Unity is strength

Regional integration, not protectionism, is the right response to fears of deindustrialisation

IN RECENT years there has been a swagger about South America's biggest economies. Brazil was not only the B in BRIC, but it also had a thing or two to teach the world about how to run a modernising economy. Argentina has nearly matched China for growth in the past two years. Now, suddenly, the confidence is giving way to fear. The worry is that competitors from Asia are eating the region's lunch.

South American currencies have been strong and the region's costs have been rising. Although China is no longer as cheap as it was (see previous leader), it remains a formidable competitor. It has been taking bites out of local manufacturing, especially in Brazil and Argentina. And Brazilian industrialists are starting to lose ground throughout the Americas, their main export market.

The governments of Brazil and Argentina, petrified of deindustrialisation, are resorting to protection. Argentine officials now require some importers to match their orders with exports, an absurdity that has led to car firms selling wine. The Argentine government no longer grants automatic import licences to Brazilian firms, making a mockery of the rules of Mercosur, to which both countries belong and which once aspired to be a proper customs union. In a more limited way, Brazil has also caught the protectionist bug. It is threatening to tear up an agreement with Mexico that allows free trade in cars between the two countries (see page 48).

South Americans are right to worry about deindustrialisation. It has been almost impossible for large countries to become developed economies without strong industry. But attacking the symptoms, not the deeper causes, may make the problem worse. The main losers from higher trade barriers will be consumers who have to pay higher prices for cars and other products, while industrialists pocket undeserved profits.

The underlying problem in Brazil is that high interest rates and taxes, plus deficient infrastructure, make doing business in the country expensive. That problem-the "Brazil cost"-has been aggravated by the strength of the real. Part of the currency's appreciation comes from the inflow of short-term capital seeking to profit from those high interest rates (9.75% even after this week's cut). Brazil is justified in trying to deter such flows through taxes and controls, though it should also eliminate the fiscal deficit which helps to drive up those rates. But in part the real's strength is a reflection of the greater wealth in Brazil, which has just overtaken Britain to become the world's sixth-biggest economy. Industry will have to get used to it.

Time to resurrect the FTAA

To her credit Dilma Rousseff, Brazil's president, is trying to cut the Brazil cost, albeit timidly. But a recourse to protectionism sends the wrong message. Instead, Brazil should be leading a new push to tear down barriers within Latin America as a whole. Consider its agreement with Mexico. The car industry in both countries has benefited because, by offering a larger market and more economies of scale, it has encouraged specialisation. That, in a nutshell, is the case for regional economic integration. Yet, despite a torrent of rhetoric and a mountain of presidential summits in recent years, integration has languished. Latin American countries export much less to their neighbours than do their counterparts in other continents. Huge distances are partly to blame. But trade is also checked by higher tariffs, hold-ups at customs, a tangled skein of separate trade agreements and poor transport links.

Brazil and Argentina should look to Mexico. After seeing manufacturing jobs migrate to China, Mexico's industry is now growing again. That is partly because of its wide network of trade agreements, including the North American Free-Trade Agreement with the United States. It is also because higher wages and transport costs are making Chinese goods more expensive. A decade ago Brazil walked out of talks to turn NAFTA into a 34-country Free-Trade Area of the Americas. Many industrialists in São Paulo now regret that. After all, their chief market is in the Americas. It could and should get bigger. But it won't happen if governments put up more trade barriers. ■

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