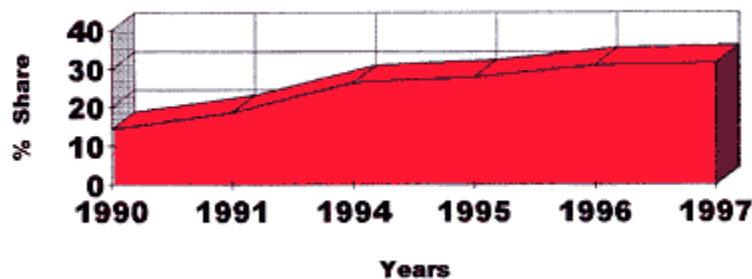
Argentina not only has reversed the poor economic performance evidenced during the past decade, but during the 90's its economic improvement (through membership in Mercosur) has been one of the most successful of Western nations. (Campbell, 1997). Considering variables such as the increasing GDP, the investment rate and specially foreign trade, the current results indicate a prosperous period of growth for this country. (Decker, 1996) But before embarking on a more in depth analysis of the nation's present

economic conditions, it is necessary to understand its overall role it has within Mercosur in terms of regional trade with the member nations.

Between 1986 and 1990, the region's share of Argentina's total trade remained around 14,3%. However, as Mercosur evolved in both strength and stability, regional trade began to grow rapidly in 1991 with an increase of its share in total Argentine trade from 18,7% in 1991 to 26,5% in 1994 and to 28% during the first six months of 1995. During 1996, this figure jumped to 31% and has remained here through most of 1997.

Figure 4

ARGENTINA'S TRADE WITH MERCOSUR Mercosur's % of Total Argentine Trade

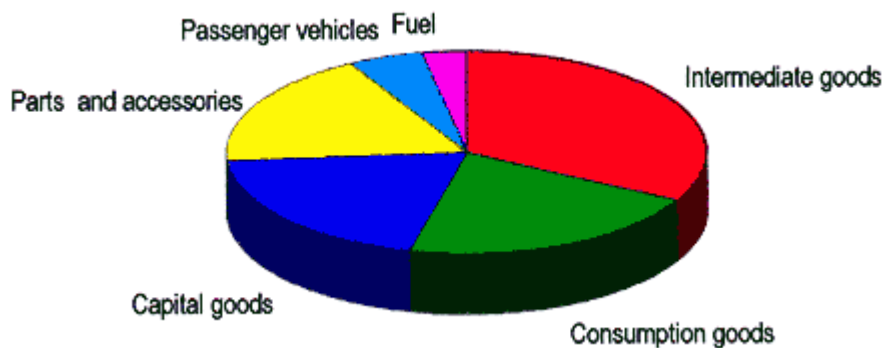


Source: Madigan, 1998

Presently, Argentina's trade with Mercosur nations represents approximately 31% of Argentina's trade with the world. The structure of imports to its neighbors is representative to that of the rest of the world's. Intermediate goods (33%) constitute the greater volume in imports, followed by consumption goods (21%), then capital goods (20%), parts and accessories for capital goods (18%), passenger vehicles (5%), and fuel (3%).

Figure 4(a)

STRUCTURE OF IMPORTS (1996)

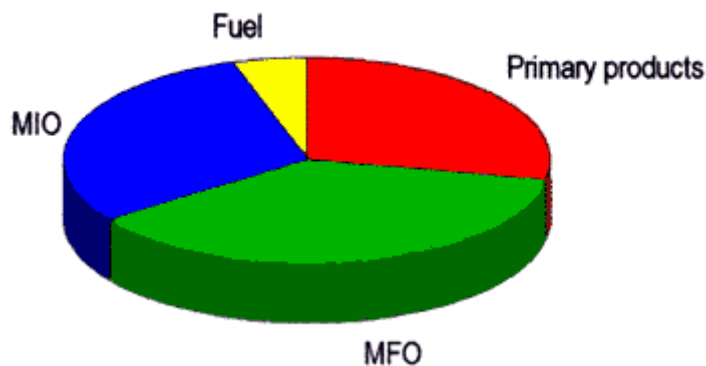


Source: Ministry of Economy Report, 1997

Argentine exports to the Mercosur nations is comprised of primary products: 28% (including cereals, unprocessed vegetables, legumes, fresh fruits, livestock, etc), manufactures of farming origin or MFO: 37% (leather and furs, edible oils and fat, dairy products, processed fish and seafood), manufactures of industrial origin or MIO: 30% (transport material, machinery and electric equipment, related chemical products, textiles and clothing, artificial plastic material), fuel and energy: 5%.

Figure 4(b)

STRUCTURE OF EXPORTS



Source: Ministry of Economy report, 1997

Within the framework of Mercosur, Argentina is consolidating two main principles to guarantee the sustained development and the welfare of its citizens: the political rationality and the economic rationality. These principles (which will be discussed in greater detail later on in the paper) have led to overall stability evident in

1. Convertibility Law: Argentina's 1991 law fixed the exchange rate parity against the US dollar and provided that it could not be changed with the approval of the Congress. As under a monetary system called a "currency board", the Law also provided that the monetary base had to be backed by foreign reserves. This prevents the central bank from discretionary issuance of money, such as for financing a budget deficit, and ensures a firm limit to the growth of the money supply.
2. Price Stability: achieved through drastic reduction in inflation figures.
3. Argentina's growing importance and key role within Mercosur: the emerging role of Argentina at the head front of the Mercosur union is becoming more clear through current economic indicators and socio-political stability in the region.
4. Privatization of Public Enterprises
5. Fiscal Balance through reduction of trade deficit
6. Environmental Protection
7. New Investment Legislation and Tax Reforms
8. Nuclear Non Proliferation agreements

Argentina's exports have increased between 1989 and 1995 at annual accumulative rate average of almost 14% (placing it among the highest, as far as growth is concerned, in the world).

The success of the convertibility plan with regard to anti-inflationary incentives (thus resulting in a dramatic decrease of inflation rate in past years), allows Argentina to be among the nations with the lowest inflation rates in the world. Two of the main achievements Argentina has obtained in the last few years are credibility and certain economic recovery, especially in the exchange market and in commercial issues. In this sense, the notable decline in country risk since 1991 enabled the state and private sector to finance themselves better in the international capital markets (Hoopes, 1996)

Table 5

	EXPORTS GROWTH RATE	TRADE GROWTH RATE
COUNTRIES	(Annual Average Cumulative Rate: 1989-1995)	(Annual Average Cumulative Rate: 1989-1995)
CHINA	19%	20%
OTHER ASIAN NICs	16%	16.70%

ARGENTINA	13.90%	16.40%
MEXICO	13.20%	13.60%
CHILE	12.10%	13.20%
EUROPEAN UNION	9.10%	10.10%
UNITED STATES	8.20%	8.30%
BRAZIL	6.10%	6.90%
REST OF WORLD	9.20%	9.10%

Source: UN Statistical Yearbook (40th Edition)

All these factors have generated an environment of wider credibility and farsightedness. This greater confidence makes possible the performance of a major number of productive projects that were not possible before for the high risk rates. With democracy and economic stability the possibilities to obtain a positive and convenient interaction with the rest of the world is decisively increased.

6. ARGENTINE FOREIGN TRADE

The Origin of Argentine Foreign Trade

During much of its modern history, Argentina has focused on the export of primary commodity agricultural products and the import of manufactured, high-value-added goods. This pattern was altered during the 1940's and 1950's with the advent of protective tariff and non-tariff barriers, imposed to allow the development of domestic import substitution industries. For most of the 1960's through the 1980's, Argentina's national policy shifted back and forth between an open and a closed regime, to the detriment of both foreign and domestic interests. (Hinkelman, 1996)

After amassing large trade surpluses for most of the 1980's, during which time the government discouraged imports in an attempt to stabilize Argentina's finances, policy makers shifted again. In 1989 they adopted an open-market approach, allowing the economy to run up substantial trade deficits while encouraging the import of capital goods and other inputs to strengthen domestic production. While this deregulation enabled Argentine industries more access to the equipment needed to upgrade production, it also unfortunately hurt many local industries that were unable to compete with foreign goods that flooded the domestic market. This was particularly true for manufacturers of consumer goods. Although roughly 20% (US\$4.41bn) of total imports (US\$21.544bn) still consist of consumer goods (Hinkelman, 1996)--despite high import duties designed to restrict such trade in nonessentials-- the vast bulk of imports are now made up of capital goods, parts for such goods, and intermediate inputs.

The Argentines in general remain somewhat distressed that the payoff in terms of higher-value-added exports has yet to be realized from allowing this import-driven trade deficit

to swell. Nevertheless, the trend is positive, especially in comparison with the past, when imports were predominantly for industrial inputs and domestic consumption. The current surge in investment in Argentina's industry should begin to show greater long term results by the year 2000.

In line with its open market policy, the Argentine government reduced and eliminated many previous existing barriers to international trade, resulting in the doubling of foreign trade between 1980 and 1996. The maximum import tariff was cut by more than half, from 50 to 20 percent, and the 15 percent surcharge (which constituted a minimum charge) was fully eliminated, allowing some goods to enter duty free. In 1989 the average tariff was 39 percent; just five years later in January 1994 the average tariff had fallen to 9.1 percent (Hoopes, 1996).

Today the tariffs on almost all imports have fallen even further, and as a signatory to the General Agreement on Tariffs and Trade (GATT), Argentina has pledged to reduce them even more. Discretionary import licensing, which had served to strictly limit imports in the past, was also dropped. At the same time, the administration also eliminated most export tariffs and implemented a drawback system to rebate tariffs on inputs for products destined for export. Between 1980 and 1995, foreign trade grew at a compound annual growth rate (CAGR) of nearly 5 percent (Hoopes 1996).

The 1995 inauguration of Mercado Comun del Sur (Mercosur) --a customs union consisting of Argentina, Brazil, Uruguay and Paraguay that allows preferential trade to occur among these partners-- has dramatically altered the trade situation for Argentina. Preferential trade among Mercosur began in 1991, and free trade went into effect in 1995. Argentina's 1993 trade with its Mercosur partners rose by nearly 30 percent (from the previous two years), and has steadily grown. Although Argentina currently maintains a trade deficit with these nations, its exports to them are also rising sharply. As the full provisions of the agreement take effect, the mutual benefits among all the trading partners are expected to continue to multiply.

Size of Argentina's Foreign Trade

After taking a large downfall in the 1980's, Argentina's total foreign trade has more than tripled in the past ten years, rising roughly from US\$11.6 billion in 1986 to approximately US\$40 billion in 1996. During these same years, the share of Argentina's gross domestic product (GDP) representing foreign trade has remained nearly level at an average of 12.5 percent. (De la Balze, 1996)

This indicates that domestic production and foreign trade have been expanding at close to the same pace. The relative proportion of foreign trade to the total economy also graphically points up that the Argentine economy continues to be largely oriented toward the domestic sphere: more than 85 percent of the economy is focused on domestic markets. While the share of foreign trade relative to the economy appears to be growing,

the overall proportional increase has been slight. Nevertheless, the focus is currently export production.

