THE PERSPECTIVE OF THE WORLD REVIEW

Volume 2 | Number 3 | December 2010

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The Perspective of the World Review

An international publication by the Institute for Applied Economic Research (Ipea), a body belonging to the Presidency of the Federative Republic of Brazil. It was created to promote contemporary debates emphasizing the theme of development from a South to South perspective and seeks to formulate proposals for the development of public policies, as well as to encourage international comparison with a focus on the scope of political economy.

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Volume 2 | Number 3 | December 2010

Brasília, 2012

ipea

The Perspective of the World Review / Institute for Applied Economic Research. – v. 1, n. 1, (Dec. 2009). – Brasília: Ipea, 2009.

Triannual.
ISSN 2177-0255

1. Economics. 2. International Economy. 3. Economic and Social Development. 4. Sustainable Development. 5. Public Policies. 6. Periodicals. I. Institute for Applied Economic Research.

CDD 330.05

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FOREWORD

The Perspective of the World Review is an international publication organized by the Institute of Applied Economic Research (Ipea) a body pertaining to the Secretariat for Strategic Affairs (SAE) of the Presidency of the Federative Republic of Brazil.

Published in Portuguese and English, its aim is to present and promote debate on contemporary themes, with a special focus on development, from a South-South perspective. In the field of economic policy, it applies a variety of approaches to examination of the essential dimensions of development and of economic and social aspects relating to sustainability.

The objective is to enhance debate with a view to presenting proposals for public-policy makers, by highlighting international comparisons and interdisciplinary approaches, with emphasis upon the role of planning. *The Perspective of the World Review* takes up the challenge of presenting issues faced by contemporary civilizations in their quest for comfortable living standards and dignified livelihoods, while at the same time bearing in mind the Planet's physical and environmental limits.

The title of this publication implicitly honors Fernand Braudel, by adopting his phrase *perspective of the world* which, alongside other memorable expressions such as *structures of everyday life* and *exchange games* underscore his originality. Braudel always sought to approach issues pertaining to dimensions of development from an historical and long-range perspective, emphasizing that, in a world dominated by means of production based upon capital accumulation, it has always been necessary to balance society, the market, and the State. According to the teachings of this master, where this balance has been effectively achieved, prosperity has ensued; whereas, where difficulties are more persistent, outcomes have been less successful.

In Brazil, this initiative is not new, the great trailblazer being Celso Furtado in his work *Formação Econômica do Brasil* (The Economic Growth of Brazil). This seminal work was greeted by Braudel for its innovative methodological approach.

LETTER FROM THE EDITOR

It is with pleasure that the Editorial Board of *The Perspective of the World Review* presents yet another issue to the public. The magazine was founded with the aim of promoting an exchange of ideas on economic-policy issues, from a South-South perspective. That the publication is fulfilling its mission is attested by the content that follows, as the articles in this issue focus upon questions relating to Africa and South America.

The problems Africa faces are by no means simple and, on current evidence, it appears unlikely that any one uniform solution can be found in the short-term, especially not in a context of strong international turbulence. Their causes hark back to interventions by colonial empires, initiatives of which were to bring on immense problems for the continent. Foremost among these were:

- establishment of colonial territories, bearing little relation to the spatial distribution of the various peoples who had formerly lived in them; and
- exploitation of peoples through enslavement of black populations.

It is hardly necessary to state that such interventions led to veritable disaster which has yet to be overcome, as is testified by the number of armed conflicts, the inequality of access to income and properties and, above all, the poverty and difficulties for fostering development, even once growth is resumed. In the light of all this, stimulating debate and awareness of international public opinion as to local problems, and fostering discussion among intellectuals and policy makers is always worthwhile, especially when the views of local players are given priority.

Problems faced in Latin America, though not exactly of the same nature, may nonetheless provide insights for debate on African issues. The main difference resides in the fact that, in the former, governments that secured independence from the metropolises earlier have had a longer period in which to construct and mature as States and to pursue political, economic, and institutional solutions for addressing challenges in the development process. This difference underlies the ample debate on cooperation and union among countries.

Lastly, despite their difficulties and diversity, it is the presence of developing or so-called emerging countries that is assuming increasing importance on the international stage and that is a source of innovative responses to the international crisis. Many such proposals have been targeted toward establishment of a new institutional model at the multilateral level, that is more democratic and better adapted to the interests of their peoples. If such initiatives are successful, the doors to promoting development in many countries will be open to a South-South approach.

THE STATE IN AFRICA

Beluce Bellucci*

ABSTRACT

Africa still faces major challenges, particularly with respect to such factors as religions and ethnic groups, among others. An understanding of the African State requires knowledge of various aspects, at both national and international levels. From a Western state-model standpoint, the African experience entails investigation of fields such as territory, language, technology, production methods, and the trend toward a neo-liberal State. Changes undertaken have sought not only development, but also a restructuring of economies to align them to the world market, and have resulted in improved prospects for progress in Africa.

> In Africa, seldom is ethnicity far removed from politics; at the same time, however, it does not provide the raw material for development. Within the scope of the contemporary State, ethnicity serves, principally, as an agent for accumulation, either of wealth or of political power. Tribalism is thus perceived as a political force in itself, and as a channel for expression in disputes for the acquisition of wealth, power and status.
>
> J. F. Bayard

1 THE STATE, POLITICS AND THE ECONOMY

There are many prejudices in relation to Africa, and these include notions relating to the State, religions and ethnicity, all of which will be examined in this text. Ideas formed by hasty judgment and science or special interests which, subsequently, circulate among intellectuals and laypeople, lead to comparisons between what is to be seen from a western standpoint and analyses of African societies based upon western societal models. Over the long term, such views have led to stigmatization of African States, by affirming that, having been established by colonial law, they merit such epithets as "external", "quasi-state", "artificial" or "pseudo-state". In counterpoint to this view, Jean François Bayard (1989) proposes a historical view of the State in Africa built upon the bases of pre-colonial State traditions and on the colonial experience. Contemporary African States have received influences both from colonialism and from pre-colonial kingdoms and empires, and are based both upon the Rule of Law and upon ancestral political traditions. These alternately draw near to and keep a distance from religion. Such phenomena are complex, making understanding and management of the African State more challenging.

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An understanding of the African State may be found delving within itself, or through its connections with the outside world; in the institutional aspects of power, in its central decision-making bodies, its leaders and administrators; in bodies where negotiation takes place and agreement is reached; and in the production of public goods and services, all of which are permeated by traditional and modern values.

The debate on the African State is extensive and the literature presents a number of historical reviews, current analyses, and alternative proposals.

When enquiring about tradition in the Modern African State, one often hears references to polygamy, female excision, solidarity networks, hierarchies and social obligations, the weight of ancestors, duties of the young, rites and cults of the pagan religions, regional and ethnic mores and customs, and the way in which Africans, in their domestic economies, relate with power.

Which of these features is incompatible with a project for modernity? Which clash with universal values? As of that point, new questions may be raised. What is the aim of modernity today? One century ago, modernity sought to "civilize" the "savages", by making them accept the Christian religion, the habit of wearing clothes, responsibility at work (above all else) among other things. Today it is well known what this "civilization" imposed by colonialism really entailed: forced labor, migration, compulsory cultivation, payment of taxes in cash, corporal punishment, imprisonment, massacres, banishment, denial of citizenship, legal segregation, and underdevelopment. These were the facets of modernity meted out to the African colonies. In counterpart, those colonized gave their labor, the fruits of which were appropriated and transferred to the metropolis. The latter became richer, accumulated capital, built infrastructure in its (European) territory, thereby becoming more knowledgeable and cultured. It became civilized to the point of requiring that Africans (not without their own participation and complicity, once they had become citizens of sovereign States) adopt the "civilized" standards of the moment: firstly, development and a strong State, and subsequently freedoms and the minimal State. First dictatorship, later democracy.

The rights to life, happiness, democracy, freedom and progress, held to be universal values, are generic abstractions that unfold as procedures, institutions, deadlines and particular rites, varying by region, ethnic group and country. How can these features be harmonized, while imbuing universal values with a historical setting? Polygamy, for example, can not be criticized outside its historical-social context. If the actual practices which brought it about have not changed, it is unlikely to be uprooted. What can be observed, even now in the 21st Century, are domestic societies living much as they did before, in terms of productive, cultural, religious and political aspects. Certainly, the proclamation of monogamy as a universal value and repression of the practice of polygamy will not bring about its demise. Polygamy will only be abolished when its material bases no longer exist. Even more complex are the religious values which, dominated by individual faith and belief, are easily transferred to other material bases, and thus continue to propagate magical values within scientific societies.

In summary, the Western State model is used as a reference, supported by concrete data, to conclude that Africans are unfit to manage their State and, therefore, that westerners should do it for them (as they did under colonialism); or that these States should be dissolved, restoring the kingdoms and tribes of old, thereby enabling local and regional governance that is "better adapted" to the ways of Africans.

The task currently being undertaken by Africans is a redefinition of the concept of *African democracy*, so as to draft a State model that incorporates Africans' historical and cultural processes alongside the scientific advances of this third millennium. This task entails not only an epistemological effort, of reason, but also the outcomes of social practices undertaken. However, the current crisis of the State has been accompanied by social difficulties throughout the continent, and the identity crisis that the western model is currently undergoing. The process of internationalization increasingly intertwines the history of the African continent with that of the rest of the world, so that it both influences and is influenced, thereby making it explicit that the historical responsibility and the quest for a new model are tasks to be pursued by all, and not just Africans. Since the crisis of 2008, the neoliberal model has come into question, and there are signs that new perspectives may be explored.

1.1 The African experience

> "Nationalism came before the nations. The nations do not form States and nationalisms, but rather the reverse." Hobsbawm

Following the wave of independence in the 1960s, debate took place between the pro-capitalist and pro-socialist schools, but such discussion always focused on how to maintain tradition within modernity.

What from the historical past should be preserved? Whether to adopt the language of the colonizer as the national language, or give preference to a local language? Should the borders drawn at the turn of the 20th Century, after the Conference of Berlin, be maintained or redrawn? What system of government should be adopted, monarchy or republic? These, and many other themes, were examined by leaders and intellectuals of the period and influenced the creation of the nations. Few States kept their traditional kings in power, as did Swaziland, where the king still reigns. All adopted the language of their colonizers as a common language, with the exception of Somalia, which already had a national language of its own. Likewise, at the founding of the Organization of African Unity (OAU) in 1963, option was made for the maintenance of the colonial borders and national governments, despite the great influence of Pan-Africanism among its leaders.

The African State in the second half of the 20th Century was forged by Africans, who fought — to a greater or lesser degree, achieving domestic legitimacy – following the model of *pax americana,* which had achieved political victory in the anti-colonial struggle and was economically strong.

The State appeared as a modernizing force; a transformer of traditions that hampered development; strong and centralized, when not dictatorial; capable of defining and executing public policies and actively participating in all fields of the social and economic life of society. The outlook for the future was promising: all the rest was mere sentimentalism. Under discussion was the dosage; not the medication. The great debate centered upon capitalist ideals and socialist ideals (which is no mean argument).

In the literature, many criticisms are to be found claiming that the post-colonial State was waylaid by bloodthirsty dictators and unscrupulous persons, and that this explained all the evils of the continent.[1] They forget that such people exist not only in Africa, but everywhere, and that they are still very much in evidence. The correct question, then, is: why, at that time, did dictators command the nations? Indeed, at that time, this was also occurring in other parts of the world, notably in Latin America. What can be observed is that, it was not the State changed because men changed, but that men changed (or rather, their style did), because the economic policies changed. Those were the men required to perform the tasks before them: some being more competent, others more personable. In Africa, many such leaders remained in power, even after having radically changed their attitudes and political thought. That model, in the circumstances of the Cold War, facilitated, when it did not demand, dictators.

