

Without a fairly level macroeconomic policy "playing field", the trading relationship between Argentina and Brazil could run into serious difficulties despite the existence of MERCOSUR trade rules and a common external tariff. In conditions of severe economic stress, the member states of MERCOSUR may find it difficult to place their treaty obligations above their immediate national interests. The Treaty of Asunción recognizes this danger when it stresses the importance of coordinating macroeconomic policy. Unfortunately, the treaty does not specify how and when this coordination is to be achieved.

3. Different Paths: Economic Policy in Argentina and Brazil

There is, in fact, a divergence in economic policy coherence and commitment between Argentina and Brazil. A comparison on a wide range of economic issues shows a better economic track record in Argentina and a consistent pattern of greater government intervention in the economy in Brazil. This is not to say that there is no need for further reform in Argentina. Argentina's financial and administrative systems especially need to be improved. The current policy of pegging the Argentine peso to parity with the U.S. dollar is unsustainable over time and should be revisited sooner rather than later. However, it is clear that economic reform has been more extensive and more successful in Argentina compared to Brazil.

Argentina has made considerable progress in achieving a high degree of fiscal responsibility under the Menem Administration. The federal government's budget was balanced in 1994. 1995 has been more difficult because of the ripple effect of the Mexican peso crisis and the beginnings of a recession in Argentina. The government has cut spending and raised taxes. This program of fiscal restraint has been successful, with the fiscal deficit for the first quarter of 1995 lower than expected. The 1995 budget forecasts a US\$ 2 billion surplus, although this forecast may be too optimistic.⁵

In contrast, the fiscal situation in Brazil is considerably less stable. The complexity of Brazil's fiscal arrangements makes it difficult to measure the precise size of Brazil's public sector deficit. The federal government has adopted a complicated

⁵ "Argentina: EIU Economic Outlook", Economist Intelligence Unit, Reuter Business Briefing, 10 July 1995. Argentine provinces are an area of fiscal weakness. However, the provinces' combined fiscal deficit was \$3.7 billion, or only 0.5% of GDP, in 1994. The IDB recently lent Argentina US\$ 750 million to restructure the provincial banks, a source of much of the provinces' fiscal weakness. See "IADB Approves \$750 Million Loan For Argentina", Reuter News Service, 10 May 1995; "Menem Battles With States to Cut Costs", Economist Intelligence Unit, Reuter Business Briefing, 23 May 1995.