In relation to other countries trading in world markets, the percentage of Argentina's GDP represented by foreign trade is fairly low. For example, in 1992 the following countries registered levels of foreign trade relative to their GDP's higher than the 11.8 percent registered by Argentina.

Table 6

FOREIGN TRADE RELATIVE TO GDP

COUNTRY	% GDP REPRESENTED BY FOREIGN TRADE
Brazil	15%
Mexico	23.4% (37.3% with maquila trade)
Japan	15.20%
China	40.20%
Taiwan	76.90%
United States	17.50%
Great Britain	43.80%
France	46.20%
Germany	60%
Argentina	11.84%

Source: de la Baize (1996)

All these numbers point to the fact that Argentina continues to concentrate on its domestic markets to a greater extent than many other countries with more developed or rapidly expanding economies.

The emphasis on domestic markets in Argentina is a function of two factors or variables:

- Argentina's economy is still relatively undeveloped when compared with the more developed economies of such nations as European Union (EU) members like the UK, France and Germany, which depend on foreign trade for a much greater proportion of their overall economic activity.
- Argentina's proportionally large and important domestic markets constitute the core of its economy, as is also the situation in Brazil, the US, and Japan. Many domestic

producers are just starting to enter the international trade sector, and it is a slow process because many of these producers need to invest heavily in imported capital goods and intermediate inputs to upgrade their production capabilities. The process is made even more difficult because the opening of Argentina's markets to increase the availability of those imports has also intensified the competition at home. Thus, domestic producers are having to become more competitive not only in international markets, but simultaneously in Argentine markets. (Carlsson, 1997)

Prior to 1989 Argentina's markets were for the most part closed to imports, while exports were highly concentrated in a few sectors. When open markets were implemented, foreign trade performed as might be expected --that is, it surged rapidly. The overall numbers also camouflage a significant differential in the rate of growth of the various trade components. Imports have more than quadrupled (from US\$4.7 billion in 1986 to over US\$22 billion in 1996, while exports have more than doubled (from US\$6.8 billion in 1986 to US\$16 billion in 1996). This differential between growth patterns between imports and exports has arisen largely because of the need to import modern technology before domestic industries can supply exports in such quantity, quality, and diversity as to become competitive in global markets. This gap --between imports and exports-- is likely to continue for some time, and narrowing it will require:

1. Intensive capital investment
2. Modification of the management structure
3. Training of the workforce

Many Argentine businesses -and whole industries- are now engaged in this challenge. Those that find a way to persevere will start to transform the current trade deficit into a more balanced level of foreign trade.

Exports

Until the 1990's exports from Argentina remained at approximately the same level for decades, although tariff and non-tariff barriers on imports permitted the country to post trade surpluses until 1981. The products exported were highly concentrated in three sectors: agriculture, industrial manufactures, and fuels. From 1980 through 1989 roughly 2/3 of Argentina's exports continued to be associated with agriculture (primary products averaged 30 percent; agricultural manufactures --processed and semi processed-- averaged 37 percent). About 1/5 of exports (21 percent) during the 1980's were industrial manufactures, consisting mainly of base metals (iron, steel, aluminum, some machinery, and chemicals). Only about 4 percent of the exports were fuels and fuel derivatives, production by the state-run monopoly was designed primarily to fill domestic need rather than to contribute to export revenues.

The country is still known primarily for its agricultural exports (grain, oilseeds, and meat products). According to statistics compiled by Argentina's National Institute of Census Statistics (INDEC) for 1996, exports of agricultural manufactures fell to a 29 percent share from a 37 percent share of total exports, while primary (agricultural) products dropped to a 24 percent share from a 38 percent share --or combined, from nearly 3/4 to about 1/2. Meanwhile, industrial manufactures rose to a 37 percent share from a 21 percent in 1996. Fuel exports rose as well, to a 10 percent share from a 4 percent share, but the real story was the surge in higher-value-added manufactured industrial products.

In 1996 exports were still heavily concentrated in a few sectors, but diversification was beginning to be visible. In that year INDEC reported that the top four exports (fuels, fats and oils, food byproducts, and cereals) together made up 37 percent of total merchandise exports. The top ten exports represented roughly 70 percent of all exports. Some of the highest growth in exports in 1996 came from higher-value-added goods, including transportation equipment (up 25.6%), chemical products (up 29.5%), and machinery and electrical products (up 13.2%)

For some, the shift in Argentine exports is occurring too slowly. Some analysts have voiced concern that the growth of non-traditional, higher-value-added exports needs to be further encouraged if they are going to supply the foreign exchange that is currently being supplied through foreign investment. Nevertheless, export rates have been growing steadily since 1992. In dollar terms, exports took a 3 percent dip in 1991, but then recovered, growing by 2.1 percent in 1992, by an even stronger 7 percent in 1993, by 14 percent in 1994, and by 20 percent in 1996. (Hoopes, 1996)

Table 7

ARGENTINE EXPORTS BY CATEGORY 1996

PRODUCT CATEGORY	US\$BILLION	PERCENT
FUELS	1.619	10.3
FATS AND OILS	1.533	9.7
FOOD BY PRODUCTS	1.341	8.5
CEREALS	1.323	8.4
OILSEEDS	0.953	6.1
MEAT	0.912	5.8
TRANSPORTATION	0.903	5.7
MACHINERY AND ELECTRONIC EQUIPMENT	0.855	5.4
BASE METALS	0.786	5.1
HIDES AND LEATHER	0.762	4.8
CHEMICALS	0.724	4.6

SEAFOOD (FRESH)	0.441	2.8
SEAFOOD (PROCESSED)	0.278	1.8
VEGETABLES (FRESH)	0.254	1.6
MINERAL PRODUCTS	0.25	1.6
OTHER MISCELLANEOUS	2.805	17.8
TOTAL	15.739	100

Source: INDEC, 1996

Imports

Argentina has become a hot market for imports. Imports grew by 20-fold between 1965 and 1996, but the major growth has only been since 1991 when the more open policies of the Menem government began to go into effect. During much of the 1980's, the nation discouraged products from abroad, but Argentina is continuing to open its markets, reduce tariffs, deregulate government monopolies, and stabilize its exchange rate (currently pegged to the US Dollar). End user demand is high for both consumer and industrial goods.

As mentioned before, imports of capital goods, intermediate products, and parts and accessories represented 72.5 percent of imports by economic utilization category in 1996. In another listing by more specific categories, it was shown that machinery and electronic equipment represented the largest category of imports in 1996, accounting for 34 percent of all imports (up 27 percent from the previous year). Imports of transportation equipment ranked second at 18 percent (up 43 percent), indicating the strength of the Argentine automotive industry, because much of this tariff represents trade in components with Brazil. Chemicals represented the third largest category with a 12 percent share of total merchandise imports (up 28 percent). Together these three categories accounted for nearly 2/3 of Argentina's 1996 imports, as well as for all imports categories representing more than US\$ 2 billion and 14 percent of the total. The top ten import categories account for 92 percent of all imports.

Table 8

ARGENTINE IMPORTS BY CATEGORY 1996

PRODUCT CATEGORY	US\$BILLION	PERCENTAGE
MACHINERY AND ELECTRONIC EQUIPMENT	7.415	34.4
TRANSPORTATION	3.834	17.8
CHEMICALS	2.577	12
BASE METALS	1.272	5.9

PLASTICS	1.113	5.2
TEXTILE PRODUCTS	0.828	3.8
MINERAL PRODUCTS	0.801	3.7
PRECISION INSTRUMENTS	0.708	3.3
PAPER PRODUCTS	0.694	3.2
FOOD PRODUCTS	0.593	2.8
PLANT PRODUCTS	0.343	1.6
LIVE ANIMALS	0.251	1.2
CEMENT AND GLASS	0.226	1
OTHER MISCELLANEOUS PRODUCTS	0.889	4.1
TOTAL	21.544	100

Source: INDEC, 1996

Trade Partners

Argentina's dominant trade partner is its largest neighbor, Brazil. Brazil achieved this standing in 1992 and has retained it every year since then. In 1996 Brazil accounted for US\$ 7.875 billion (21.1 percent) of Argentina's total trade. The nation's second largest partner is the United States, with US\$ 6.645 billion (17.8 percent) of total trade. Argentina conducts almost 39 percent of its trade with these two countries alone.

Aside from the two largest trading partners, eight other nations had trade with Argentina greater than US\$ 1 billion in value in 1996. Individually their share of total foreign trade ranged from 5.5 percent to 2.9 percent, falling substantially below those of the top two partners. In order of their ranking these are:

Table 9

ARGENTINA'S TOP TRADING PARTNERS 1996

COUNTRY	TOTAL [US\$ BILLION]
BRAZIL	7.875
UNITED STATES	6.645
ITALY	2.069
GERMANY	1.988
CHILE	1.812
THE NETHERLANDS	1.528

SPAIN	1.442
URUGUAY	1.43
FRANCE	1.286
JAPAN	1.071

Source: Cooper, 1998

When foreign trade with these eight traders is combined with the two top partners, the top ten trade partners account for almost 73 percent of Argentina's trade. Argentina's trade relationships with its neighboring countries have been significantly affected by Mercosur. From 1975 to 1989, an average of only about 11 percent of Argentina's total foreign trade was conducted with Brazil. When the first step of preferential trade began at the start of the present decade, that figure jumped to 17 percent in 1990, and it has been rising steadily ever since. By 1992 Brazil had become Argentina's number one trading partner, and the amount and proportion of trade between the two countries continues to grow. To date Brazil has been the major purchaser of Argentina's new, non traditional, higher-value-added exports.

Balance of Trade

During the past 30 years, Argentina has maintained a balance of merchandise trade surplus in all but four years: 1981 and 1992 through 1994. During many of these years, Argentina actively managed its trade by using tariff and other barriers to artificially exclude imports. When open-market policies were introduced, imports began to outpace exports, causing deficits in the early 1990's. Based on improved export performance in early 1995 and 1996, officials have projected break-even performance, or perhaps even a slight surplus by the end of the decade. (Fidler, 1997). To regain its trade surplus, the country is focusing on diversifying its exports, stepping up production of high-valued added goods, and trading with its Mercosur partners.

Argentina's current accounts have been in deficit in 20 of the past 30 years, most recently showing a surplus only in 1990. In addition to merchandise trade, the current account deficit includes trade in invisibles (services), investment payments, and transfers. Argentina has generally maintained a deficit position in trade in services, and has historically paid out more investment income than it has received, keeping its finances on edge. Countries that generate substantial amounts of inbound investment and a high rate of growth in the domestic economy can sustain such disparities, but imbalances in current accounts pose more than the usual danger for Argentina, because its domestic economy could still be hurt by the loss of the outside funds.

Thus the development of exports, especially non traditional ones, is taking on greater urgency. In 1996 non traditional industrial products accounted for 40% of the growth in exports. In comparison, 40% of the increase in imports consisted of capital goods, which

in turn are being used to increase productivity. Argentines point out that their current account deficit in 1996 was only 4% of its GDP, barely half the level of Mexico's deficit when it got into trouble at the end of that year. (Carlsson, 1997).