With the crisis of the 1980s, as hostages to international aid grants needed to face up to their domestic crises, the African States were cowed into adopting the neoliberal model.

At that time, the previously-advocated Strong State was deemed outmoded, and privatization and a decentralization of functions, with civil liberties, good governance and free flows of capital were in vogue. Traditional African values flourished in this power vacuum, encouraged by non-government organizations (NGOs), by religious groups, and by the discourse of international experts from organizations such as the World Bank, the International Monetary Fund (FMI)

1. As, for example, Biyoudi-Mampouya (2008).

and the United Nations Development Programme (UNDP). After all, it was postulated, if modernity is no longer to be attained via industrialization or building of a domestic market, why modernize minds? If modernity is now ecological, the natives should revert to their cultures, production, rites and religions. Such positions were endorsed by various African leaders and disseminated by NGOs.

In the second decade of the 21st Century, still suffering the effects of low production, economic and political crisis, civil wars, endemic health issues and the destruction of school systems, despite some signs of recovery of economic indicators in recent years and having found new international partners, Africa still has no new State model with which to underpin its rebirth. It lacks theoretical and practical bases; but is now feeling its way, speculating and criticizing, rather than simply lamenting. New forms of participation are being sought and, in some places, the masses are beginning to take to the streets (much to the chagrin of leaders and dominant classes) evidencing hope for change.[2]

Accepting and understanding the weight of ethnic groups and of regions, and also of the African religions (be they traditional or syncretic) within state institutions and decision-making bodies is crucial for understanding how they work.

Beyond the rationalism inherent to public institutions, the African State is a place of power (in the traditional sense) with primordial functions in society (solidarity and obligations) and, whereas society continues its pre-contractual relations, based on extra-economic ties, such power will surely prevail. There are reasons to believe that groups and countries that maintain external relations with the continent will remain interested in maintaining domestic pre-capitalist or post-modern relations with Africa, in the same way that the people seek forms of participation in decision making.

In this context, classification of the African State into five periods — *i)* traditional (or pre-colonial, until the 19th Century); *ii)* colonial exploitation (from the end of the 19th Century until World War II); *iii)* colonial valuation (from World War II until the early 1960s); *iv)* independent developmentalist (up until the 1980s); and *v)* the Neoliberal State (from the 1980s to the present day) — helps us understand the changes that have occurred and, during each of these phases, the types of governments, institutions, and specific economic, social and cultural policies that have prevailed, imbuing each with an identifiable individual "face" in each period, in the light of modern and traditional, internal and external pressures.

2. In this regard, see events in Mozambique at the beginning of September 2010, where popular demonstrations against an increase in the price of bread and the cost of living in general led to a retreat by the government but left more than ten deaths. "When appraising the situation (which will probably be repeated, not only in Mozambique but also in other African countries, as it was in 2008 when, for the same reasons, the 'revolt against hunger' broke out after rises in the price of rice in many parts of the continent) it becomes evident that 'something is rotten in the kingdom of globalization" (National Union of Peasants (UNAC) Mozambique, 2010).

2 THE AFRICAN STATES UP PRIOR TO THE 19TH CENTURY

Africa has experienced various forms of social organization, ranging from segmented societies to centralized models. The distinction between societies without a State and centralized systems[3] postulates that the former are based upon groups organized around the extended patriarchal family, with common heritage, i.e., clans, with common ethnic ties, under the authority of an elder. For their part, centralized systems also preserve social stratifications, configured as casts or orders, and range from sultanates to kingdoms and States.

The great West African empires, such as Ghana in the 8th Century, Mali in the 14th Century, and Songai and Bornu in the 16th Century, were organized politically on the basis of trade with the Arab world. Their towns were built on the banks of rivers and dominated vast expanses of hinterland. They were characterized by religious and political ties, by personalized power, by lack of a written language, and by decentralized organization. The central authority held a monopoly on material goods and lived off tribute paid in goods and men, and revenues from taxes on harvests and cattle, levies on metals, customs duties, and booty from warfare. Tribute provided the economic bases of some empires, such as those of the Wolof of Senegal and the Hausa cities of Nigeria.

Exchanges took place in the local market, and medium and long-distance trade depended upon the safety of trade routes. Exports consisted of gold, slaves, kola nuts, gum, ivory and hides; and imports of iron and copper bars, pearls, and cloth. Despite their economic power, comparable to that of the Arabs and Genovese and Venetian merchants, these States never achieved overseas conquest nor established strong local economies.

Although currencies had long circulated in certain African regions, they were not used for purchases, but rather, for payment of debts in parallel to the merchant economy. This was the case of cowries, pearls, bars of salt or of gold, which were equivalent to goods and chattel, as were women in matrimonial alliances or men in times of war.

Currency in circulation thus reached only a part of society. Monetized mercantile, fiscal and tributary networks did not constitute a monetized society, with debits and credits, enabling transfers of possessions or property of real or symbolic value (HUGON, 2009). Thus, money did not penetrate the interior of the African continent. It did not assume all the functions it has in a capitalist economy: general equivalence, means of exchange and of payment, store of value and deferred payment, or basis for accumulation. In gift economies of segmented, little-stratified societies, the giver affirms superiority in

3. On this subject, see Evans-Pritchard and Meyer-Fortes (1964).

relation to the receiver. The receiver is obliged to reciprocate with a counter-gift at a later time, i.e., he becomes indebted. Differently, in hierarchical societies, tribute delivered is the mark of one's submission to the sovereign who receives it. The circulation of prestige goods displays ties between wealth and power, as power is an accumulation of social ties and of symbolic goods, and not merely of material goods.

> If we were to make a fair distinction between one type and another, the number of African societies that have a separate political organization (the empires, kingdoms, city-states, chieftainships or sultanates) would certainly be greater than that of societies considered without a State in the classical sense, thus contradicting the view of traditional Africa as a mosaic of clans and tribes or of societies recently emerging from prehistoric humanity (Dozon, 2008, p. 24. Free translation).

And this is taking into consideration that affiliation to groups and lineages constitutes one of the essential vectors of these States (especially at the level of dynastic organization) and that population movements make borders movable and uncertain.

Pre-colonial African States ensured unity, order and the defense of territories they had conquered and, upon installing administrative, judicial and military bodies, they overturned the previous social organization; i.e., they were dynamic structures in constant transformation. They were societies that acknowledged social divisions, had aristocrats, priests and field workers, both freemen and slaves and, furthermore, various closed casts subject to prohibitions, such as blacksmiths, musicians and sculptors.

These societies possessed longstanding traditions and state culture, even if, as a whole, they did not last very long or possess great capacity to control their territories. They were societies in which clear divisions existed, between oppressors and oppressed, exploiters and exploited, i.e., they were aware of the mechanisms of domination and of exploitation. A number of African kingdoms remain to this day. Kings legitimately ascend to the throne and exercise their obligations, and the aristocracies and casts display their status, even when such manifestations are officially forbidden in today's States.

Aside from political systems, Sub-Saharan Africa has myriad beliefs, rites and representations of both the living and the dead, which are also viewed with prejudice by westerners. The "religion of fetishism"[4] invented in the 18th Century has been presented as magic and is despised and looked down upon as the work of the devil up to the present day.

4. The pioneer of this line of research was Charles Brosses who, in 1760, in Geneva, published, *Du culte des dieux fetiches or Paralléle de l'ancienne religion de l'Égypte avec la religion actuelle de la Nigritie* (cf. Dozon, 2008).

Traditional religions revere mythological entities, ancestors and spirits, organized into symbolic and cultural systems that have a place within political and social organizations. Thus, lineages were collectively upheld by genealogical ties, but also by the myth of the founder and by common legend, placing before them the same obligations and interdictions. Kings were accompanied by priests and identified with supernatural powers, blending divine power and earthly power, in this sense no different to western monarchies.

Symbolic and cultural systems, however, were ruled by historical movements and underwent changes in response to events. In situations of extreme poverty or epidemics, whole populations would change their territories and abandon their goods; the same would occur in response to conflicts and institutional crises. Groups would abandon their cults and appropriate the cults of neighbors, thereby demonstrating great flexibility in molding themselves to circumstances.

This capacity to adapt also applied to contact with Islam and Christianity. The Islamic theurgic and divination arts were accommodated into local systems. With Christianity, symbols such as the cross were incorporated, taking on new meanings and giving rise to syncretic cults. For these reasons, the words spell (*feitiç*o), fetishism and animism fail to do justice to African paganism (Dozon, 2008).

The presence of Christianity in northern and eastern regions of Africa harks back to the first centuries AD. Beginning in the 15th Century, along the Atlantic seaboard, Europeans evangelized fugitives from slavery, the banished, and traders hooked up to the economy of merchant trading posts. The major Christian missionary thrust, however, was contemporary to the European colonization which advanced upon Sub-Saharan Africa throughout the 19th Century and took part in the establishment of new territories and the formation of States. Its participation in colonial activities was of greatest relevance in Central, Southern and Eastern Africa, having lesser influence in Western Africa where it was blocked by the presence of Islam.

The "invention of Africa"[5] was a form whereby colonizers appropriated African paganism and classified it in accordance with their interests. They identified the pagan gods, and those deemed compatible with Christianity were classified as civilized; those that were not, were demonized.

This activity relied upon participation of Africans, especially through religious syncretism that blended components of local cults and cultures with aspects of Christianity in the struggle against fetishism and witchcraft of the local cults. In this contact, the African custom of changing rites and gods was based upon the notion that their gods were no longer protecting them from the penury brought

5. Expression used by Mudinbé (1988).

on by colonialism. The modern "strong men", prophets or "modern sovereigns" ended up replacing the "strong objects" that comprised the magical world.[6] This phenomenon proliferated also into Muslim territories, with messianic movements proclaiming adherence to the Koran against the colonizers.

3 THE EXPLOITATIVE COLONIAL STATE

When considering the colonial economy, conceptualization and quantification of economic surplus and accumulation must take into account that a significant part of the surplus was transferred from the territory, mostly to the metropolis, i.e., almost nothing was allowed to accumulate internally, thereby characterizing an exploitative colonial economy.

From the 19th Century and up until the period of independence, mechanisms of accumulation were closely linked to relations with the outside world, given that there was practically no accumulation within domestic societies.

After the Conference of Berlin[7] the European powers instituted plantation economies, whose production was all for overseas consumption, based on European capital. This led to growth of large companies, geared toward the export of agricultural goods to Europe, known as concessionary or royal companies.

The metropolises issued sovereign charters, granting ample powers to capital groups. These invested in the colonies for economic gain, paying a tax to the metropolis which thus found itself unencumbered of the costs of administration. In most cases, these companies replaced the State in all its functions, but were dedicated especially to the enlistment and organization (and disciplining when necessary) of labor for their own productive enterprises. The financial success of such enterprises varied, depending upon the region and colony but, in all cases, the dispossession of African peoples was brutal.

3.1 The colonial pact

The African colonial pact,[8] whether or not formalized, was the specific means employed by European capitalism to transfer revenues from domestic societies to owners of industrial enterprises in the metropolises. It was based upon a set

6. See the early 20th Century movement in the Ivory Coast, under William Wadé Harris, an early Liberian missionary. The Harrist movement, which assumed great proportions, sought conversion to Christianity and struggled against fetishism and witchcraft. It called upon people to join in view of the superiority of the God of the colonizers, in the light of their conquests and victories and their administrative and scientific prowess.

7. The Conference of Berlin took place in 1884-1885 and set criteria for the partition of Africa among the European powers.