As Argentines focus more and more on opportunities within Mercosur, the balance of trade situation is indicative of trends. Trade with Mercosur members posted a deficit of US\$ 1.428 billion in 1995; however, this was reduced to US\$ 530 million in 1996, and US\$ 389 million in 1997. (Warn, 1998).

Argentine Trade Policy

The wide ranging reform programs introduced back in 1989 have effected drastic changes in an economy that had reached an acute crisis stage in the late 1980's. Most of the statist controls imposed during prior decades have been fully removed, deregulation and restructuring of public and private sectors is well underway, and industries are being privatized. Argentina has adopted outward-looking trade policies in this early phase of economic recovery.

Even with the government's adoption of open market trade policies, the process of becoming internationally competitive is proving to be somewhat slow, yet certain. There is a great need to reform industry, management, and labor structures. Open market policies have not eliminated the issues that Argentine businesses face in producing goods that can compete in both domestic and international markets. As a result, imports are likely to remain high for some time in order to meet domestic consumer demand, industrial investment in capital goods, and consumption of intermediate inputs for re-export production. However, it is in this situation that US businesses can seek to maximize their opportunities. The rising consumer demand in these areas, represents uncharted waters for potential growth in which American companies can derive the most benefit. (Decker, 1997)

The government has committed itself with its open trade policies for the most part, allowing for a transitional period only when protection of an important industry becomes necessary for its survival. Nearly barriers to exports have been eliminated, and exports have been showing an increased growth rate --growth was particularly strong during the first six months of 1996-- although growth has nevertheless been comparatively gradual and occurs from a relatively low base level. (Carlsson, 1997).

Observers argue that 1996 has been the turning point for Argentina's exports. First, some see the domestic market as nearly saturated for a wide range of goods, even without the negative effects of the emerging markets downturn in early 1996 which have served to depress imports. Second, and more positively, the effects of investment appear to be greatly more noticeable: Argentine manufacturing activity --up by 15% in 1996 from 1995-- increased for the 21st consecutive quarter in the first quarter of 1996. (Fidler, 1997). Also, the fixture years promise to be a record period for harvests of agricultural

products, while international demand seems to be either growing or at least stable for the intermediate products that form the bulk of Argentina's exports.

The Argentine government is seeking to improve trading relationships and increase export access regionally -culminating in bilateral trade agreements and in the Mercosur pact -and on a global scale through GATT, potential ties with EU, and the future hemispheric free trade area of the Americas (FTAA).

7. FOREIGN INVESTMENT IN ARGENTINA

Origin of Foreign Investment

Leading Foreign Investors: The main sources of foreign investment in Argentina are the US, Europe, and its closest Latin American neighbors, Chile and Brazil. The US has been the leading foreign investor in Argentina, topping the list in 1991 through 1994; US investors' share of the country's total foreign investment over the past four years was more than 40 percent. Much of that participation has been in the form of the purchase of privatized assets (primarily infrastructure assets), with the next most prevalent form representing capital investments in the consumer products, and automotive industries.

Table 10

U.S FINANCIAL INVESTMENT POSITION IN ARGENTINA (US\$ millions)

YEAR	PUBLIC SECTOR BONDS	SHARES AND CB	TOTAL INVESTMENTS
1992	853	1.148	2.001
1993	7512	10470	17982
1994	10127	13963	24090
1995	5574	9207	14881
1996	7648	12730	20378

Source: Bureau of Economic Analysis, US Department of Commerce, 1997.

Table 11

US DIRECT INVESTMENT POSITION IN ARGENTINA (US\$ millions)

PERIOD	POSITION
--------	----------

	(US\$ MILLIONS)
1974 - 1978	6818
1979 - 1983	12930
1984 - 1988	13338
1989 - 1993	15331
1994 - 1996	22426
TOTAL	70,843

Source: Bureau of Economic Analysis. US Department of Commerce, 1997.

Other principal foreign investors include those from Italy, Spain, France, Brazil, Chile, Germany, Switzerland, the Netherlands, and Canada. As noted, backing the overall foreign investment trend are bilateral agreements between Argentina and various countries, primarily those from Europe and the Americas. Typically, these bilateral trade agreements establish a government-to-government framework for channeling private investment and official financing and guarantees between firms from the participating nations. They also usually provide for international arbitration of investment disputes and grant foreign investors protection from uncompensated expropriation and full capita) repatriation rights (even in the event of a currency crisis). The agreements and new reforms have gone a long way toward reducing Argentine sovereign risk for all investors, not just those covered under bilateral national agreements.

Sources of foreign capital are expected to diversify in the wake of the continued expansion of free market reforms around the world. Argentina's rich natural resource wealth, relatively high national income, open market economic policy, and historical international bent should continue to make it attractive to foreign capital in the years to come.

Based on announced projects scheduled for completion between 1994 and 2000, the US should remain the major investor in Argentina, being involved in 35 projects and 5 additional joint ventures with Argentine or third country firms. French firms are participating in 7 projects plus 4 multinational joint ventures; UK firms in 7, plus 3 joint ventures; and German firms in 7, plus 1 joint venture. Other investors include Chileans (6 projects and 3 joint ventures); Canadians (4 and 2); Italians (4 and 2); Japanese (2 and 1); Mexican (2 and 1); Dutch (2 and 1); Brazilian (2 and 1); Swiss (2 projects); Australian (1 project and 1 joint venture); and the Irish and Venezuelans with 1 project each.

Investment Climate and Trends

Historical Perspective At the beginning of the 20th century, Argentina was a liberal democracy with the tenth largest economy and the sixth highest per capita income in the world. Its abundant natural resources, coupled with some of the best agricultural land in the world, attracted immigrants and development capital from around the globe. Indeed,

these factors --together with a largely middle class population of European ancestry -- made for a welcome and attractive environment for direct foreign investment. In the late 19th and early 20th centuries foreign investors, primarily from the US and the UK, rushed in to develop first infrastructure --ports, railways, and electric power and natural gas production and distribution facilities-- and later manufacturing operations.

For 1880 to 1930 the nation flourished with a stable currency tied to a gold standard and an annual average inflation rate of only 1.5 percent; between 1900 and 1920 gross domestic product (GDP) doubled. Moderate protectionism began to develop during the period of World War I; however, this focus on import substitution actually opened additional opportunities to establish manufacturing plants in Argentina. During these years, major foreign corporations from the US, the UK, and Germany opened plants to manufacture electrical products, chemicals, and pharmaceuticals and cosmetics. Unfortunately, the prosperous times wound down, and the Argentine economy was seriously damaged by the economic dislocations of the Great Depression.

Both demand and prices for Argentine exports fell dramatically, and the international climate of protectionism led to a domestically oriented economy and--during the 1940s--to the nationalization of some public services, such as railroads and power generation and distribution. Nevertheless, even during this period, foreign firms continued to establish Argentine plants to manufacture consumer durables for the domestic market, although they were hampered by a lack of locally available subcontractors, materials, and components. This situation led many operations to integrate vertically to produce the needed inputs. This expensive strategy was sustained by the monopoly and near-monopoly status the producers enjoyed in serving the isolated Argentine domestic market, but led to industries with a cost structure that was largely non-competitive in international markets.

Economic recovery and pent-up demand allowed markets to develop, and --in the late 1950s-- led to the enactment of a pro-foreign investment regime. This policy shift attracted investment, primarily in the automotive, petroleum refining, chemical and petrochemical, and machinery and equipment industries. The resulting surge in foreign investment led in turn to over expansion in some areas and a subsequent halt in new investment. Until the turnaround in policy that decreed an open economic system under the Menem administration in the late 1980s that made Argentina far more attractive to international investment, most foreign investment consisted of the incremental expansion and upgrading of existing operations.

Fortunately, the reforms of the Menem administration seem to be working in many critical policy areas. Argentina's economic problems are now little worse than those of many European countries. The days of high volatility in macro-economics variables and in government policy-making seem to have come to an end. The growing maturity of the system has begun to promise the stability that enables the longer range business planning critical to attracting foreign capital, and --perhaps even more important-- has begun to restore the public's confidence in the political and financial system.

Development of Liberal Investment Policies The unprecedented economic boom led by free-market reform has likely changed forever the pace of and attitude toward direct foreign investment in Argentina. Out of the depths of decades of managed economics and economic nationalism has emerged a more democratic, global market-oriented economy that is virtually wide open to foreign investors. Since 1989 Argentina has largely welcomed --and even actively encouraged-- foreign investment, facilitating it to a greater extent than ever before. Argentina has, in a few short years, developed what is arguably the most liberal foreign investment regime in Latin America.

The Menem administration's free market policies have swept away a great deal of excessive regulation, reduced tariff and non-tariff trade barriers, abolished the foreign exchange controls that had hamstrung its international economic posture, placed foreign and local investors on equal footing, and greatly reduced currency risk. In sum, the regime has created an entirely new playing field for foreign investors. Not surprisingly, some of the same investors who drained an estimated US\$50 billion in capital out of the country during the 1980s are now leading the charge to put their funds back into the economy under more favorable terms. Since the reforms of 1989-1991, more than US\$30 billion in portfolio and direct foreign investment has made its way to Argentina.

The privatization of state-owned businesses --such as oil giant Yacimientos Petroliferos Fiscales (YPF) and the national telephone company-- was a leading element in attracting foreign investment. The stabilization of the Argentine peso under the Convertibility Law (which pegged the peso to the US dollar on a one-to-one exchange rate), the opening of local financial and capital markets to restriction-free foreign participation, and the reemergence of local credit have provided the market liquidity critical to direct investment.

Elimination of Investment Barriers Crippling barriers to foreign investment --such as outright bans on participation in some sectors and discriminatory operating approval procedures-- have been removed. A 1989 amendment to the 1976 Foreign Investment Law provided for "national treatment," giving foreign investors the same rights and obligations as local investors. In 1993 measures contained in the 1989 Economic Emergency Law, the 1989 State Reform Law, and the 1993 Foreign Investment Law were combined in a single act known as Decree 1853, which has removed nearly all restraints on foreign investment. Now, with certain government-mandated exceptions, foreign entities may own 100 percent of Argentine companies and may repatriate capital and remit profits back to the home country without limit. In general --in contrast to recent years-- Argentine laws, regulations, and policies do not interfere with foreign investment.

In addition, the 1992 Bilateral Investment Treaty with the US, Argentina's largest foreign investor, guarantees US companies the right to invest in the private sector on a most favored nation basis, that is, at terms that are at least as favorable as those accorded to domestic or third-party investors. Other bilateral investment agreements are in force with Austria, Belgium-Luxembourg, Canada, Egypt, France, Germany, Hungary, Italy, Poland, Spain, Sweden, Switzerland, and the UK. In addition, treaties with Chile and Turkey had received congressional approval and awaited final ratification, while treaties

awaiting congressional approval were signed with Armenia, Bolivia, Bulgaria, Denmark, Ecuador, Finland, Jamaica, the Netherlands, Rumania, Senegal, Tunisia, and Venezuela. Further treaties or additional treaty provisions were under negotiation with Ecuador, Finland, Iceland, Indonesia, Malaysia, Morocco, Norway, Russia, South Korea, and the United Arab Emirates.

Favorable results of this long-standing international interaction between Argentina and other nations include standards of business that are more or less in line with practices in industrialized countries and a net positive relationship between Argentines and foreign business interests, making Argentina an attractive place for foreign entities seeking business relationships. And Argentina is perhaps the Latin American nation that is best disposed toward European and US business culture. Argentines are familiar with and continue to demand foreign products and services, which have long set the standard in the country. At present, this is particularly true for US goods such as consumer products and entertainment items. With local firms actively seeking foreign participation to raise capital and benefit from managerial and technological transfers, and the removal of all restrictions on capital movements, there seems to be few --if any-- better locations in Latin America for growth-oriented direct foreign investment.

Argentina's cumulative growth rate in its GDP of approximately 30 percent between 1991 and 1994 places it among the fastest growing in the world. However, growth has been largely concentrated in certain manufacturing industries and not all sectors have benefited. In fact, some provincial economies have actually contracted during this period. Industrial production has risen almost 60 percent since the implementation of the Convertibility Law.

Size of Foreign Investment

Cumulative, recorded, direct, non-financial foreign investment (investment other than portfolio investment placed in securities that can be liquidated rapidly --the so-called "hot money") in Argentina as of year end 1993 amounted to approximately US\$28 billion for the period 1990-1993, the third largest inflow among emerging markets worldwide (only Mexico and China received more foreign investment during the period). Significantly, nearly one-third of that total was in the form of investment in assets privatized by the Argentine government. Estimates for private capital inflow in 1994 vary, but should result in the addition of another US\$3 to US\$5 billion to the cumulative total. This is a dramatic turnaround for an economy that saw net private capital outflows of an estimated US\$50 billion during the 1980s; more than US\$5 billion fled abroad during Argentina's economic and financial turmoil in 1989-1990 alone.

In 1990 and 1991, more than US\$15 billion in net private capital made its way back into Argentina. Foreign investment reform, currency stabilization, the beginning of effective privatization efforts, and a drastic reduction in perceived country risk--which fell to less than 3 percent from almost 32 percent by one measure between early 1990 and year end

1993 were major contributors to this reversal. In addition, macro-economics and global financial market trends during this time, such as the beginning of a recovery from recession among the DECD nations, and a low interest rate environment that pushed global investors towards opportunities in higher-yielding emerging economies, added to favorable domestic conditions.

Foreign investment continued its heated pace during 1992, remaining strong in 1993 and 1994. The Deregulation Decree and the Bilateral Investment Treaty with the US, eliminating most restrictions on internal commerce and foreign trade, set the tone for investor optimism in 1992. Mass privatization continued unabated with foreign investors eventually becoming the beneficiary owners of more than one-third of all privatized assets. By the end of 1993, foreign companies had purchased nearly US\$9.6 billion in asset value of privatized entities. Private capital inflow in 1992 almost reached US\$8 billion and was slightly more than US\$5 billion for 1993. With privatization largely completed, the massive capital inflows of the early 1990s are expected to subside. However, assuming continued growth and stability, foreign investment should remain in a surplus position for the remainder of the decade, although observers expect annual flows to level off at a figure around US\$2 billion. Projects valued at more than US\$16.5 billion have been announced or contracted for between 1994 and 2000.

Sectors of Foreign Investment

As noted, the largest share of recent foreign capital has gone towards the purchase of privatized state firms and their assets. The second largest share of foreign capital inflows has gone to the private sector through equity investments and credit. Foreign direct investment is occurring through direct purchase of assets, mergers and acquisitions, and new business formations, primarily from major multinational industrial corporations.

Infrastructure sectors such as telecommunications, sewer and water, oil and gas, transportation, ports and port services, and mining have received the greatest portion of the capital inflows. Other sectors that have participated to a significant degree include manufacturing, especially of automobiles and household durable and non-durable goods, and the construction and housing industries. Government policy is currently encouraging investment in a variety of sectors, including mining, construction, the auto industry, energy, forestry, fishing, processed agricultural products, and tourism.

For projects scheduled between 1994 and 2000, the greatest number are in food, beverage, and tobacco processing, while the next highest number --and highest dollar value-- are found in the automotive sector, with 12 scheduled projects, mostly representing the expansion of existing operations. Some 12 projects represent various industrial and consumer manufacturing operations, while oil and gas production and distribution account for 8 projects; electric power generation and distribution for 5 projects; and mining operations for 3 projects. Other areas include various telecommunications and broadcasting projects; wood and paper products; and pharmaceuticals projects. Investment in services is also growing, with several

investments in large-scale retail and wholesale ventures being particularly noteworthy, as are investments in financial and business services, and hotels.

Table 12

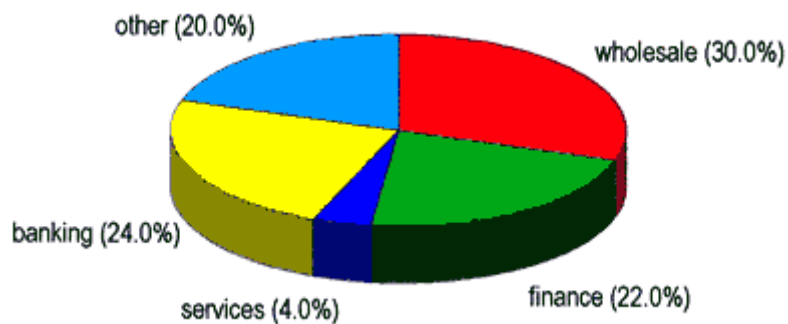
US DIRECT INVESTMENT POSITION BY INDUSTRY (US \$ millions)

INDUSTRY	1990	1991	1992	1993	1994	1995	1996
Petroleum	470	409	499	566	815	903	930
Manufacturing	1293	1461	1633	1993	2571	3576	3760
Banking	149	148	159	135	626	839	950
Wholesale Trade	337	361	430	552	603	1057	1250
Finance	168	302	538	578	801	801	860
Services	41	49	60	77	83	107	150
Other	21	362	35	455	445	699	850

Source: Argentina's National Security Commission, 1997. (Table 12 and Figure 7)

Figure 7

US DIRECT INVESTMENT BY INDUSTRY



Investment Policy and Changes

Foreign investment is legally defined as any contribution of capital belonging to foreign investors and/or the acquisition of shares of existing domestic enterprise using foreign capital. In general, any investment made by foreign individuals, companies, or unincorporated entities, as well as by Argentine companies with more than 49 percent foreign ownership control --or in which foreigners have the right to appoint and control the management of the entity-- is deemed foreign investment. However, investments made by foreigners resident full time in Argentina are generally classified as domestic investment, while those made by Argentine nationals residing abroad are considered foreign investment.

Investment Authorization and Procedures--National Registry of Foreign Investment
Foreign investors have the same rights and obligations that the Argentine Constitution and laws give to national investors involved in economic or productive activities within the country. At this time, foreign investment does not require formal approval and the registration on the Registro de Inversiones de Capital Extranjero (the Registry of Investment for Foreign Capital, or RICE) is optional, other than that decreed by specific legislation such as in the case of financial institutions and mass media. This does make for trouble in assembling accurate national investment statistics but does remove much of the red tape from the formerly cumbersome investment registration process.

The Secretaria de Comercio a Inversiones (the Secretariat of Trade and Investments) of the Ministry of Economy constitutes the nation's foreign investment authority. Foreign entities wishing to invest in Argentina for the first time are encouraged to contact this agency for specific information on the rules and regulations regarding the type of investment contemplated.

Foreign investors may make investments using any foreign currency, capital goods, capital or profits from existing operations denominated in local currency, or intangible assets under certain conditions. They may also invest by means of capitalization of accounts payable to foreign creditors. In short, just about any assets can be used for investing in Argentina. Investment can also be made by the conversion of foreign debt into equity. This is usually accomplished when foreigners who desire to invest buy sovereign Argentine foreign debt at a discount on international markets, submitting this debt to the Argentine government for cancellation, and receiving official assets valued at a peso equivalent in return. The investor receives assets rather than cash, and usually must plan on making additional cash investments for upgrades and working capital. This option is generally available only for public assets, although it may be possible to invest in private operations through debt-equity conversion by negotiating with the authorities on a case-by-case basis.

An investor may voluntarily register with the RICE. No benefits accrue to firms choosing to register, although at times in the past registration was required in order to obtain foreign exchange to repatriate capital and earnings. Registration consists of a formal notification including the following:

- Name and address of the foreign investor.
- Name and location of the target firm.
- Description and purpose of investment activity.
- Currency used and the amount of the investment.

For transactions between a foreign-owned local company and its parent that involve a technology or trademark transfer, assignment, or license by foreign nationals in favor of Argentine residents or entities, the parties must submit a registration request to the Instituto Nacional de Tecnologia Industrial (the National Institute of Industrial Technology, or INTI). Terms and conditions of the transaction and the consideration given should conform to standard market practices and have a reasonable relationship to the technology transferred. Such contracts between unrelated parties may be registered for informational and tax purposes. Patents, trademarks, and copyrights are protected in Argentina but, as is true worldwide, infringements can and do occur because effective enforcement is difficult. Investors are urged to familiarize themselves with local rules, customs, and practices in an effort to avoid infringement problems.

Foreign capital contributed in either portfolio or direct investments may be unconditionally repatriated at any time. Foreign investors have the right to remit earnings from their investments immediately, and registered foreign investors are allowed to use export proceeds for remittance abroad in the event that domestic foreign exchange controls go into effect that would otherwise restrict remittances. The federal government may suspend the rights of foreign investors only during a designated foreign payments emergency.

Reserved, Restricted, and Unrestricted Investment Activities Prior federal government approval was necessary under the 1976 Foreign Investment Law for investment in sectors such as defense, telecommunications, mass media, banking, publishing, insurance, and a number of other industries. Recent changes have eased this requirement. There are no special operating or performance requirements for foreign investors.

Barriers to entry may still exist in one form or another. Foreigners are barred from direct investment in uranium mining or nuclear power generation as a matter of national interest. Some restrictions also continue in mass media. Foreigners have reportedly been denied broadcasting licenses, although their participation is not officially prohibited either by law or government policy. Foreign investors may only enter the fishing and insurance industries through purchase of a controlling interest in an existing Argentine operation, as no new licenses are being issued in these sectors at this time. However, unlimited entry will likely be permitted in the insurance industry subsequent to ongoing restructuring and reform.

Investments in banking and related services are not restricted, but foreign participation (ownership of local banks and the opening of branches or subsidiary operations of foreign banks) must be approved by the Banco Central de la Republica Argentina (the central

bank, or BCRA). Such permission is decided on a case-by-case basis and depends on the nature of the investment and the investor, and the situation in Argentina at the time of the application.