8. This was a colonial pact for Africa, which began in the late 19th Century when capitalism had already undergone its second industrial revolution, and lasted until the Second World War. It should not be confused with the colonial pact between Europeans, Brazilians and Africans that was in effect at the time of Brazil's independence. The former was, in effect, a pact between colonialists of the metropolis and the colonial administration in the colony, and not between colonizers and Africans.

of laws and juridical procedures, generally imposed by force upon the African population, and can be summarized as follows:

1) forced cultivation*:* obliging rural populations to cultivate crops determined by the metropolis, such as cotton, cocoa, and others, for export;

2) forced labor: consisting of forced enlistment, usually for very low wages, for work on infrastructure projects (ports, roads) or for private colonial companies, particularly on plantations and in mines; and

3) payment of taxes: obliging Africans to pay taxes in the currency of the colonizer. To this end, they should become wage-earners and/or produce for trade. This policy was of great importance in bringing African populations into the money economy.

These were the economic principles of colonialism in Africa. To these were added *industrial conditionalities*, under a policy that allowed establishment of industries on African soil, only in so much as they did not compete with those of the metropolis.

This set of measures brought millions of Africans into the world economy, without immediately removing them from their domestic societies. This is how Africa was introduced into the world economy, and is what led the continent to a state of underdevelopment. Workers were tied down to a system of exploitation that impeded them from improving their own living conditions. Their lot was to visualize another material and cultural world, which, however, remained forever beyond their reach.

3.2 Articulation of the means of production

During the colonial occupation, the economy was based upon a complex articulation involving two systems of production. On the one hand, units were created and managed under the capitalist system (modern agricultural, mining companies) that served the interests of the metropolises and relied upon capitalist relations (wage labor); on the other, the economy of domestic society, which produced in accordance with its own "traditional" methods and values.

Non-modern domestic society, classified as "backward", continued to furnish the food consumed by Africans, thus supporting the proto-workers for infrastructure projects, mines and plantations, and giving them succor when no longer needed by the capitalist sector.

Colonialism in Africa imposed itself upon structured societies and established specific relations of exploitation. It did not, however, take land ownership from the hands of the people, a primary condition for capitalist production (according to Marx). Neither did it make wage labor a general rule. It left domestic society with its own social relations, which were conserved and/or adapted to serve colonial interests.

As Meillassoux (1977) explains, colonial exploitation, by means of articulation of these two systems of production, was the outcome of reproduction of a cheap labor force and of income transfer (punction) from domestic to capitalist society.

> It is known well that in underdeveloped countries, subsistence food production remains almost entirely outside the capitalist sphere, maintaining direct or indirect links to the market economy, either by furnishing fed workers to the domestic sector, or through the production of export goods produced by farmers fed from their own harvests. This food economy thus pertains to the *sphere of capitalist circulation*, only in that it provisions the labor force, while remaining outside the *sphere of capitalist production*, given that no capital is invested and relations of production are of the domestic non-capitalist variety (Meillassoux, 1977, p. 155-156).

Relations between the capitalist and domestic sectors can not, in themselves, be regarded as sufficiently binding to explain the unequalness of the exchange. The relationship is established between sectors in which different relations of production predominate, and through dynamic relationships between the capitalist and domestic economies in which the reproduction of a cheap labor force comes into play for the benefit of capital.

Access to a cheap labor force means that capitalism, through maintenance of domestic society, has at hand means of extracting a maximum from workers while paying wages below their real value. This is because the labor force, when not employed "productively" by capital, assumes tasks within domestic society.

The costs of nurturing the labor force until it reaches a productive age, and of care in the event of disability or old age, are not included in the wages. From the socially-necessary working time that constitutes the value of wages, costs produced in domestic society are discounted. The calculation includes only what is produced by capitalist society since, from the capitalist standpoint, capitalist society is the only one that matters. It thus considers only what it produces itself as being "socially necessary".

The exploitative impulses of the developed countries rely essentially upon the productivity of labor to ensure greater profits. Articulation of the means of production opens up the possibility of obtaining greater profits than could be gained under *normal* conditions of value-added extraction, without productivity increases. In this manner, income, of the pre-capitalist category, is appropriated by capital through exploitation of the domestic community. Capital helped itself to the structures of this community, resorting to extra-economic impositions, often of a violent nature, to exact the partial or total fruits of the work of peasants. Thus, the domestic laborer that performs work in commercial agriculture or is engaged in non-agricultural activities such as mining and construction, upon being individually exploited, transmits an additional exploitation, i.e., exploitation of the domestic community (Nunes, 2000, p. 188). Under this arrangement, the greater the return on capital, the more the domestic community is burdened.

It is worth noting that migrant labor exerts a strong ideological influence, as it contributes toward an inversion of the causes of extreme poverty in the eyes of the worker. A Mozambican miner, for example, might regard South-African mines as places where money is to be made, in comparison to the paltry cash earnings to be obtained in his own community. Frequently, wage work would be seen as a means of escaping poverty – enabling the worker to obtain goods that mark his social integration – rather than the cause of his plight.

> Colonialism did not seek to replace domestic production by capitalist production. It was not simply a matter of destroying one mode of production and replacing it with another, but rather, the contradictory organization of economic relations between the two sectors, capitalist and domestic, with the former preserving the latter so as to carry off its subsistence and, in so doing, destroying it. (Meillassoux, 1977, p. 159)

This notion of contradictory organization of economic relations, and of different world views, is important for understanding the behavior of populations. These are not passive agents. Articulation is a play of forces, and the domestic community, even when subordinated, has ways of defending itself against change. There is a relative independence of the domestic sector in relation to the capitalist sector, which becomes more apparent in certain historical circumstances.

Nonetheless, on the one hand, if this articulation preserves the domestic economy so as to exploit it, on the other, it contains the elements for its destruction in the long term.[9]

3.3 The traditional and the modern

The colonial States were administrative, juridical and political systems created by European nation states and which served the latter economically, but which also had great symbolic capacity, especially in that they engendered, among the colonized, a feeling of belonging to the same territorial unit. These were States of Exception, if compared to the European States since, internally, the *indigenato* laws[10] applied, at least in the French, Portuguese and Belgian colonies. It was in these States of exception that Africans experienced relations of power with

9. Maintenance of the domestic society did not block influences of capitalist values and techniques, such as introduction of agricultural implements, health and education, which altered customs and rules of conduct.

10. The *indigenato* regime did not extend the Rule of Law to natives, as they were not considered citizens. Natives were subject to common law, but owed obligations, such as forced labor, payment of taxes etc. to the colonial State. It was foreseen, in law, that a native could become a citizen, i.e., by undergoing a process of "assimilation", whereby European culture was acquired. The *indigenato* regime remained in effect in the French colonies until 1946, and in the Portuguese colonies until 1961. In the English colonies the system was based on segregation, under which there was no chance of assimilation, all being subjects of His Majesty, but with no prospect of transfer from one culture to the other. In practice, the two models served to enable submissive participation and brutal exploitation of African peoples.

whites, and that they first expressed their initiative and launched their struggles for nationhood.

By means of the monetized economy, the administrative and fiscal organization, and through education and Christianization, the colonial State left its mark on the populations under its governance, from a racial, ethnic, religious and customary standpoint. Colonial States were States of exception, up until the end of the *indigenato* regime, for two reasons. Firstly, because they derogated the laws that applied in their metropolises, subjugating local populations and suppressing public liberties. Secondly, because there was a constant reinvention and renewal of traditions in their territories. This was true of social customs that underwent new developments, such as dowries and funerals, the importance of which were enhanced with monetization.

It was such a State that led Aimé Cesaire (1976) to affirm that colonialism is nefarious, not only for those that suffer under it, but also for those that put it into practice. Though it lasted only a short period of time, European colonization was not merely a parenthesis in African history (Dozon, 2008). The territorial and State frameworks established, notwithstanding their arbitrary nature, were of undeniable symbolic efficacy, and were accepted by the colonized population. Thus, isolated nationalities – Angolan, Senegalese, Mozambican, Malines etc., became references of identity for those peoples, and for others.

The European colonizers demarked territories, delimited borders and made inventories of populations, with a view to their economic exploitation, of course.

In this way, they cut economic-social formations into two or three. In counterpoint, they established modern State systems, and linked the various levels of power to their knowledge of the colonized populations, so as to administrate and control them. This was the administrative and *ethnographic* State, which gave its name and character to the native population.

The *ethnicization* of colonial territories, that gave rise to western Africanism, was the work of English social scientists and of French, Belgian and Portuguese administrators. This ethnographic work consisted of establishing ethnic or racial names and characterizing, appraising and ranking social groups. Thus, populations, "races" and "ethnic groups" governed by complex social orders, especially kingdoms, were better regarded than those that possessed no specific political structure. The former were considered "civilized"; whereas the others were regarded as "savages". Likewise, Islamized groups were more highly regarded than those described as animist or fetishist. An attitude of collaboration on the part of a group, when faced by a colonizing power, might also lead to a more favorable assessment (Amselle and M'Bokolo,1985; Lopes, 1997; Dozon, 2008).

The Europeans did not create ethnicity, though they did invent certain tribes and names that had not formerly existed. Classifications they made between "ethnic groups" and societies took on a colonial significance that was to have grave consequences, as in the case of the Hutus and Tutsis.

The relationship between the population and the State has almost always been problematic. Relations between the State and the national component of the population reflect the existence of a political community of a Nation State.

> Indeed, a majority of African States is multiethnic or multinational, and the strength of plural societies organized around ethnicity, region, language, race etc., relativizes the State's claim upon a citizen's obedience. Co-occurrence of obedience to ones ethnic group and to a State does not, in itself, imply a crisis of the State: individuals in Africa, as in other places, are constantly faced with situations where their identity is judged. They have overlapping roles: for example, to be Fang and Gabonese is no more demanding than to be, simultaneously, faithful to a church, active in a political party, member of a trades union, and French. It is the circumstances of time and/or place that determine the priority of one or another identity; and it should be understood that an affirmation of ethnic identity is not, *a priori*, incompatible with a statement of nationality (Sindjoun, 2002, p. 45. Free translation).

After the first decades of colonization, movements of revival of magic and ancient rituals were detected. The advance of modernity, the merchant economy, new products, and teaching of the young fostered unequal development among peoples and groups. Those that benefited from modernity drew closer to western beliefs; whereas, those that were left out tended to revert to their traditional beliefs, thus raising tensions in the social fabric.

This penchant for spells displays a form of defense against processes of modernization, given that significant portions of these societies were excluded from their benefits. Ironically, it was from among those that most benefited from and came into close contact with modern religions that the nationalist leaders of most countries emerged. However, modernization of living and working conditions are not incompatible with the ideological perpetuation of pre-existing forms of social and political control over the oppressed. Thus, modernizing and traditional values and practices remained side by side and overlapped.

In summary, this colonial State was marked by brutal exploitation of African manhood and society, but also by a proliferation of mystical and magical activities, and by prophetic[11] movements that arose to uproot magical practices. This period is also marked by conversion of Africans to Catholicism and to Prot-

11. Significant prophetic movements arose, such as kimbanguism, under Simon Kimbangu, who founded the Church of Jesus Cristo in the Belgian Congo and worked with Abako, the main Congolese political party, in suppressing both fetishism and colonialism.

estantism, and also by the strengthening of Islam, especially in countries of the Sahel, through Marabutic brotherhoods and trade networks.

The Christian churches of the South, as places for agglutination, teaching, healthcare and social welfare, influenced socio-political commitments, winning people over to the colonial governments, or opening up space for opposition and resistance, as did also the Islamic establishments to the North.

4 ENHANCING THE VALUE OF THE COLONIAL STATE (THE COLONIAL STATE OF VALUATION)

With the end of the Second World War the situation changed. The USA, the great winner, had no colonies and European capitalism was undergoing internal restructuring.

If efforts were made to improve the living conditions of Africans and increase the wealth of Africa, England, France and Belgium would then be able to sell more goods and create new English, French and Belgian jobs on European soil for sale on the African continent. They would also, in turn, be able to secure more foodstuffs and raw materials from their African dominions.

To trigger this spiral of development, more investment in the colonies would be needed. Should private investors be unable or unwilling to effect such investments, owing to depressed monetary markets or reluctance to speculate in Africa, then national States would have to assume the task (Fage, 1997, p. 438).