Investments in non-mining activities in frontier areas require permission from the National Superintendent of Frontiers, a part of the Ministry of Defense, although investment in mining activities in these areas is unrestricted. The government is in the process of modernizing federal mining codes, and provincial governments are actively seeking to develop mineral resources in the western half of the country. Foreign investors are being actively encouraged to participate in this development. Chilean companies have already become heavily involved in mineral exploration in these areas.

Most of the past state monopolies --such as those that existed in communications, oil and gas exploration and production, airlines, railways, port operations, and distribution of water, power, and fight--were disbanded by the government's prior privatization efforts. Foreign investors have been allowed to participate in privatization on an equal footing with national bidders, and foreigners accounted for nearly 40 percent of such investment.

Special Considerations and Arrangements for Foreign Investors As is the case with any foreign commitment, the investor should exercise extreme caution before proceeding with the investment. This means acquiring extensive knowledge of all applicable rules, regulations, and policies, as well as familiarity with the historic and current local market situation. Detailed study of the country's markets may protect against costly errors that could result from misunderstanding the foreign investment terms and conditions. In view of the recent, rapid change in the economy's structure and in Argentine commercial codes and rules regarding foreign participation, it is especially important for foreigners to familiarize themselves with the current environment and local market players.

Although generally allowed to own real estate directly in most of Argentina, foreign investors may face restrictions on land ownership near international borders (both land and coastal borders). Ownership of this type of property is subject to the prior approval of the Superintendent of Frontiers in the Ministry of Defense.

Investment Incentives

All formal investment incentive programs requiring direct federal budgetary expenditures were suspended or eliminated by either the Economic Emergency Law of 1989 and the Deregulation Decree of 1991. Now, foreign investment incentive policy is based on the concept of national treatment towards foreign companies seeking establish operation abroad.

8. REASONS FOR INVESTING IN ARGENTINA

Inferring from the detailed responses given by US firms with established operations in Argentina in the survey (Please see Appendix D), it is evident that Argentina currently possesses a very favorable environment in which to seek new business opportunities. In comparison to its neighboring Mercosur countries, Argentina represents a new, reformed and stable economic model that means "boundless opportunities for business growth for American wishing to invest there." (Questionnaire respondent).

A. The investment environment in Argentina

1. Economic Fundamentals

Commitment to economic stability

After its experience with continuing inflation during the 1980's and especially after the hyperinflationary peak of 1989, Argentine society established a serious commitment to economic stability. As a result, people have been providing steady support for the strict fiscal and monetary discipline upon which Argentina's economic policy is based. American companies have recognized this grass roots commitment as a true guarantee of economic stability in the long run.

Very low inflation

Companies based in developed countries are extremely cautious about inflation, so much in fact, that it affects investment decisions in their own country. So it is no coincidence that Argentina's foreign investment boom really began with the Convertibility Plan of April in 1991 (a few months after Mercosur came into effect) and which dropped inflation to record-low levels, going as low as 0.2% for the whole of 1996. This trend, as can be seen in the following table, has been reinforced in recent months.

Table 13

ANNUAL INFLATION RATE, CONSUMER PRICES

YEAR	% INFLATION RATE
1989 (record high)	1086.60%
1990	950%
1991	84.50%
1992	17.50%
1993	7.40%
1994	3.60%

1995	1.60%
1996	0.20%

Source: Ministry of Economy, Public Works and Services 1997.

Table 14

ANNUAL INFLATION, 1996, SELECTED COUNTRIES

COUNTRY	INFLATION RATE %
Argentina	0.20%
Spain	3.40%
Korea	4.60%
Chile	7.90%
Greece	9.10%
China	9.90%
Brazil	20%
Mexico	43.80%
Venezuela	78.30%
Italy	4.50%

Source: The Economist, 1997.

Convertibility

US companies place great value on the guarantees that the Convertibility regime offers. This scheme on the peso (Argentina's currency) being pegged and directly convertible to the US dollar at a fixed rate of 1 peso = 1US\$. By law, the Central Bank of Argentina must sell dollars at this rate as demanded by the market, as well as fully back the monetary base with international reserves. Bound by the Convertibility Law, all of these rules are central to Argentina's economic policy and are applied rigorously. This system provides companies with a series of guarantees that make Argentina one of the safest places in the world to invest.

1. **Fixed exchange rate: protects the value of investments and earnings**
2. **Backing with reserves: guarantees convertibility of pesos to dollars**
3. **Total freedom of exchange: allows remission of the total invested capital and earnings at any moment.**

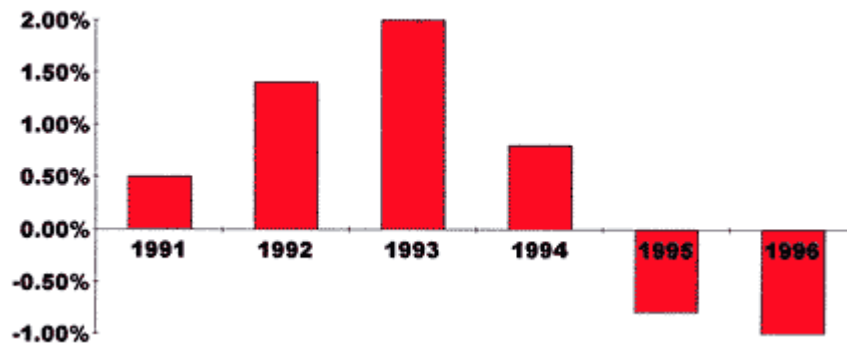
4. **Bi-monetary system: allows bank deposits, payments and contracts to be carried out in dollars.**

Monetary and fiscal discipline

US firms based in developed countries specifically value austerity in monetary and fiscal matters. Within the framework of Convertibility, issuing money is limited to incoming foreign reserves. Furthermore, management of government spending is quite rigorous. Argentina is one of the few countries in the world which has kept its public sector accounts under strict control during the last few years. (Baxter, 1997).

Figure 8

PRIMARY FISCAL RESULT WITHOUT CAPITAL RESOURCES in % of GDP



Source: Ministry of Economy, Public Works and Services 1997.

B. A strong, dynamic market

The Argentine Market

Many US companies, especially those targeting consumer markets, have realized that by investing in Argentina they gain direct access to 34 million consumers with a per capital GDP of US\$ 8,200, a mature and diversified market offering countless business opportunities. Its dynamics are impressive: from 1990 to 1997, the GDP grew from US\$ 179 billion to US\$ 319 billion. Projected estimates for the years 1998 and 1999 approximate US \$344 billion and US\$ 370 billion. (Please refer to Appendix A: Profile on Argentina)

Mercosur

What is even more significant from the standpoint of US companies making huge investments for large-scale production, like the automotive industry, is the fact that by

investing in Argentina, they gain access to Mercosur. This is the common market formed by Argentina, Brazil, Paraguay and Uruguay. As mentioned previously, Mercosur has a combined population of 200 million and a GDP of US\$ 900 billion.

C. A pro-business environment

A favorable social environment

When referring to direct investments, especially those with long pay-back periods, it is important to bear in mind their exposure to "political risk". US investors are very susceptible to the social environment present in the host country. With regard to this, Argentina is a democratic nation where people really believe in free enterprise. Furthermore, there is a strong consensus about the need to maintain both monetary and fiscal discipline. Besides, there are no ethnic or religious conflicts. The population, mainly of Italian, Spanish and German descent and belonging to the middle class, have a high level of education. (Diaz, 1996).

Minimal government intervention

The development of new business is greatly favored by freedom of action. Argentina is one of the countries in the world with the least state interference over private enterprise. (Mosbacher, 1997).

There is total freedom for setting process and wages. In fact, some regulations which were still in place, especially in the areas of wholesale and retailing, foreign trade, professional services, transportation, seaports, banking and insurance have been eliminated. A system of competitive markets has been set up in previously state-owned or highly regulated sectors such as electric power production and the oil industry. This has exposed protected sectors to free markets, thereby lowering costs and generating new business opportunities.

Privatizations

The privatization program initiated in 1990 gave tremendous impulse to foreign investment, not only for its direct effects (US companies took great part in the bidding process during privatizations), but also for the indirect effect resulting from Argentina showing commitment with free enterprise. The bidding process itself, which demanded competing consortia to have ample previous experience in their respective fields, made it necessary for them to include US companies, being that local private firms lacked expertise in privatized industries such as utilities and railways, which had been state-owned monopolies until then.

Among the privatized companies were airlines, the state telephone company, railroads, electric power generation and distribution companies (including hydroelectric power plants), the state oil company (YPF), oil fields, steel mills, seaports, radio and television

stations. By the end of 1996, the total value of privatized companies reached US \$40 billion. (Fidler, 1997)

Taxing system

American companies pay particular attention to taxing systems, penalizing countries that eat into their income with abusive taxes. Quite to the contrary, Argentina's taxing system tends to burden consumption more than business earnings. Relatively low by international standards, the tax rate for company profits is 30%.

D. A well-educated workforce

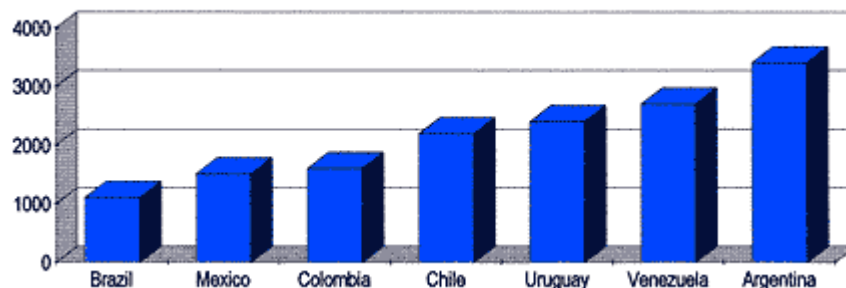
A tradition in education

Finding skilled labor, capable of working efficiently in an organizational and technological environment similar to that of developed countries, is indispensable for an American company's success in local operations. Given the national tradition of investment in education going back into the last century, Argentina has an undisputed edge over the rest of Latin America in this area. The literacy rate of the population over 10 years of age is of 96.3% and the enrollment rate at elementary schools is just short of 100%. (Diaz, 1996).

Argentina has one of the highest rates of university enrollment in the world. Consequently, it is no surprise that labor is comparable in skills and aptitudes with that of most developed countries, especially at technical and professional levels. With more than 2 million university graduated professionals, Argentina offers a large, well-educated and skilled labor force. (Fidler, 1998)

Figure 9

UNIVERSITY STUDENTS per 100,000 inhabitants



Source: UNESCO -1996 Statistical Yearbook for Latin America

E. A vast supply of natural resources

The existence of an abundant supply of natural resources enables countless business opportunities, based both on their direct exploitation as well as on the provision of goods and services to these activities. Moreover, they are an especially valuable asset for growth in the long run.

Oil and gas

Argentina is not only self-sufficient, but also exports oil and by-products such as fuel and gas oil. Fuel exports climbed to US\$ 1.6 billion in 1996, representing more than 10% of the total value of exports. Current crude oil production is 40.2 million cubic meters a year and detected reserves are ten times this level. Gas production is 27 billion cubic meters a year and detected reserves are 20 times this level. (Baxter, 1997)

Hydroelectricity

With a 7.4 million kilowatt yield, Argentina's hydroelectricity plant represent 45% of the electric power capacity of the country. During the next four years (1998-2001), hydroelectric production capacity will increase by 30% due to the addition of new generators at the major plant sites. (Madigan 1998).

Fertile lands and regional micro-climates

Within the 190,000 square kilometers of Argentine arable land, the world's, most fertile farmland can be found. Stretching from semiarid regions to subtropical forests, the great diversity of micro-climates and ecosystems enables the harvesting of a great variety of crops. In addition, the low cost of land suitable for forestry and the high rate of forest growth (surpassing the average in leading forestry countries), have resulted in significant investments in this area.

Mining

Argentina is considered "the world's final mining frontier" (Diaz 1996). Its extensive mineral deposits, located long the borders with Bolivia and Chile, have a geological structure similar to that of these countries with long mining tradition. Since deregulation and the opening of the sector to private companies along with the approval of the Mining Investments Law in 1993, which provides fiscal stability for 30 years and a series of tax exemptions, a number of large mining projects are underway. Most of these have been taken on by foreign companies. Estimated investments for the next five years are in the order of US\$ 1 billion. (Baxter, 1997).

Fishing

With a 4,700 kilometer coastline, Argentina has an extensive maritime zone of exclusive economic use. it is considered one of the best fishing areas in the world. Within it, an

abundance of valuable species can be found. Aide from local fishing fleets and through established agreements, fleets from all over the world fish in Argentine waters. In 1996, the total catch yielded 974,000 tons, of which 634,000 were for export. (Carlsson, 1997).

F. An attractive site for foreign investors

The current environment for US investments in Argentina is without a doubt one of the most attractive in the world. (Hoke, 1997). The key elements in creating these favorable conditions are:

Zero Bureaucracy: US companies do not need to register with the government in order to operate in the country. Forming a company entails the same procedures regardless of whether capital comes from a US investor or a local one.

National treatment principle: US companies receive the same treatment as local companies. While in Argentina, they have open access to all economic sectors, including those often reserved for local companies in other parts of the world, like telecommunications, cable television, nuclear energy, airlines and defense industries. Furthermore, US companies have equal access to incentive programs and contacts with the government.

Free transfer of capital and earnings: At any time, foreign companies may transfer the total amount of profits and of invested capital without any delay or quantitative restriction.

Bi-monetary system: In Argentina, a peso-dollar bi-monetary system is in effect. Banks accept deposits and checks in dollars and the law allows making contracts and payments in foreign currency.

Quality of life for foreign/ US executives: Argentina's major cities are very safe by international standards and enjoy a cosmopolitan atmosphere. They offer a great variety of high quality cultural activities. International schools offering foreign curricula teach in English, French, German, and Italian as well as in other languages.

A tradition in welcoming foreign companies: Although it is true that the current boom of foreign direct investment projects originates in 1991 with the Convertibility Plan (previously discussed), Argentina has maintained a friendly attitude towards foreign companies throughout its history, especially American firms.

10. BUSINESS OPPORTUNITIES FOR US FIRMS

Argentina ranks very high to many American businesses looking for new international opportunities. It is the wealthiest nation in all of Latin America on a per capita basis. As mentioned before, it has a very favorable environment characterized by economic stability, liberalization of trade laws, the reduction of tariffs, the drastically reduction of inflation rate, and a steady growing economy. (Campbell, 1997)

The vast opportunities existing for American companies can be classified into the following:

1. Export opportunities
2. Foreign investment opportunities through privatization
3. Public procurement opportunities

A. Export opportunities

Argentina demands a wider range of goods to meet business expansion and upgrades in diverse sectors as well as the wants and needs of its consumers, particularly those of its battered but recovering middle class, still the largest in Latin America. Since 1993, this demand for USA made goods has leveled off somewhat following this initial boom period, but a moderate to strong demand continues to exist virtually across the board for capital, intermediate, and consumer goods.

In addition, even when domestic industries are filling most of the current demand in their particular markets, they are increasingly relying on imported materials and components from the United States, as well as on capital goods, creating additional markets for US suppliers. And the overall demand for goods is expected to continue to be greater than the country's ability to produce them for some time into the future. (Please refer to Questionnaire Responses). A majority of the respondents listed this as a crucial reason for new opportunities: the increased demand for goods and services that the domestic production cannot serve due to lack of capacity.

The consumer demand can be broken down most easily into the different types of products and industries as follows:

AGRICULTURAL PRODUCTS

Agriculture and food products: Although Argentina is one of the world's top food exporters, there are a number of items the country is importing from the United States to an even greater extent. These include prepackaged convenience foods --especially snack foods-- and processed fruit and vegetables products. In 1996 the market for processed fruit and vegetables reached US\$ 2.2 billion (60% of which is was satisfied by US production).(National Trade Data Bank, 1997)

Agricultural chemicals: Argentine demand for USA-made agricultural chemicals will continue to grow because of the importance of the agricultural sector to the country's economy and the shortfall in domestic productive capacity, which is unlikely to be

reversed in the short term. In particular, the need to improve yields through use of fertilizers, pesticides, and herbicides -which have been traditionally used sparingly in Argentina -is expected to drive this market. The import market for these products was about US\$ 55 million in 1996 with an annual growth rate of 4% projected for the next four years. Currently American firms cover approximately 55% of the market with other major European chemical companies being the major competitors.(National Trade Data Bank, 1997) Competition from local suppliers is only moderate, and trade barriers are few. To date few international suppliers have developed a strong presence, so there is ample room for new American suppliers to establish relationships.

Agricultural Equipment: Argentina's government realizes that it must make additional investments in more and more sophisticated farm machinery to increase efficiency in its agriculture sector, having invested little in this area in recent years. The government is offering special lines of credit for agricultural producers and the level of investment is expected to grow, especially for tractor and tillage equipment, and particularly for used farm machinery that allows operation upgrades at a reduced cost. Modern agricultural technology is also needed because some farmers are switching to less familiar crops creating a new demand for USA made specialized equipment which currently dominate in satisfying this new need.

Food processing and packaging equipment: The opening of the Argentine economy to competition from overseas suppliers has created an opportunity for those American companies who wish to export state-of-the-art processing equipment and other labor-saving devices to the Argentine agricultural sector. The 1996 market for such imports rose by 15% from the previous year to US\$ 120 million. (National Trade Data Bank, 1997) The competition from local suppliers and other countries has been no more than moderate and the trade barriers few, offering a great opportunity for US suppliers of processing equipment for both traditional and nontraditional products and processes.

Table 15

AGRICULTURE ITEMS IN DEMAND

bailers, new and used	fish processing machinery
cold storage facilities	meat processing machinery
snack foods	miticides
cotton harvesters, gins and modules	processed fruits and vegetables
fertilizers	insecticides
dairy products machinery	used tractors
	planting seeds for fruit, vegetables, and grain crops

Source: National Trade Data Bank, 1997

AEROSPACE

The market for commercial aircraft in Argentina has begun to rebound after a decade of stagnation. Airlines Argentines and Austral --the newly privatized national carriers-- are updating their domestic fleets and are expected to begin investing in transcontinental aircraft to upgrade their international service. As a result, this US\$ 310 million annual market is expected to expand considerably over the next several years. As the Argentine economy recovers, the market will also improve for executive jets, turboprops, and helicopters.

As Argentina moves to upgrade and modernize its air fleets to become internationally competitive, the need to improve airport conditions is also growing. "Argentina is seeking to upgrade its air transport infrastructure and modernize its navigation systems to support the growth in air traffic and this has meant wonderful new business for us." (Questionnaire respondent from Lockheed Aircraft).

International competition to service and supply the Argentine market is relatively heavy, and trade barriers are few. Aggressive marketing and attractive financing are the inroads into the Argentine air transport equipment markets.

Table 16

AEROSPACE ITEMS IN DEMAND

air traffic control radars
approach and landing aids
avionics
executive jets
helicopters
passenger aircraft
ground support equipment

Source: National Trade Data Bank, 1997

COMPUTERS AND SOFTWARE

In 1996 the total Argentine market for computers, peripherals, and software stood at about US\$ 500 million, and was growing at an annual rate of about 10% for software and 15% for hardware. Imports account for nearly 75% of the software and almost all -90%- of hardware sales. Banks, other financial institutions such as insurance companies in particular, and commercial firms have been the largest users of computer products, but demand from utilities and heavy industry is growing as these sectors are privatized and their operations are modernized and streamlined. "The market for our computer products

has increased dramatically in the last decade; the boom has been phenomenal for Unisys and the opportunities are still growing at record speeds". (Questionnaire respondent)

Companies such as Unisys which offer a full service package, including hardware, software, installation, training, and follow-up technical assistance, are likely to be most successful. There is little competition from local suppliers, trade barriers are few, and intellectual property protection and enforcement is improving.

Table 17

COMPUTER PRODUCTS IN DEMAND

hardware for local area networks (LAN servers)
word processing software
general business application software
laptop notebook computers
minicomputers
operating systems software
printers
personal computers
operating systems software

Source: National Trade Data Bank, 1997

CONSTRUCTION MATERIALS

The far-reaching overhaul of Argentina's retirement system and the resurgent development of the mortgage lending sector is generating capital for new housing and commercial developments. Environmental legislation is also playing a role in this market, as industries revamp their facilities to comply with more stringent controls. In 1996 the total market for such infrastructure was about US\$ 750 million, with imports representing only about US\$ 85 billion.

Even though this market has been largely supplied by domestic producers within the past decade, competition has been increasing for them especially regarding modern high-tech materials. It is in these further developed materials that US companies have the greater opportunity for market penetration. "The greatest area focus has been chemical additives and prefabricated housing in the outer-city suburbs of Argentine's provinces." (Questionnaire respondent from Lone Star Industries). Special items in great demand include: fastening and power tools, concrete molds, chemical additives, and prefabricated housing.

ELECTRICITY

The electric sector in Argentina has been privatized. Many of the power distribution facilities are outdated and in need of repair. US corporations can take a role in generating, distributing, and managing power operations and in providing equipment to upgrade facilities. Although international competition is relatively stiff, there is only moderate competition from local suppliers and few trade barriers. The market in the electric power sector is projected to grow at an annual rate of 25% from 1996, opening new opportunities through rapid expansion.

Table 18

ELECTRICITY ITEMS IN DEMAND

dry cells
electrical wires for low voltage distribution
fuses for low and medium voltage distribution
monitoring devices for electrical generation, transmission
and distribution
switch boxes for electrical consumption data control
transformers

Source: National Trade Data Bank, 1997

HOUSEWARES

As Argentina's middle class recovers and its buying power increases, so will the opportunity to export many household items into the country. However, this is highly competitive market. Due to the general need for housewares of virtually all categories and all quality and price levels, and the recent reduction of import barriers, the housewares sector has attracted numerous suppliers. But, new opportunities remain for new American suppliers prepared to identify and serve market niches. Items in special demand in this category include: cleaning supplies, appliances or "white goods", silverware, tools, and glassware.