Enhancing the value of colonies was a policy designed to benefit the metropolises. Particular care was taken to restrict competition from foreign goods vis-à-vis products from the metropolis in the colonial market. The capture of colonial markets by metropolitan industries was upheld through mighty protectionist barriers, customs duties and quantitative restrictions on foreign imports.

After Bretton Woods, with the establishment of the dollar as the main international currency, the European countries undergoing reconstruction sought to protect their dollar-denominated hard-currency reserves. Thus, the Colonial powers created free monetary-exchange zones for their currencies in their respective colonies. The consequence of this was emergence, in Africa, of zones where the dominant currencies were: the pound sterling, French franc, Portuguese escudo and South African rand (the currency used by South Africa to settle accounts with its neighbors) (Leite, 1989; Fage, 1987).

Prospects for development, creation of industries, investment in the countryside and in urbanization, rapidly began to effect deep changes in African geography and to produce alterations in African thinking, which thenceforth assumed a nationalist outlook. Objective conditions provided the bases for Africans themselves to take the lead in this process of modernization. Subjective conditions were clearly manifested at the 5th Pan-African Congress of 1945,[12] held in Manchester, during which, for the first time, full independence for all African colonies was proposed; i.e., total political power, including, if necessary, armed struggle; thereby going far beyond the demands for improvements and equality in the colonial system proposed at previous congresses.[13]

In this environment national liberation struggles flourished culminating, in the late 1950s and early 1960s, in the independence of all the African countries, excepting the Portuguese colonies of Angola, Mozambique, Cabo Verde, Guinea-Bissau and São Tomé and Príncipe, which achieved independence in 1975; of Zimbabwe (1980); Namibia (1990); Eritrea (1993); and Western Sahara which remains a colony of Morocco to this day.

African nationalism, however, according to Sindjoun (2002) is not merely a "nationalism of combat" forged during the anti-colonial struggle, as claimed by Badie and Smouts (1992), but also a "nationalism of government", mobilized by leaders to legitimize themselves before the population and ensure its identification with the State, and repressing attempts at secession such as occurred in Nigeria in the 1960s.

Modernization and economic-enhancement policies publicly highlighted local modernizing elites, thereby making the colonies less susceptible to witchcraft, as science assumed greater prominence on the agenda. Thenceforth, African public spaces were divested of religious or magical-religious significance to become more explicitly political, with parties, trades unions and the press comprising a new State. National and scientific outlooks began to dominate African politics, to the detriment of religion and ethnicity.

Two characteristics of post-war colonial States merit notice: *i)* investment ceased to concentrate on infrastructure for facilitation of exports and began to focus on manufacturing plants; and *ii)* opening up to Africans of opportunities in public administration and granting of political and trades-union freedoms. All this was, of course, adapted to the particularities of each colonial metropolis and colony. Thus, in 1946, France abolished the *indigenato* system and extended political participation to the (now) citizens; whereas Portugal only did the same in 1961. For their part, the English colonies already had legislative councils with participation of Africans, except that they never en-

12. The 5th Congress, though chaired by W.E.B. Du Bois, who had also presided at previous congresses, also had as organizers and prime influences George Padmore and Kwame Nkhruma.
13. South Africa, though independente since 1910, was governed by a white minority.

joyed majority representation until, starting in 1948, elected Africans began to outnumber appointed members. These councils were early precursors of self-government, rather than parliaments.

The enhanced colonial State drew up development plans in practically all the British, French and (after a 15-year delay) Portuguese colonies. This new policy of enhancing the colonies required another sort of State and, though democracy could not be established, legislations swiftly enacted provisions on wages, thereby putting an end to the *indigenato* regime and forced labor, while also providing for certain liberties. Investments were made and development plans drawn up targeted at fostering nascent industries. To accompany this change in lifestyle, new education and healthcare facilities had to be introduced.

Little assimilation had hitherto taken place. But now, it became essential to have well schooled and disciplined Africans to place at the service of capital. Africa was to become a buyer of consumer and capital goods exported from the metropolises. This, allegedly, would open up prospects for improving the lives of populations, in that they would become wage earners, acquire universal culture, and gain awareness of the state of the world. As a consequence, nationalist ideas matured, and independence took its place on the agenda, not as a distant hope, but rather, as something palpable, with real prospects of applying a government program for the nation as a whole as a vision for the future.

The proposals of the 5th Pan-African Congress offered strong bases for achieving victory, whereas the policy of enhancing the value of colonies was never likely to be long lived. Pressures came from all sides. Financially, it would be more advantageous for capital if all encumbrances and risks of projects were born by the nations. Politically, the movements clamored for an end to colonialism, claiming that it was no longer sufficient just to put an end to its worst aberrations. Internationally, at United Nations' forums, there were calls for independence, to which the United States gave support with a view to bringing an end to the primacy of European interests on the continent.

The short-lived Colonial State of Valuation, for ontological reasons, could not be so democratic as was perhaps intended. Independences were granted, earned, or otherwise achieved. Where freedom of party affiliation and free elections were allowed, power changed hands, and generally the colonial powers gave way to pressures (Ngalasso-Mwatha, 2010, p. 370). Nonetheless, in a number of countries, such as Cameroon and Madagascar, sanguinary repression was not averted. In Algeria, after 132 years of colonial rule, an eight-year war raged; likewise, the former-Portuguese colonies faced fifteen years of armed conflict.

5 THE INDEPENDENT DEVELOPMENTALIST STATE

René Dumont (1962) in criticizing the economic policies of the Sub-Saharan African States, pointed out that they were making large-scale investments with capital-intensive technology; that they were failing to respect local technologies or respond to the hopes and aspirations of Africans; that they were serving the interests of groups of the East or West; and that they were thus doomed to failure. Despite this critique, the great debate of the decade raged between capitalists (neocolonialists) and socialists. The basic difference between them resided in the character or class of State they envisaged, and alignments maintained during the Cold War. Whereas neocolonialists, allied to countries of the West, sought to maintain freedom of activity for local groups with capital and defended repatriation of profits; the socialists, aligned with East-block countries, proposed nationalization and state ownership of the economy, investment of profits in accordance with the needs of the population and centralized long-term planning. Both favored strong government structures, led by a single party or in thrall of a "great leader" with capacity to conduct large-scale projects, funded by English, French, Belgian, Italian, Soviet and Chinese resources (among others). Obsessed with the 'development' of their countries, projects aimed at achieving industrialization, and thus required technical-scientific knowledge and capital. In this respect, they could be classified as "developmentalist" States, though the rate and degree to which their goals were attained differed widely.

Most post-independence Heads of African States revered pre-colonial repertoires, such as the "conscienceism" of Nkruma in Ghana; the "negritude" of Senghor in Senegal; and the "ujamaa" ideology of Nyerere in Tanzania, making reference to mystic powers and boasting of idealized traditional forms of solidarity. At the same time, this same movement renamed various countries. French Sudan became Mali; the Gold Coast - Ghana; Dahome became Benin; and Upper Volta - Burquina Fasso. But national borders were maintained; the colonial period was not discarded, and neither was the territorial legacy left by the colonial powers after the Congress of Berlin.

Many leaders contributed toward the balkanization of Sub-Saharan Africa, for example, Houphouet-Boigny of Cote d'Ivoire, and even more progressive figures such as Sékou Toure of Guinea-Conakry, Modibo Keita of Mali, or Kwame Nkrumah of Ghana and, more lately, Samora Machel of Mozambique, and became symbols of alternative development with policies based on national targets.

It can be observed that the African States inherited colonial territories which, though they might be considered artificial in relation to their pre-colonial past, are nonetheless an outcome of colonial policies which have become incorporated into the historical experiences of the peoples of such territories.

The building of independent States by such leaders resorted to nationalist statements, in apparent contradiction with national and ethnic identity, in much the same way as was done during the colonial period; i.e., they preached national unity and development goals based upon ethnic values. Castells (2002, p. 133) reminds us that "ethnicity was transformed into the main pathway for state control over resources. However, it was the State and its elites that created and recreated ethnic identity and loyalty, and not the inverse."[14]

Swaziland, after independence in 1968, organized as a traditional monarchy; Nigeria and Cameroons adopted federalist systems; northern regions of Nigeria apply Islamic law (*sharia*) in apposition to the principles of the lay state which central governments have sought to deploy. From the standpoint of integrity, excepting Ethiopia, the African States have faced up to problems very well. This goes to show the weight that colonial-era borders have had on the historical experience of Africans, based upon legality, the will of African leaders, and sustained by the founding charter of the OAU and of its successor, the African Union, both of which uphold the inalienable nature of these borders. Upon its founding, in 1963, the OAU set a vision of Africa as a distinct objective goal encompassing its Member States and providing an international profile to Pan-African relations.

This complex inheritance, especially the recycling or reinvention of African societies within their colonial contexts, was transferred to the post-colonial States. This explains why the territorial legacy remained untouched for so long, given that, from their standpoint, the purportedly artificial nature of borders was, in effect, the limit which framed their worlds and truly African forms of existence, simultaneously resulting, on the one hand, in a long span of history and culture on the continent and, on the other, in the brief (but effective) duration of the colonial period (Dozon, 2008).

On an initial level of analysis, in the early 1960s, the States were like their international counterparts. They were endowed with "rational-legal" frameworks, comprising a constitution, civil law and various levels of executive, legislative and judicial power.

The post-colonial States constituted or reconstituted themselves as States of exception; or as States of exploitation, until 1945 (1961 for Portugal). Their civil codes, copied from the West, were of little effect, since customs (such as polygamy, dowries and initiation rites for the young) continued to regulate gender, family, and inter-generational relations. Likewise, royalty retained its prerogatives and hierarchies. The post-colonial States were no less authoritarian than the colonial State.

14. Massimo d'Azeglio said of the building of Italy in the late 19th Century: "We have made Italy, now we must make the Italians" (*apud* Hobsbawm, 1990, p. 56).

This double reality of the post-colonial African States enabled them to claim to be under the Rule of Law while, in effect, functioning with a blend of colonial despotism and traditional authoritarianism, at the service of development, producing what Dozon (2008) has called a "structural pathology", ranging from the grotesque to the obscene, in the assessment of Mbembe (1979).

Nonetheless, the post-colonial State did not stop there. Aside from achieving symbolic and political efficiency (through juridical and political institutions at various levels, characteristic of Modern States) it established mentalities among the managers and the managed, put limits on practices of patronage and, at the same time, allowed traditional practices such as polygamy to go unpunished.

More positively, the post-colonial State proved able to incorporate a symbolic space in which public institutions could organize and engage in the building of a national identity. They thus constitute complex phenomena that can not be reduced to a single simplistic explicative model. Within them, are to be found patrimonialism and sacred power harking back to pre-colonial state formations, and which are not simply replications of European models:

> The African States, since gaining sovereignty around the 1960s as geopolitical entities, have not ceased to be under strong tensions. They have not, in effect, ceased to face the confrontation between "rational-legal" modernist forms of their institutions and the realities of their authoritarian and patrimonial practices (which are themselves marked by pre-colonial and colonial habits) and to balance (well or badly) the centrifugal and centripetal forces and tensions among them, which may be more acute when outcomes stem from the same feats and the same historical experiences (Medard, 1998 *apud* Dozon, 2008, p. 53. Free translation).[15]

What characterized the independent African States, despite their colonial and pre-colonial heritage, their patrimonialism, patronage, despotism and sacred practices of power, was their capacity to conduct public policies and establish themselves as lay States. They remained aloof from religion in their pursuit of the development process.

Investments of the central powers in Africa, up until the mid-1970s, imposed upon it an economic development model reliant upon strong systems of government based upon dictatorship and a single party. In 1981, a World Bank report on this part of the African continent asserted that what had been done was "most adequate". The United Nations Children's Fund (UNICEF-1992) classified two first decades of African independence as "noteworthy", stressing, among other favorable factors, good economic performance, increased exports and a 14% growth of *per capita* GDP, between 1965 and 1980 (Lopes, 1997).

15. Medard, J.-F. La crise de l'État neo-patrimonial et l'évolution de la corruption en Afrique subsaarienne. *Mondes en développement*, v. 26, n.

Optimistic development projects of the 1960s, applauded and encouraged by the industrial powers had, by the late 1970s, begun to show their incapacity to sustain these countries. Poorly planned investments, lack of capacity to manage the technologies applied, corruption in government, and dependence upon foreign models were among the reasons cited for the failure of economic policies, which culminated in an economic, political and financial crisis of unprecedented proportions throughout the continent. Investments brought no return; the foreign-debt shock made the situation worse; and the States, for lack of revenues, ceased to invest, thus engendering high unemployment and the swelling of cities.

To this crisis of modern African society was added a crisis of domestic society (at the root of which were actions of colonial and modern inspiration over the course of a century). The logic of non-accumulation and non-consumerist culture of (domestic) lineage societies did not serve modernity and, for this reason, was repudiated under developmentalist projects. Without definitively abandoning these projects, such societies ended up suffering significant destructuring. Various factors combined toward this: removal of workers from activities in lineage society for employment in capitalist production; implantation of schools, which hampered transmission of ancestral knowledge; health posts, that led to a rise in birth rates and a reduction in mortality, thereby fostering rates of growth unsuited to lineage production; demarcation of territories, blocking free circulation and installation of villages; large-scale deforestation, that accelerated degradation and reduced prospects for production, etc.

Although this helped foster accumulation, traditional society made little use of it, and began to rely on capitalist production. It also lost its ability to reproduce itself, for example, ceasing to produce its own work implements, including simple hoes. In the colonial period and in the first years following independence, traditional societies were relatively well balanced, as they remained in articulation with modern society and still managed to reproduce. Moreover, the crisis in these societies arrived rapidly and brutally, as they were agricultural societies possessing sparse reserves.

This double crisis, that began in the 1980s, left the States internally weakened and without resources, unable to hold their own vis-à-vis the multilateral organizations and great powers that were pressuring for their disestablishment. The unemployed masses, laid off by the crisis in modernization projects and famished members of domestic society were left to the care of governments lacking any prospects and which, in many cases, fell prey to corruption to perpetuate themselves in power. This, then, set the stage for a resumption of ethnic and regional wars and all manner of struggles against the central authorities. Famine assailed entire regions; governments faced financial collapse, and had to resort to foreign aid to settle their accounts and avoid large-scale food catastrophes.

6 THE NEOLIBERAL STATE

The strong developmentalist State suffered a crushing blow in the 1980s and, as a consequence, in the 1990s, the "predatory model" (Castells, 2002) came to predominate among African States ("weak" States[16] fell prey to "extremely high demand") South Africa and a few others being exceptions.

> (...) promoting governance of weak States, improving their democratic legitimacy and strengthening self-sustainable institutions (...) became the main thrust of contemporary international policy (...) If a science, art or technique exists for building States, then it must meet all of these goals at once and will be in extremely high demand (Fukuyama, 2004, p. 131, *apud* Siqueira, 2010).[17]

The Berg Report (World Bank, 1981) as it became known, stated that the causes of Africa's problems could be attributed to poorly adjusted macroeconomic strategies and mismanagement in the public sector, and that these causes should be addressed, with a view to restoring the macroeconomic balance, as priority goals of development. To this end, the report proposed:

- improvements in foreign-exchange and foreign trade policies (implying devaluations and anti-protectionist measures);
- greater efficacy in the use of public-sector resources (reducing the weight of the State in the economy, reducing budgetary spending, and incentives for the private sector); and
- better agricultural policies (priority for peasant agriculture, better relative domestic prices, and liberalization of trade circuits).

At the same time, the report accepted the importance attributed by African governments to policy consolidation and creation of basic infrastructures for fostering national integration, and deemed the development of human resources to be a good approach. In summary, the report on the 1970s in Africa stated that:

> the situation is not uniformly discouraging. There are signs of progress throughout the continent. There are many more Africans in schools, and most now live longer. Roads, ports and new towns have been built and new industries established. Technical and management posts formerly held by foreigners are now filled by Africans (World Bank, 1981. Free translation).

16. See the excellent dissertation by Isabel Siqueira (2010) on "fragile" States.
17. Fukuyama, F. *Construction of States.* government and organization in the 21st Century. Rio de Janeiro: Rocco, 2004.

After having been subjected to intense theoretical discussion, the premises of the Berg Report were implemented under guidelines of the structural-readjustment programs adopted in all Sub-Saharan countries. Thus, in the early 1980s, the State sector throughout Africa was put to task, despite the fact that, until the mid-1970s, its management of economic development (notwithstanding its inefficiencies) had achieved positive indicators, attracted financing flows to the continent (benefited by favorable agricultural, mineral and raw-material prices) and generated relatively high economic growth as compared to most of the industrialized countries.

This situation, however, began to change after the first oil shock, in 1973, which marked the beginning of a period of recession and industrial reconversion in the developed countries, accompanied by gradual adoption of protectionist policies on the part of the main raw-materials importing countries. It was the onset of the neoliberal era of Ronald Reagan and Margaret Thatcher.[18]

The decline of international trade and a sequence of economic policies totally dependent upon imports contributed toward emergence, in the early 1980s, of chronic public and private foreign debt of the so-called Third World. Exacerbation of this caused the balance of financial flows between the central and peripheral countries to be most unfavorable for the latter. This directly affected their long-term prospects of economic recovery, owing to the ever-larger portion of their hard-currency revenues channeled toward payment or servicing of foreign debt.

Another factor influencing the reorientation of African economies in the early 1980s was the rise to power of economic liberals in the United States, the United Kingdom and Germany, where they embarked upon economic policies of privatization and non-intervention of the State in the economy. Also weighing against direct participation of the State in the economy were changes in the cooperation policies of the socialist countries, caused not only by deterioration of their economies and balance-of-payments difficulties, but also owing to a reorientation of their strategic and economic development policies.

18. Subsequent financial problems in the region were exacerbated by a fall in export revenues, owing to a drop in commodity prices and an accumulation of arrears on the foreign debt, which soared from US$ 210 million to US$ 14.15 billion in 1992. The continent's accumulated debt in 1996 exceeded 300 billion dollars. By 1991, it had reached US$ 281 billion, according to the World Bank. Debt service amounted to over US$ 10.2 billion in 1992 and, in countries such as Guinea-Bissau, Somalia and Sudan it accounted for over 100% of GNP. Overall debt service, in that same year, was equivalent to 32% of all exports of Sub-Saharan Africa (Lopes, 1997).

The debt of Sub-Saharan Africa in the 1980s developed as follows
(in billions of US dollars)

1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
56.2	64.0	70.2	79.3	82.7	96.2	113.0	137.9	139.6	143.2

Source: World Bank (1994 *apud Serra*, s.d.).

Thus, instead of giving priority to cooperation projects, involving recuperation of state-owned agricultural companies or even new projects, preference was given to assisting cooperative organizations in the traditional family-agriculture sector. It was in this context that the World Bank and IMF, with their structural-adjustment programs, intervened directly in the economies of the African countries.

In 1961, reports of the UK's Royal African Society had predicted a grand and radiant future for the continent, with Western participation, naturally. By 1991, the Society was reporting on the catastrophe occurring on the continent, and held African governments responsible for maladministration and for having copied western models. In 1992, the Gross National Product (PNB) of Sub-Saharan Africa was smaller than its foreign debt (US$ 280 billion); debt service corresponded to 32% of exports (US$ 10.2 billion). Sub-Saharan Africa (excepting South Africa) had a GDP equal to that of Belgium, and accounted for less than 2% of world trade.

Three generations of policies for the African continent as a whole were implemented by the Breton Woods institutions in the 1980s and 1990s:

- in the early 1980s - stabilization of the economy, through short-term management measures that failed, however, to address underlying causes of the balance of payments crises;
- in the mid-1980s - the focus was structural adjustment, with a view to intervening in productive and institutional sectors; and
- in the 1990s - policies that acknowledged the importance of social factors and incorporated the theme of sustainable growth.

In the 1980s, the prices of Sub-Saharan Africa's main export products (*i.e*, coffee, cocoa, cotton and tea) fell by 50%. In the same period, capital investment (on a *per capita*) basis dropped 50%, exacerbated by pressures of the foreign debt. The economic adjustment policy brought maladjustment into the lives of populations.

Between 1980 and 1989, 241 adjustment programs were carried out and became part of the prevailing ideology of the countries of Sub-Saharan African. As a consequence, GDP contracted by 1.1% per year throughout the decade. Despite total compliance with the IMF's Structural Adjustment Programs, outcomes were dramatic: capital accumulation slowed in most of the countries; public investment dropped drastically; foreign investment almost totally dried up; industry's share of GDP rose in only six of the countries between 1982 and 1988; and only six countries managed to increase exports by over 5% (Lopes, 1997).

As a consequence, famine became widespread, unemployment rose, and social upheaval reached even the remotest villages. Indeed, crisis afflicted most of the continent. Nonetheless, the IMF and the World Bank became net recipients of

Sub-Saharan African resources. It was against this backdrop that, to defray public expenditures, most African state companies were closed, transferred, privatized, underwent management reforms, or altered their relationships with other State bodies.

Discussion on economic policy, strategy and ideology gave way to quantitative and microeconomic debate on formulas for salvation (not previously a component of liberal economic theory) presented as the sole and indisputable alternative. On questions of food and agriculture, the focus of the Structural Adjustment Programs was threefold:

- reestablishment of the macroeconomic balance, which implied restricting demand for food consumption, reducing food imports, and increasing exports of agricultural-food products;
- resetting of prices, which meant depreciation of exchange rates, raising interest rates, putting an end to protection and subsidies, and elimination of controls and rationing of foreign-exchange, credit and consumption; and
- denationalization (privatization) of agricultural trade of production companies, aside from dismantling of monopolies and resetting of profitability rates.

This program ran counter to agricultural-food policies of the 1970s for Sub-Saharan Africa, which had featured the following:

- incentives for agricultural enterprise, to finance accumulation, industrialization and the public treasury;
- provisioning of low-cost food;
- the principle of food self-sufficiency;
- penalization of cash crops, by means of taxation;
- substitution of imports;
- direct participation of the State in agricultural-food chains; and
- rationing and free (or nearly free) distribution of food to consumers, control of exchange rates, etc.

These principles became constant elements under the Structural Adjustment Programs that restored agricultural-food chains and focused upon:

- expansion of exportable agricultural-food production chains, to generate hard currency needed to service the foreign debt;
- contraction of systems for importation and processing of foreign imported agricultural-food products (wheat, rice, meat, sugar, powdered milk, etc.); and

- fostering re-adoption of traditional food products (traditional tubers, cereals, etc).

The Structural Adjustment Program set as goals the redistribution of wealth from consumers to farmers, and of income from towns to the countryside. For their part, the stabilization programs which sought to reduce the wage/profit ratio led to exacerbation of hunger and malnutrition, a drop in living standards, and deindustrialization. To enhance the competitiveness of the exports of these countries (i.e., their agricultural produce) what could be more appropriate than to offer incentives in the countryside and credit to individual peasants? At the same time, in the towns, inefficient and uncompetitive factories were closed. The aim was thus to enhance workers' productivity and reduce the wage/profit ratio, so that more resources could be transferred abroad.

However, resources such as oil, diamonds and precious metals continued to be exported, contributing substantially toward economic growth of certain countries. The problem, as Castells (2002, p. 115-116) reminds us, resided in the use of resources thus generated and of international aid received by African governments:

> Africa is not oblivious to the global economy; rather it is poorly articulated, owing to its fragmented participation in the global economy through selective relations, such as limited quantities of exports, speculative appropriation of high-value resources, cash transfers abroad, and parasitic consumption of imported goods.