INDUSTRIAL EQUIPMENT

Plastics processing machine and equipment: sectors generating the highest demand for this include packaging, beverage bottling, and construction. This market currently represents US\$ 60 million. Competition is moderate from local suppliers, but intense from international providers with barriers being very low. US companies are currently the leaders with major European brands following.

Pollution control equipment: the need for these is growing as industry and government become increasingly aware of environmental concerns. The major area is water quality control, in which several new global companies have begun to compete for. The 1996 market was approximately US\$ 5 million but is expected to grow by at least 10% per year in the next four years. (National Trade Data Bank, 1997)

Products in great demand include: bottling equipment, liquid industrial effluent treatment plants for medium sized equipment, packaging equipment, water and sewage treatment equipment.

MEDICAL AND SCIENTIFIC EQUIPMENT

Imports from medical equipment represented over US\$ 350 million in 1996. The estimated average annual growth rate in the market for the period 1994-1999 is 13%. Competition from local suppliers is small, especially in high-technology equipment. Presently, the United States is the number one supplier of both medical and scientific equipment. However, there is a particular niche that has yet to be fully exploited: supply of scientific equipment for agricultural and natural resources industries (specially oil) which need advanced materials to remain competitive. The market in 1996 for such equipment was US\$ 8 billion, but is also expected to continue growing with emerging areas opening for US suppliers.

Demand for these specific products exists and is increasing rapidly: prosthetics, lasers, scanning microscopes, x-ray apparatus and tubes, pacing monitoring systems, quality control instruments, and MRI (magnetic resonance imaging) equipment.

MOTOR VEHICLE AND VEHICLE PARTS

Strengthening the important automotive industry is still a high priority for the Argentine government. recent relaxation of import restrictions have opened up the market for automotive products from other countries, including replacement parts for these imported vehicles. Although there is a large domestic auto parts industry, it is primarily designed to serve the rather narrow range of domestically built models, leaving wide open the provision of parts for imports. Not all imported parts are model-specific: spark plus, gaskets, and diagnostic equipment for computer controlled fuel injection engines are popular generic imports. In 1996 imports represented approximately US\$ 760 million and the estimated annual growth rate from the period 1996-2000 is 5% (National Trade Data Bank)

OIL AND GAS FIELD MACHINERY

The privatization of the oil and gas industry has created opportunities for US suppliers of field machinery. Private operators are now concerned with increasing both productivity and corporate profits. Equipment needs to be upgraded to expand and increase capacity

and efficiency to meet the new standards imposed by international competition. Competition from local suppliers is significantly low because local industry lacks the capability to produce the more sophisticated equipment required. The market is growing steadily having reached US\$ 100 million in 1996. Items specifically needed include: cementing equipment, compressors, control devices, meters, injection equipment, pipeline equipment, and valves.

TELECOMMUNICATIONS

Currently, hundreds of telephone lines throughout Argentina are being modernized and rehabilitated to provide an underlying infrastructure to support private investment in equipment. Once the work on the lines is complete there will be a demand for high-tech equipment and services as Argentine firms begin to upgrade their equipment with state-of-the-art telecommunication systems. Imports represent US\$ 370 million but are expected to increase dramatically by the end of the century. "Argentina represents an amazing potential market for Nortel's services and products ...from fax machines, cellular phones, and fiber optics ...to signal switches... the possibilities for expansion in the future are immeasurable." (Questionnaire respondent from Nortel Telecommunications).

The cable and television market also represents significant export opportunities for American firms. The existing network of 1,000 cable operators who have as subscription of 4 million customers is expected to grow by twice fold in the next decade. (Hinkelman, 1996) Other areas opening up worth mentioning include: sporting goods, toys and computer games, and electronics. However, in these sectors US companies face severe competition from other firms especially from southeast Asia.

B. Foreign Investment Opportunities through Privatization

As mentioned previously, billions of dollars are being invested in a number of Argentine enterprises that the state formerly owned and operated. In the oil, gas and electricity sectors alone, about US\$ 25 billion is expected to be spent in the next few years to upgrade and expand privatized operations. About US\$ 1 billion will be invested in water and sewage programs. Several billion dollars will be spent to improve transportation networks, ports, and telecommunication services.

The privatization process continues. Airports, seaports, three nuclear mint, and the country's largest petrochemical plant are all scheduled to be privatized by the end of 1999. All of these privatizations will create opportunities for American investors who wish to participate in auctions for the facilities and in the rebuilding and expansion of these operations. Privatization projects exist in a number of sectors including electricity, franchising, legal services, mining, oil and gas, tourism, telecommunications, power generation, and transportation.

Table 19

MAJOR OPPORTUNITIES FOR US COMPANIES IN PRIVATIZATION SECTORS

Source: Herrera-Vegas, 1996

Electricity

The privatization of the electric industry has created opportunities for foreign investment. Demand for electricity continues to increase, and there is a concurrent need to upgrade electrical generation, transmission and distribution facilities.

Franchising

Opportunities for franchising are now booming in a number of product areas. Both foreign and domestic operations have opened franchises (restaurants, beauty stores, sporting goods, etc.) Activities are set to double within next four years (1998-2001) to US\$ 550 million.

Legal services

A number of legal and consulting services are required for the many privatization projects and the future demand will be for legal services dealing with corporate mergers, international trade, capital markets, tax law, environmental regulation, and international litigation. Even though foreign lawyers are not permitted to fully practice in Argentina, there is a growing demand for outside legal consulting.

Mining

Investment in mining infrastructure or expansion of existing operation has increased due to recent mining law and regulatory structure which provides numerous benefits. Observers are forecasting strong growth in this sector of the economy and by the year 1999 it is estimated that mining production will double to account for 5% of GDP.

Oil and Gas

Investment opportunities exist in the establishment of plants to explore and develop oil holdings throughout the country and to pump gas across wide areas in order to supply domestic needs and the needs of bordering countries (i.e.: Chile)

Telecommunications

There are numerous opportunities for American investors in underwriting the installation of large-scale telecommunication networks and the sale of smaller scale goods and services to private consumers.

Other notable sectors include:

* Tourism: with opportunities for American investors in a wide range of areas: airport services, camping sites, car rental services, catering services, credit lines for modernizing hotels, and for extending the business of tour operators, convention centers cultural centers, airlines, resorts, etc.

* Power Generation: through privatization projects involving major hydroelectric power plants as well nuclear plants, the federal government has invited foreign investors to bid as a concession for sale.

* Financial Sector: a number of Argentine provincial and municipal banks are to be offered for privatization. Americans are being encouraged to invest in existing entities, such as the public ones being offered.

Other smaller-scaled privatization efforts include petrochemicals and forestry management enterprises.

C. Public Procurement Opportunities

The volume of public procurement has decreased in a number of areas since the privatization of many of the country's state-owned companies took effect; in particular, those that relate to oil, gas, certain transportation services, ports, and telecommunications are now in private hands and are developing their own means of bidding and financing. However, the government is still very much involved in the transition process and although many purchases are not strictly "public procurement," they will certainly be transacted, in some form or another, under the government's sponsorship or aid. In many cases, the government's role has changed from owner of public services to regulator of them, continuing to retain a certain degree of control over standards and procedures.

Some of the billions of dollars raised by the government during the privatization process, much of which was spent to reduce the federal deficit, will also spent on future projects.

The government has established priority sectors for the investment of such public funds. These include:

1. Social sectors of education, health care (especially for mothers and infants), and water and sanitation services
2. Economic sectors that integrate education with industrial production, advance scientific and technological research, rebuild transportation infrastructure, increase environmental protection, and goods and services
3. Law enforcement and public safety
4. Governmental reform at the federal, provincial, and municipal levels.

A number of government-sponsored projects have recently been initiated in the areas of computer systems, environmental protection, oil pipelines, roads, railways and waterways, social infrastructure development, and decentralization and improvement of secondary education. All of the mentioned undertakings represent wondrous opportunities for American companies seeking to invest in growing Argentine operations. (Campbell, 1997).

Whether it is in the area of exporting goods and services, directing foreign investment to special projects by means of privatization, to public procurement incentives, the room for continuous and sustained growth is unmeasurable. Argentina is in a critical period of its long term economic recovery and the doors it has opened will benefit not only its current conditions, but also enable US businesses to expand their operations to the country. (Hinkelman, 1996)

11. SOCIAL IMPACT OF ECONOMIC REFORM IN ARGENTINA

Never have things looked so good for Argentina, at least not since the 1930s, when it was among the 15 richest nations in the world. Economic growth just hit 8% on annualized basis for the second quarter running, fed by vast new investments in everything from auto plants to vineyards. (Friedland, 1997). Inflation which soared unchecked for years, is non-existent and government finances are in such good shape that Mr. Menem boasts that this South American country meets the criteria for membership in the European Union better than many EU members.

Yet, never has such a broad cross section of Argentines been so bitter about their prospects. In recent weeks, they have taken to the streets and highways by the thousands in protest, riled by an unemployment rate of 17.3% and lagging wages. Argentina's economic restructuring has meant a heavy dose of harsh reality for its people and some domestic industries. Privatization and system wide restructuring have inflicted casualties: about 400,000 employees in what had been thought to be safe, private, and previously sacrosanct government operations have lost their jobs, and the stark reality is that there as yet simply no new jobs for many of these people in the new Argentine economy.

Although the privatization of big state enterprises over the past seven years has brought the country needed technology, better service, and in many cases, lower prices for everything from plane tickets to electricity, many Argentines are still opposed to the government's policy of getting the state out of business. These concerns come against the backdrop of a string economy, spurred in large part by the efficiencies unleashed when the government sold off energy, telecommunications and transport.

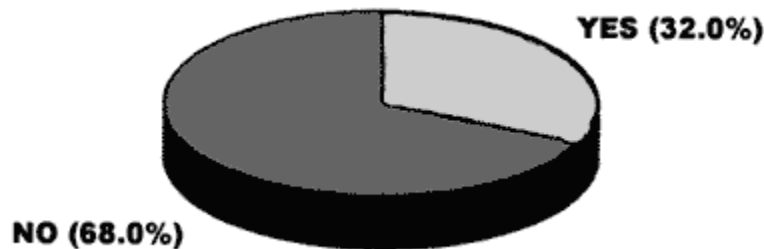
What is not doing so well is domestic consumption due to the big side effect of Mr. Menem's free market policies, that is unemployment. Particularly hard hit is Argentina's

once coddled middle class, which lost the patronage of what was once a benevolent, yet bankrupt government. This temporary decline in the middle class spending means that "Argentines are not appreciating the benefits of privatization".

In a recent poll conducted by Clarin (leading local newspaper) to 10,000 Argentines across the classes the following results were given to the question: Do you believe the latest privatization projects to be beneficial to the nation?