6.1 Still States

Even though, for almost twenty years, the Nation States were weakened by neoliberal policies and internal disputes, only Ethiopia lost territory to the formation of another independent State: Eritrea, in 1993, secession of which was based on pre-colonial claims. Attempts of secession by the Kingdom of Buganda culminated in its abolition in 1966, and incorporation into Uganda. Current movements in Somaliland seek to challenge central authority in Ethiopia (which they purportedly exercised in the remote past) and not necessarily secession of the Tigre region. There have been few other attempts at secession (in Senegal, Uganda, and Namibia).[19]

The civil wars of the 1980s and 1990s, generally considered ethnic conflicts, did not bring into question national borders. Movements in the Ivory Coast, in 2002, and in the Peoples' Republic of Congo and the Democratic Republic of Congo, in the 1990s, did not challenge the integrity of those nations and, despite their common history, no attempt was made to unify the two Congos. Similarly,

19. After this text was written, a referendum held in Sudan in January 2011 approved secession of the South of the country and creation of a new State. The North has Arab and Muslim traditions, whereas the South, where most of the country's oil is to be found, has black-African and catholic traditions.

the States of Ruanda and Burundi did not dissolve following violent conflict between Hutus and Tutsis.

Since the 1980s, when neoliberal policies took hold, privatization of public bodies has been pursued, alongside a weakening of monetary protection, exemplified by devaluation of the CFA franc[20] in 1994, and lowering of tariffs, especially those targeted at peasant farmers producing crops for export and whose earnings, since the 1950s, had been small but steady. Greater prominence was also given to programs of decentralization targeted at fostering good local governance. Also, at this time, there was a great proliferation of NGOs in Africa.

The dynamics of NGOs is quite unlike anything that had been done since the era of independence. The emergence of NGOs is a direct result of neoliberal policies that imposed their own forms of domination and which attributed to them roles formerly exercised by the States.

NGOs operating in Africa intervene in the agricultural, health, education, housing, and transport sectors, among others, working on their own account, without fostering emergence of local civil society. The widespread activities of these associations within national territories, and the powerlessness of the States, has lent weight to ethnic, religious and regional identity claims and awakened ancient yearnings. Disputes for land and for riches of the subsoil have been tackled by excluding participation of others. Actions stimulated by NGOs to promote local groups have strengthened parallel economies, leading to all manner of gangster-like relations that have gained force in the face of weakened States (Nunes, 2000; Dozon, 2008).

Day-to-day problems have engendered adoption of survival strategies and, thus, tensions and conflicts could hardly fail to emerge, affecting domestic family life. Whereas the policy of "reducing the State" was meant to result in better management of routine affairs, corruption has risen incessantly, multiplying as the processes of privatization and decentralization come into contact with international drug and arms trafficking and smuggling of goods, leading to a "criminalization of the State in Africa" (Bayard, 1989).

As of the 1980s, modernization projects and development plans practically ceased to feature in public policies. Talk focused instead upon sustainable development and human development, within the scope of small-scale local projects and the increasingly-numerous NGOs, whereas the State was divested of its pri-

20. The currency used by 14 countries of Western and Central Africa, all former-French colonies except Guinea-Bissau and Equatorial Guinea. Created in 1945, its name reflected the acronym for French African Colony. Since the early 1960s, the same acronym has stood for African Financial Community. It is divided into two regions: the Western CFA franc; and the Central CFA franc, each being legal tender in its respective region.

mordial role of promoting development. Thus, a series of essential public services were entrusted to private companies or associations and transformed into innumerable projects for combating poverty, promoting humanitarian actions and assisting refugee or displaced populations. Under the neoliberal wave, Africa was further from achieving better prospects for progress than it had been in the 1960s (Dozon, 2008, p. 150). Most notable has been the dissemination of "political tribalism", *i.e.*, a phenomena of closing identity, that translates into crises of otherness, especially in urban centers, and recurrently resorts to violence and terror.

The religious history of Africa is continuously enriched through exchanges among local peoples; between the first inhabitants of a place and newcomers; between Arabs and Africans; between Africans and Europeans; such that it nourishes a number of assimilation and hybridization phenomena, but does not feature conflicts between faiths. The only faiths that were radically threatened were the pagan magic-religious systems, which were more tolerant and welcoming to each other, and that have almost totally disappeared in some regions of Africa, but which endure in others. Colonialism worked very well in this context of religious pluralism, guarding and repressing religious innovations and movements, such as Muslim or prophetic brotherhoods, that were – paradoxically and at the same time – the basis for colonial development (Dozon, 2008).

Counter to the 19th Century European ideal — according to which modernity should be a complement to the development of Nation States capable of transcending social, communitarian, religious and ethnic particularities — what can be perceived in Africa and in other parts of the world is a formation of post-modern ethnic, mono-faith States. Such States have sprouted from the colonial and neocolonial order and have accommodated to the prevailing globalization. In general, whenever a State presents itself as the expression of a group it has faced crisis. It is not heterogeneity of identity that lies at the heart of such conflicts. If it were, Somalia, that is ethnically homogeneous, would not be in conflict.

The increasingly frequent phenomenon of magic (witchcraft) and the process of demonization, which has become common in an environment dominated by "the blessed and the reborn" cast the State in a retrograde light. The globalized ideal of "doing well in this life" (according to which, good health and abundant wealth are attributed to divine providence as rewards for obedience to the laws) paints being excluded as the work of the devil. Hope has become an attribute of the divine.

To the extent that capitalist development brought on a deep economic crisis, reducing prospects for a better future, it has become facile for such societies to turn their backs on science (a basic premise of modernity) and to pin their values on traditional beliefs.

In the early 1990s, with the end of the Cold War and with popular mobilization (especially of urban youth) it was thought that such tensions could be resolved. Democracy was envisaged as multiparty systems based on public liberties. Many States (such as Ghana, Mali, Benin, Mozambique, Namibia, and other countries of southern Africa) survived the democratization process. Others (such as Serra Leone, Liberia, the two Congos and Sudan) engaged in prolonged civil wars; or (like the Ivory Coast, Cameroon, the Central African Republic, Gabon and Uganda) underwent severe crises. The number of conflict regions on the continent rose to fifteen.

Manifestly, in many cases, the end of the Cold War unleashed pent-up tensions of the decades of nation building, which had not been debated politically. Internal struggles, stemming from ethnic competition or religious intolerance occurred within the contexts of weakened States. The termination of advantages obtained under the Cold War, the Structural Adjustment Programs, the low prices of many export goods, land pressures, all contributed toward reducing funding sources, thus causing migration and internal divisions.

In the 1990s, a plethora of NGOs bolstering Christian, Islamic and traditionalist movements and supported by international networks or multinational companies, meddled in socio-political issues.

With the American post-World War II boom, there was an expansion of Pentecostal churches (among them, the Universal Church of the Kingdom of God) which promise a share of material progress here and now. These new reformist Christian churches have staged a come back of the language of magic, as their conception of salvation entails liberation from individual demons. Prior to seeking to transform converts into godly souls, such churches first give credence to existence of the Devil. According to these faiths, the plight of the sick, those in financial difficulties, facing family conflicts or unemployment does not stem from the will of God, but rather, from possession by the devil, meaning that they are in need of exorcism (Dozon, 2008). Such practices are, at times, viewed as a return to magic, manifested in new forms and by new means.

Liberal policies intrude upon the central functions of the State while, at the same time, impinging upon the character of the Nation State in which people share common references, leaving space free for ventures involving gods, the devil and capital. Thus, in the mid-1990s,

> not only was Africa increasingly at the margin of the global economy / information society, but also, with a majority of its Nation States undergoing disintegration and its peoples disoriented and accosted, it was obliged to regroup into survival communities, under a great variety of labels, according to the taste of the anthropologist (Castells, 2002, p. 140).

7 CONCLUSION

Africa's potential, its mineral wealth, agricultural production and abundant labor force have ceased to be of interest under the new technical-scientific parameters of the revolution underway since the 1980s. Since that time, little has been said about development; the focus now being upon restructuring of economies (meaning adapting them to the needs of the global market) and financial stabilization, to ensure continuity of revenue flows to the central countries. Evidently, African and non-African groups linked to State systems and to the aid establishment have, during the course of the crisis, accumulated untold wealth.

Most African countries, though accepting the rules as presented, have served as a sort of global capital reserve, while rampant capitalism has made inroads through edges and gaps, taking advantage of the vestiges of colonialism, of apartheid, and of internal wars. It is against the background of deep crisis that the quest for an urgently-needed African renaissance proceeds.

7.1 Onset of the 21st Century

Since the colonial era, contemporary African States have struggled for territorial unity and national awareness, through development of ethnic configurations and the formation of ethnicities, though not always for independence. Almost all African countries have regions characterized by ethnicity or religion. Religious pluralism is a common feature of post-colonial States and, in many regions, devotees of various types of prophets live alongside each other, without any major conflicts.

Manifestly, in the line-up of unifying and disaggregating forces lies one of the best explanations for the structural weakness of African States and of their propensity for patronage and tribal-based systems. Nonetheless, this is a modern phenomenon, since the processes of nationalization and ethnization on the one hand, and of centralism and particularism on the other, walk hand in hand; each mobilizing a set of administrative, scientific and technical governance practices, characteristic of the era when the Nation States were undergoing construction. These are substantial characteristics of the African States and which, though at the root of their weaknesses, belie the ideia that they are artificial constructs. Such historical experiences explain why, to date, neither secessionist movements nor the creation of new States have prospered.

Disaggregating forces have held the upper hand over unifying forces in the power balance of African States which, despite their authoritarianism, have become weakened States. Some observers go so far as to affirm that the very existence of such States is due solely to recognition of the international community;[21]

21. See Herbes (2000).

that they are mere territories, with a modicum of governance and of common technical forms of organization; and that they are barely effective in terms of economic and social life.

In the first decade of the new millennium, despite the authoritarianism of the post- independence years and policies which, for more than 20 years, have sought to undermine the State, and notwithstanding the civil wars, massacres and genocide, such as occurred in Ruanda or the Congos, the States have not been eclipsed. No express desire for secession has been voiced; rather the contrary, expressions of national sentiment have become increasingly vocal.

To all appearances, the continent is susceptible to change in the 21st Century. GDP growth of around 2.4% in the 1990s was followed by rates of 4% between 2000 and 2004, surpassing 4% in 2005. Africa's share of worldwide economic production increased by 5.5%, more than any of the member countries of the Organization for Economic Co-operation and Development (OECD). Average annual inflation rates on the continent are in single figures and, in more than 30 countries, are below 5% *p.a*.

Foreign Direct Investment (FDI) flows to African rose 200% between 2000 and 2005 (from 7 to 23 billion dollars). The Johannesburg Stock Exchange has market-capitalization rates higher than those of São Paulo (Bovespa) and Shanghai. Another essential factor for attracting foreign financing has been a lowering of the debt burden, which was partially forgiven or written off: Africa's biggest debtor, Nigeria, has paid off its entire foreign debt (Lopes, 2007).

At the start of this millennium, many investment possibilities are available on the continent, which suffers from essential economic and social deficits that need to be addressed. In the trade area, African exports have grown 25% on average in recent years, a performance equal to that of China, and outstanding when compared to the 14% reported for other countries of the South.

Economic progress on the continent has been accompanied by a waning of violent conflicts, which have declined from 15 in the early 1990s, to essentially three: Darfur (and its ramifications into Chad and the Central African Republic); Somalia; and residual skirmishes in the Great Lakes region (eastern Congo, Burundi and northern Uganda). Moreover, unresolved conflicts persist in Western Sahara, the Ivory Coast, the Niger delta, and on the border between Ethiopia and Eritrea (Hugon, 2009).

Improved security is also evidenced by upbeat figures on crime, delinquency and proliferation of light weapons. Also, the reform that transformed the Organization African Unity into the African Union has had a positive effect upon the coordination of African peace-keeping efforts, on new prospects for economic collaboration, and on the presence in the region of new international players, such as China, the United States, India, and Brazil.

This scenario of stronger economic performance will, under present circumstances, unquestionably contribute toward the restructuring and strengthening of the African State, in this dialectic among the central and private, national and ethnic, modern and traditional, regional and international spheres in which actions take place, thereby giving rise to new models of social and political life, with decisive participation of peoples who, (regrettably?) as yet, have been unable to achieve well being outside or without the framework of the State.

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SÃO TOMÉ AND PRÍNCIPE REACHES ADULTHOOD: GOVERNANCE AND MISTRUST OF THE STREET

Augusto Nascimento*

ABSTRACT

São Tomé & Principe comes of age against a background of racial antagonisms, flaws in the economic and social fabric, and political instability. Whereas the breezes of globalization upon reaching the country are shaking up its insular society, the management and performance of institutions is sorely in need of improvement. This text briefly reviews the archipelago's post-independence history and attempts to outline various prospects for political development.

1 INTRODUCTION

Shortly, some citizens of São-Tomé born after Independence, in 1975, will become grandparents. Few have any clear memory of colonialism and younger ones lack even an impression passed on by their forbearers. Such memories may be blurred by the accelerated pace of social and cultural change, in the world and in the archipelago. The course of world events tends to be viewed through the prism of racial antagonisms, supposedly coincident with asymmetries of economics and power in the world, and a standpoint of militant post-colonialism now quite out of step with the world. Be that as it may, Portuguese colonialism appears increasingly distant and, consequently, exempt from responsibility for the course of the country's destinies over the 35 years since independence.

From a generic and simplistic standpoint, these three-and-a-half decades appear marred by economic and social failures, exacerbated by political instability in the two latest decades of multi-party government. Paradoxically or not, this instability indicates that institutions (and especially those that ensure alternance of power) are working reasonably well, and that democracy is palpable, in terms of freedom of political expression, both in the streets and in the press.

Having failed to fulfill successive promises of prosperity, as the recurrently trumpeted theme of change (the prototype of which was Independence) the prevailing sentiment seems to be one of perplexity, when not simply of resignation. In this country, where globalization crosses paths with a web of local dynamics that enmesh this tiny island State, the complexity of policy decisions extrapolates

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the smallness of its territory. Moreover, the alarming incapacity of politicians to reach compromise appears both artificial and unreasonable, in face of the huge difficulties facing the archipelago. Indeed, one might think that such difficulties could be overcome, as the archipelago does not face such dire problems as those of governments and peoples in more adverse socio-political contexts.

Perhaps the past can shed some light. This article provides a brief historical overview of the post-Independence[1] period, by examining deeply-entrenched cultural and political traits in the social fabric, in an attempt to outline various scenarios for political development of the archipelago.

2 THE HISTORICAL BACKGROUND

Covering approximately one thousand square kilometers, the archipelago had a population of roughly 80,000, in 1975, counting islanders, indentured laborers and their descendents, and Europeans.[2] Due to strong population growth, the population in 2000 had reached 132,301 (Santo, 2009, p. 189) and, according to projections, currently stands at more than 150,000.

At the time of Independence, Europeans held all prominent positions, most of them being wage earners, either in the colonial administration or on the plantations that owned 90% of the land. For decades, they dominated the economy of the islands, monopolizing the land and disparaging local labor, preferring to hire workers imported from other colonies. There was practically no economic alternative to the export of cocoa; almost no diversification of the economy and, due to the dynamics of local accumulation, no prospects for enrichment of islanders. Up until the 1950s, colonial policy attended solely to the interests of plantation owners. The archipelago was described as a plantation colony; and not a place for settlement. It was a society based upon routines and social immobility, with racially-stratified labor and the ethnocentrism of its colonists (with their feelings of racial supremacy) living among and in command of indentured laborers working in the fields. Such employment was considered poor compensation for the despoilment that some Europeans perceived, and to which they were themselves subject. Over decades, the progressively marginalized islanders accumulated resentments stemming from their subordination under a system which left them feeling cheated.

1. Historical summaries of the period covered by this article are to be found in Hodges and Newitt (1988), Seibert (1999, 2002) and Nascimento (2000a).

2. During the colonial era, such indentured laborers were imported to do field work. For a long period these field workers were subject to tutelage of farmers or farm managers and were kept apart from local society. Indeed, the islanders made efforts to distinguish themselves from the indentured laborers, who were obliged to do demeaning work in conditions of virtual slavery. Whereas some such indentured laborers were later repatriated, others established themselves on farms, and some remained after Independence. To this day, differences between islanders and former indentured laborers have not been totally erased.

These features, typical of colonialism and molded by authoritarian and conservative thinking, only began to be removed in the 1960s, with the launching of economic and social policies targeted at achieving social integration of the local and immigrant populations. Within the limits of political control allowed by a regime unwilling to see its legitimacy questioned, the social environment was opened up. Throughout the 1960s, social coexistence was apparently peaceful. Meanwhile, effective opposition to colonialism was negligible, because sedition was prevented and controlled. Many São-tomenses were oblivious to politics.

It is sometimes said that colonialism left a reasonably well-organized economic legacy and infrastructures of some value.[3] Despite references to the deliberate ageing of productive facilities, unsheathed to justify poor economic performance in the post-Independence period, the most troublesome colonial legacy was not related to the economy, but rather, to human and social capital. In view of the dictatorial tone of its final half century, colonial rule did not allow for the emergence of a local elite, and neither did it foster the habit of debate on the future of the archipelago.

Moreover, São-tomense society reached Independence devoid of memory of any form of political or social competitiveness, much less of any social struggles.[4] It was a society held hostage to a tradition of immobility, at first sight aligned to the limited horizons of the archipelago, in which only in the final years did the paternalistic policies of the colonial regime appear to relax at all. The struggle for political emancipation was thrust upon the archipelago by the coup d'état, in Portugal, on April 25, 1974. In 1975, the view of the São-tomenses as a peaceful people prevailed, as corroborated by various visitors in the years following Independence.

In the final years of the colonial era, the destinies of the archipelago would rest upon decisions made in Lisbon and upon the outcomes of military confrontation in Portuguese colonies on the African continent. In 1974-1975, the archipelago's change in course came from outside. The Movement for Liberation of São Tomé & Príncipe (MLSTP) was comprised of exiles with backgrounds formed in various African countries. In the midst of conflicts, their militancy

3. Evidently, this does not invalidate questions as to whether an economy based upon small farming, and especially cocoa exports, would be capable of facing up to challenges of development, ranging from increasing national income to redistribution of income and personal and collective wellbeing. Today, it is a consensus that the cocoa economy could not support such aspirations – see, for example, Santo (2008). But, after Independence, despite discourse about the decrepitude of installed productive capacity, an option was made not to diversify the economy, but rather, to nationalize the plantations. Thus, the State of São Tomé preserved the economic structure inherited from colonialism, bearing with it the burden of State bureaucracy.

4. From the colonial era to the single-party regime, the police kept strict control over popular movements. Moreover, in the post-Independence period, a self-perception of ill-fated destiny deflated social movements, excepting when in reaction to some apparently more serious occurrence. In view of the constant realignment of factions and blocks, not everybody subscribed unconditionally to such pessimistic views.

had little impact and was hardly noticed on the islands. The leaders of the MLSTP had lost touch with events on the archipelago. After the April 25 coup, the struggle reached the islands through the actions of young students, under the pro-MLSTP *Associação Cívica*. In a political context already favorable to independence, they capitalized upon expressions of the islanders' resentments for decades of subjugation to colonists, and upon trumpeting of a brilliant future once the latter had been removed.

At the same time, doubts persisted among the more conservative São-tomenses (by this time, a minority) who were opposed to independence. Actually, Portugal was by this time no longer counting upon preserving colonial ties, nor even on safeguarding the interests of Portuguese residents. It was hoping, above all, for a smooth uneventful transition. The radicalism of *Associação Cívica* proved to be unsettling, but this was finally reigned in by an agreement between the Portuguese authorities and the MLSTP leadership. Also, political turbulence was avoided by the Portuguese authorities' conviction that independence was inevitable and their consequent acquiescence.[5]

The country thus became sovereign and free; however, such freedom did not extend to its citizens. Under the thrall of the MLSTP, which absorbed all other party organizations that had emerged after the coup d'état in Portugal, Independence came on July 12, 1975. Thus, a new authoritarian political regime, of socialist stamp, was brought into being. The State was subjugated to the party, the MLSTP, led by a small group under the egis of its president, Pinto da Costa.

Quite unforeseen, the changes of 1975 came from outside and rapidly underwent radicalization. The leaders of the independence movement came from exile abroad. Imbued with an idealized vision of the land they had left behind them, often over ten years earlier, they perceived the gap between their own yearnings and the desires of their compatriots, whom they viewed with an ideological bias. They had not accompanied changes that had taken place in the land under the final years of colonial rule. To overcome this gap between their ideological view of their land and the economic and social changes that had taken place, they proposed volunteer action, inspired by socialist ideology. They took it upon themselves to interpret the changes wrought in the archipelago from a standpoint of realizing human historic destiny. In this they were aided by the [cold war] confrontation occurring at that time. They thus resolved to filter foreign influences, as a means of developing the aspirations of their fellow citizens.

5. This conflict, which led to the exile of São-tomenses on the eve of Independence, is a source of resentment to this day. Some authors perceive this episode, in which the old leadership of the MLSTP expelled the youths of *Associação Cívica*, as being the leitmotif of subsequent conflicts during the period of political liberalization. However, it can be affirmed that, since 1990, a culture of political confrontation has arisen alongside institutional mechanisms, in detriment to the settlement of differences and alignment of interests.

In the field of foreign relations, and without prejudice to incipient diplomatic ties, the new country further deepened the isolation inherited from colonialism. While maintaining almost inescapable relations with the former colonial power, it fostered political animosities in the relationship with Gabon,[6] a country where MLSTP leaders had found sanctuary during the pre-Independence period, and forged ties of cooperation with socialist countries, notably Cuba, Russia, the German Democratic Republic and China. By this time, while maintaining close links with Angola,[7] the archipelago had turned its back to the nearest coast. The option to pursue tourism was deliberately discarded, in view of its perceived association with moral degradation, and especially prostitution, as if it were the epitome of capitalism. What the new leaders really wanted was to control foreign influences[8] by setting limits to the appetites and demands of the population. As difficulties led to disappointments, abroad would assume mythical proportions for the people of São Tomé.

Backed by a police force whose mission, purportedly, was to defend the independence of the islands against the machinations of neo-imperialist agents, political and social control of the population depended upon this filtering of all interaction between the country and the world. Isolation in relation to the outside world was facilitated by difficulties in the field of communications. Curiously, on the one hand, the nature of the tiny islands and the ease of imposing control and, on the other, the tight networks of family ties, served to temper the virulence of the dictatorial regime in the post-Independence period. Fear was cultivated, and some of the less timid or less socially prominent citizens were persecuted; but only one political prisoner died in jail.

In São Tomé, the seat of power and by far the most populous island, opposition assumed a dissimulated approach.

6. For a summary of the relationship with Gabon, see Hodges and Newitt (1988, p.120). At the time, though nothing was explicitly stated, it could be perceived that allusions to threats from abroad were targeted at that country. Formal relations with Gabon existed, but there was no friendship with the president, in part, owing to ideological differences between the governments of the two countries.

7. Relations with Angola have historical roots going back to the colonial period. More recently, Angola had been the source of most laborers for the plantations. The anti-colonial struggle brought the future leaders of the two countries together and, after Independence, closer ties were established between the two States. Angola was stop along the way between the archipelago and the rest of the world, and provided military and economic support for the archipelago. Angola is nowadays the country with the largest São-tomense expatriate community.