Figure 10

ARGENTINE OPINION POLL ON PRIVATIZATION



Source: Clarin Newspaper, 1997

Supporters of the structural economic reform argue that the gap between expectations and the positive macro-economics numbers will close soon enough, turning Argentina into an Asian-style exporting giant with rising wages and jobs for all. (Warn, 1997). But most Argentines still hold values brought from Europe by their grandparents and parents, values that were reinforced by the paternal promises of Juan Peron. General Peron, the populist caudillo who ran Argentina from 1946 to 1955 and again briefly in the 1970s, created an all embracing partnership between unions and the state, in which political support was traded for extraordinary benefits.

However, most Argentines do not want to live in a place like South Korea or Thailand. They want to live somewhere like the Netherlands, where the state puts emphasis not just on global competitiveness, but on the welfare of the people. The clash between these two visions, aggravated by widening income inequality and the conspicuous consumption of the wealthy is becoming more acute by the day. This is the crux of the issues facing this resource-rich nation of 33 million. Although Argentines got used to the European-style safety net woven together by General Peron and those who followed him, by the 1980s a vast and inefficient state had bankrupted the country. It is no time for them to realize the short-term sacrifices will create long-term growth and recovery for the future generation of Argentines. (Friedland, 1997). Future decline in the unemployment rate is visible as sustained GDP growth is sought to bring jobs well into the year 2000 (as a result of a projected unemployment rate of approximately 10%. (Fidler, 1997)

Figure 11



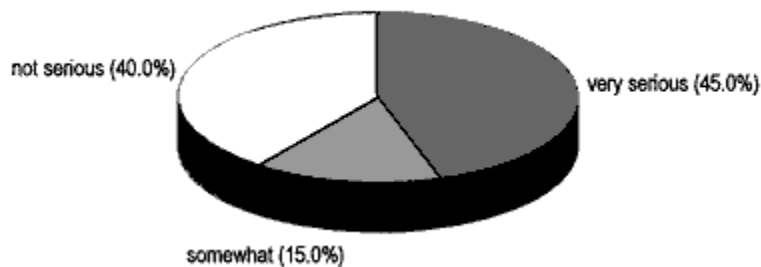
Source: Fidler, 1997

Opinion polls show that voters believe corruption is Argentina's second largest problem after unemployment. But much corruption is small scale, typically involving a junior official or employee who requests a small payment or favor for easing the path of a negotiation. According to Argentine popular opinion, government is smaller, thanks to privatization, but it is not yet obvious that private sector behavior has improved. Indeed many people still feel business practices among many companies to be questionable. (Fidler, 1997).

In another recent survey a group of 4000 individuals ranging from college students and professors, to business executives and nurses were asked to define the issue of corruption in Argentina today. They were asked: "Would you say corruption is a very, somewhat or not a serious matter at all?"

Figure 12

CORRUPTION IN THE MINDS OF THE ARGENTINE



Source: Clarin Newspaper, 1997

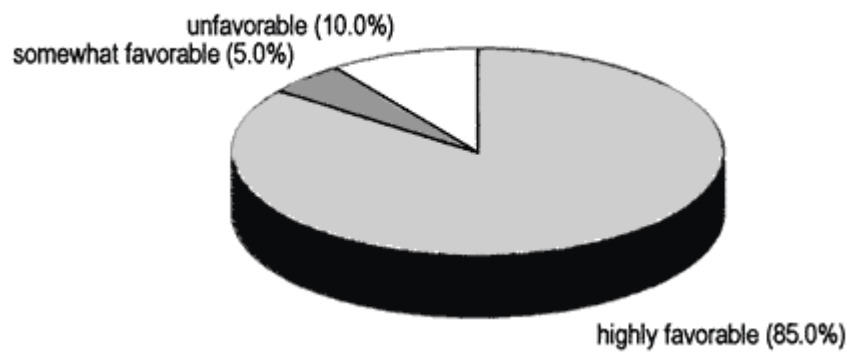
Clearly, the issue of corruption is not as urgent as that of unemployment. A large number of Argentine believe that current corruption is not a serious problem at all. This may very well be the case if one looks back at past figures and corruption evidence. Without a doubt, corruptive activity has subsided somewhat due to stricter control and decreasing inefficiencies in government enterprises. This is evident in the results presented in the survey above. There is also a greater perceived sense of national credibility as a result of less major corruption.

Adding to Argentina's international credibility are its increasingly solid trade ties. Together with Brazil, Paraguay, and Uruguay, it has formed the South Cone common market or "Merco" as most Argentine refer to it. It is with great optimism that a great majority unite to support the achievements and long term goals of Mercosur. There is no other existing subject within Argentina in which all people agree with the most. No matter what class, educational attainment, profession or age, Argentines are supportive in voicing their positive opinions regarding the regional agreement. (The Economist, 1997)

There appears to be a consensus regarding Mercosur's "more than favorable" influence on Argentina as a whole. (Warn, 1998). Among the most popular reasons included are that: Mercosur has become a powerful presence in the negotiations for a free trade area covering all of the Americas by 2005 and its increased active role in world trade stage enabling Argentina to be seen by the rest of the world. Other reasons mentioned are the eventual transfer of all factors of production allowing people from the member nations to move across the borders (culture attainment, educational and labor transfer) with no difficulty whatsoever and the increased "bargaining power" of the larger market in terms of global trade and investment.

Figure 13

**MERCOSUR'S OVERALL IMPACT
(based on survey to 10,000 individuals)
1997**



Source: Warn, 1998

Argentines seem to be very optimistic about the country's membership into the South Common Market, however they are more concerned about their domestic and internal climate and the immediate improvements needed in the area of unemployment, welfare, inter-political battles, and the temporary erosion of the middle class.

However, there is an inevitable chance that Argentina's reforms will continue because the old solutions have been shown to be unworkable and there are enough politicians committed to the new ideas, enough personnel capable of administering them, and, perhaps most compelling of all, fresh memories of a far worse past that should help both the public and the government to keep each other on a steady course.

12. CRITICISMS ON MERCOSUR

Ever since Brazil, Argentina, Paraguay and Uruguay formed the Mercosur customs union in 1991, free-trade supporters have worried about whether the Southern Cone might become a protectionist fortress. This fear has been further fueled by a recent World Bank study by Alexander Yeats, principal economist for the bank's International Trade Division, contending that a significant amount of the increased trade within Mercosur is a result of trade diverted from more efficient non-Mercosur producers to less-efficient producers within the bloc. (Hudgins, 1997).

If true, this would be bad news. The region is in desperate need of greater market openness; a Mercosur fortress would lead to a less competitive region. But such a conclusion is far from certain. In order to judge Mr. Yeat's work, it is first necessary to establish the criteria by which to judge any trade policy. As a rule of thumb, governments should take every opportunity to open markets. Trade barriers restrict the freedom of individuals to exchange their own property with citizens of other countries. tariffs are taxes that punish individuals for making choices of which their governments disapprove. Further, economic liberty is the only known path to growing productivity, prosperity and good-paying jobs. Thus all trade liberalization, like all tax cuts should be applauded.

Critics of Mercosur must show that it is a faux free-trade zone that reduces net liberty by increasing the cost of importing goods from other countries, and thus harms consumers within Mercosur. Mr. Yeats certainly does not succeed in doing this.

Mr. Yeats's study shows that Mercosur exports have grown to \$61.89 billion in 1994 from an annual average of \$34 billion for the 1984-86 period. But he observes that a greater share of these exports is between Mercosur countries, 19.5% now compared to 6.7% in the mid-1980s. America and Western Europe have become less important destinations. But Mr. Yeats ignores other reasons for shifting exports. For example,

communism's fall in Eastern Europe in the late 1980s no doubt has meant Western Europe turns more to those markets for trade. (Nogues, 1997)

Significantly, total imports into Mercosur jumped to \$78 billion in 1995 from around \$29 billion in 1990. Purchases from the U. S. grew to \$17 billion in 1995 from \$6.68 billion in 1990. This is not surprising, since the Mercosur countries have been reducing trade barriers to nonmember countries as part of their World Trade Organization commitments. This import surge certainly does not suggest a Fortress Mercosur in formation. (Devlin, 1997).

Mr. Yeats goes on to offer a calculation of trade intensity he says will "highlight the relative importance of (seemingly minor) changes in trade between countries that have relatively small global trade shares." He looks at the variation from expected bilateral trade patterns based on a trading partner's share of world trade. But the fact that a statistical microscope is needed to make such variations visible suggests that they are of little policy importance.

A seemingly more plausible concern is raised by Mr. Yeats's calculation of expected exports by Mercosur countries in light of their comparative advantages. For example, auto manufacturing is one of Brazil's largest industries. If that sector were growing more competitive, would one not expect its exports to take a greater share of both Mercosur and non-Mercosur markets? Mr. Yeats finds that in this key, capital-intensive sector, Brazil is not penetrating third markets. But it will require time and tough marketing for Brazilian cars to take market share away from American- and Japanese-made vehicles. In any case, customer choices, not mathematical calculations of theoretical comparative advantage, determine the "correct" share of a market.

The Mercosur auto story is more complex than can be encompassed in a single calculation. In the early 1990s Mercosur countries reduced tariffs on autos to 20% from as much as 100%. As auto imports into Mercosur surged, Brazilian auto manufacturers screamed that they would collapse without special protection. Brazil's government restored high tariffs and other restrictions, giving the industry three years to adjust to competition. This was unsound policy. It resembles America's restrictions on Japanese imports in the 1980s. It limits the freedom of Brazilians to purchase foreign-made cars, though possibly no more than the situation before the creation of Mercosur. But it does not suggest a developing Fortress Mercosur. The reaction of Brazil's Mercosur partners to this auto arrangement perhaps is most instructive concerning the virtues and dynamics of regional agreements. These partners, angered by Brazil's move, did not follow its lead. Argentina kept its tariffs on autos low, guaranteeing its consumers greater access to vehicles from non-Brazilian suppliers. And its Mercosur partners will keep the pressure on Brazil to end its protectionism in three years, as it has promised.

What, then, are the lessons of this flap over Mercosur? First, regional trade agreements by definition give preferential treatment to suppliers in member countries and probably

cause some trade diversion. But as long as no new barriers are erected to nonmember countries, there is no loss of freedom to citizens in the member countries. Yes, it would be better if each country eliminated its barriers to all other countries. But since that's not politically possible, countries should establish free trade where they can and fight the next battles for open markets where the opportunities arise.

Second, statistics should not set off panics about inappropriate policies. For example, Mr. Yeats observes that the spreads in tariff rates between Mercosur countries and nonmembers are far higher than the spreads created by other regional arrangements, such as NAFTA and the European Union. But Mercosur countries began with some of the world's highest tariff rates. The spreads are not a result of new trade barriers. Mr. Yeats's insight, if true, suggests no policy action.

Increased economic liberty should be the primary goal of trade policy. If Mercosur countries create a customs union by raising trade barriers to nonmembers, then citizens of member countries could have freedom restored with one hand and stolen with the other. Import substitution by any other name still would be a failure. Mercosur needs open markets to provide the consumer goods that are incentives for workers to be productive, the inputs for enterprises, and the competition to force enterprises to become efficient. And Mercosur countries need to continue to deregulate their domestic markets. They should avoid policy harmonization that preserves government control of economies and leads to the kind of stagnation experienced now by the EU.

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