For further information on relations between the archipelago and Angola, see Nascimento (2000b).

8. Much the same had been done by the colonial administration. Nonetheless, despite well-founded accusations that this had led to a closing of the archipelago, in the final years of colonial rule proposals were floated to invest in tourism, and controlled visits to the archipelago were allowed. With Independence, these became less common, essentially because the country had turned its back to Gabon and closed itself to the outside world. Santo (2009, p. 98-99) argues that tourism was abandoned as a development strategy for ideological reasons. Without refuting that argument, this author feels that the tendency was to subordinate economic rationale to the political goal of consolidating the MLSTP's hegemony. Pragmatism gave way to the goal of remaining in power.

The archipelago was subjected to the usual mindless actions of regimes of a socialist and authoritarian stamp, and witnessed power struggles among leaders of the MLSTP, from which Pinto da Costa emerged triumphant. In 1979, he arrested his erstwhile prime minister, Miguel Trovoada, on the charge of attempting to lead a coup d'état.[9] Subsequently, this aggressive underhand approach was to cause gradual desertion of leading cadres, upon whom it dawned just how limited their prospects were, between blind fidelity to their leader and renunciation of all active militancy.

Seeking alternatives, in view of the duplicity of their leaders, mid-ranking cadres and the general population lost interest in institutional and productive pursuits, and learned how to get by, in a context of growing and unequally shared economic privation[10], the climax of which occurred during the 1983-84 droughts. This quite unexpected and unprecedented climatic phenomenon had serious repercussions upon the already precarious survival strategies of the populace, bringing into doubt the ancient aphorism that, poverty notwithstanding, no one died of hunger. Some inhabitants of São Tome viewed the drought as a transcendental judgment upon the errors of mankind. The political project designed to combat religion that, with a view to eradicating colonial obscurantism sought to replace the customary celebration of St. Thomas the Apostle's Day (on which, according to tradition, it always rains) with a commemoration of People's Power, met with strong rejection. Less than ten years since Independence, the difficulties seemed insurmountable.

Economic performance declined. Aside from the easy pickings gained from appropriating export earnings at the expense of workers, nationalization of the plantations aimed to overcome rural-urban social differences. As a consequence, former-indentured laborers found their subordinate position perpetuated, and further worsened by the economic difficulties that the country faced. While claiming that all land belonged to the State, the MLSTP made symbolic land grants to all inhabitants of São Tome. What in effect happened was that, as a consequence of nationalization, natives with little or no knowledge of agriculture took the place of colonists in the management of the plantations. The relative status of islanders and former-indentured laborers was maintained, despite the fact that all now enjoyed formal citizenship rights. Appeals for greater efforts to increase production

9. Miguel Trovoada was held in the building of the United Nations Development Programme (UNDP), and was freed and allowed to go into exile in July 1981.

10. By this time essential goods had become scarce. With devaluation of the currency, the supply of locally produced foodstuffs declined. To purchase imported foods, people of São Tomé stood in line for hours in the People's Shops, even to acquire such staples as bread and milk. Finding sufficient food became an arduous everyday task.

for the good of the community fell pray to the rigidity of authority. Predictably, they were ineffective in view of hierarchical relations unsupported by capable performance and increasingly viewed as arbitrary, even by those who had endured the encumbrances of colonialism, but whose fresher memories of the political and social trauma of recent years were even more vivid. Off the plantations, the limitation of horizons, stemming from subjugation of daily life to petty and (worse still) constantly changing regulations, led some to apathy, and others to despair.

The people of São Tomé rose up in 1979; and those of the Island of Principe in 1981. The first uprising, though spontaneous and politically uncoordinated, was particularly violent; the second had less impact and was rapidly put down. The first fed fears of the security forces against alleged reactionary agents and, in a frenzy of militancy, probably inspired by the Mozambique Liberation Front (Frelimo) and the Popular Movement for Liberation of Angola (MPLA),[11] reaffirmed the leadership role of the MLSTP. The outcome of this spontaneous uprising was a hardening of the group in power, with a distancing from the population, although the ritualized performance of nationalist celebrations and mid-level decision-making procedures appeared to confer some support. Be that as it may, the population remained deprived of any means of political expression and, increasingly, lost faith in the leadership.

Alongside declining living standards, there was a gradual crumbling of institutions, assaulted by self-serving attitudes, the economic repercussions of which were to prove devastating. By the mid-1980s, all that remained of socialism was the futile effort to create a New Man [*homen novo*], supposedly a blend of the post political-independence culture of emancipation, on the one hand and, on the other, renunciation of yearnings for the colonial era, subliminally pruned of all causes of popular alienation. This proposed discipline and regeneration could only last so long as the exaltation of Independence remained alive.

The goal of the *New Man* (which, for a certain time, stood for the aspirations of African manhood, freed from oppression and alienation) also underpinned economic options and, alongside contemporary belief in the role of the State in development, also underlay motivations for political and social control, such as retaining power in the hands of a few. Unilaterally dictated, designated by

11. In 1979, the Group of Five, comprised of Angola, Cape Verde, Guinea-Bissau, Mozambique and São Tomé & Príncipe was established. Affinities among the leaders developed during the struggle against Portuguese colonial rule. Their ideological and political convergence was further strengthened by the fact that their independence was taking place amid the heat of the Cold War ideological stand-off. The Group of Five Summit Meetings occurred in various countries, and only ceased after the wave of democratization in the 1990s. Mozambique Liberation Front (Frelimo), Popular Movement for the Liberation of Angola (MPLA).

new labels for individuals, now referred to as *nationals*,[12] the apparent social homogeneity (in effect, defined by containment of individual ambitions) ended up serving as a mechanism for social control, to be upheld by those same individuals. Rhetoric of the independence movement notwithstanding, the illusion of exercise of political power by the masses was reduced to a mere ritual, since all real decision-making power was concentrated in the hands of a very restricted group.

By the mid-1980s, few still subscribed to socialist dogma. Gradually, opposition festered. Though the population did not organize to contest political office, yet it distanced itself from the political aims of the MLSTP which, in effect, offered to offset growing privations with promises of a brighter future. Lacking in moral substance, the exercise of authority was increasingly ineffective. Against this background, the State of São Tomé began to dissolve,[13] its institutions decayed, and social life fragmented.[14]

Nonetheless, political change would not result from popular pressure,[15] unless one counts festering resentment spurred by hours wasted standing in line to purchase essential goods and all the rigmaroles of *schemes* which, even in comparison to the much-maligned colonial period, served to aggravate the lives of the São-tomenses. Following the crisis of governance (the initial signs

12. Some authors imply that Independence conferred upon the people of São Tomé and other Africans the status of citizens, as apposed to colonized peoples. In fact, in the 1980s, the most commonly used designation was '*nacionais*'. However, under this status, people were liable to more obligations than rights, generally obligations stemming from engagement in tasks prescribed by the political leadership. It was as if, more than mere citizens, the people of São Tomé had in some way become property of the State. This was, evidently, a goal in line with the socialist aims of the MLSTP. Aside from questioning whether acceptance of this ideia had been duly assessed at the time of transition and exaltation of Independence, one might well also ask: did not such acceptance stem from the legacy of a colonial culture of subservience and obedience to authority? Or, did it originate from an almost invisible, yet powerful, cultural trait of African societies, based on rights over people, rather than rights over goods? If the latter hypothesis is correct, it becomes necessary to reassess not only the cultural depth of Portuguese colonization on the archipelago – which, though it lasted several centuries, when compared with other colonial ventures can be regarded as a mere varnish, breached in the wake of independence – but also to consider the influence of this cultural ballast on the political configurations and local practices, also as compared to other African contexts.

13. By using this term "*deliquescente*" [dissolve], I [the author] aim to indicate the loss of authority and of efficacy of the State since Independence which has not, however, totally annulled its political, social and (circumstantially) unequal preponderance. The population of São Tomé remains aware of the need for a State. It is relying upon this perception that the party in power recurrently proposes to reaffirm the authority of the State, as a precondition for reconstruction and development of the country.

14. According to Branco and Varela (1998, p. 42-43) notwithstanding its aim of social transformation, the São-tomense State was a "soft state" whose institutions were incapable of implementing its political objective of consolidating a national political administrative system, and it proved incapable of imposing a productive economic system.

15. This view is defended by Branco and Varela (1998, p. 11-13/36) both of whom were associated with the MLSTP and assumed government responsibilities. In the 1980s, as the winds of change swept the archipelago, under the rule of Pinto da Costa, the reformers had the opportunity to debate their reasoning with more orthodox cadres. Espousal of the ideia of a change in course within the core leadership of the MLSTP stems from the memory of this (contained) confrontation between advocates of reform and of orthodox positions, which also coincided, to some extent, with a generational struggle and responses to world events. Foreign authors tend to stress the role of exogenous forces for change and for democratization. Ferreira (1990, p. 164) holds that the desire to install democracy arose from dissatisfaction with economic disorder, and from pressures from foreign governments and international institutions. Seibert (1999, p. 152-153/409) considers that the principal motive behind the changes that took place as of 1984 were economic weakness, rather than popular pressure. From the standpoint of the MLSTP leadership, what mattered was preservation of their power, regardless of political or economic changes. Eventually, they were overtaken by events.

of which had been a reformulation of the economic model in the second half of the 1980s) Pinto da Costa decided to seek rapprochement with the West, through adjustments in the economy and, lastly, through political changes. In accordance with the recipe for conversion of authoritarian regimes into open political systems (gradual social and political changes, appeals to dissidents to return, convocation of a National Conference[16] and the emergence of groups that, over time, could become opposition parties) the preannounced path leading toward liberalization was followed. Curiously, resurgent resentment emerged throughout the land, bent upon discrediting the intentions of Pinto da Costa in promoting political liberalization.[17]

3 THE RECURRENT PROMISES OF CHANGE

The changes of the early 1990s led to a remodeling of political and institutional structures, in line with the Western model; as was purported to be the objective of some of the *independentistas*. Following the referendum of 1990, a new constitution[18] came into force in 1991, under which the country was described as a representative democracy. Under the slogan of Change, former-exile Miguel Trovoada mobilized vast popular support for his election as president. Though the MLSTP had made the transition to social-democracy in the late 1980s and added Social Democrat Party (PSD) to its title, it was an alliance of dissidents under the banner of the Party of Democratic Convergence – Reflection Group (PCD-GR) that won the election.

Monolithic thinking had been breached, but parties tended to be groupings devoid of ideological content, whose efforts focused merely on disputing power.[19] From the onset, such efforts focused upon subordinating democratic institutions to special interests. Quite apart from the almost vertiginous accumulation of economic difficulties, exacerbated by the Structural Adjustment Program, a great majority of people still prized the multiparty regime. Disregarding aspersions as

16. The National Conference, of December 16 to 19, 1989, sought to overcome resistance to change within the MLSTP. See Branco and Varela (1989, p. 65).

17. This refers to some observers who, though not natives of São Tomé but having some knowledge of post-independence history, ceased to doubt that the pressures for political liberalization had become irreversible. However, certain of the more strident proponents of democratization – some of whom had abandoned the MLSTP – repeatedly expressed their doubts as to the principles underlying Pinto da Costa's position, even after they had witnessed the first concrete achievements. They sought to disqualify them and to block them politically, rather than to express well-founded doubts with respect to the irreversibility of the new political path. If such arguments were voiced, it was because it was felt that they would find resonance with a population whose resentments, at having been subject to so many privations, grew in proportion to their perception of the duplicity of their rulers and the belief that they were simply protecting their own privileges.

18. Drafted by a Portuguese constitutionalist invited by Pinto da Costa, the text underwent reformulation with a view to strengthening presidential powers relating to defense and foreign policy.

19. For Seibert (1999, p. 412) the parties represent not just ideological dissentions, but also rival groups in the dispute for power. This description still applies today.

to the authenticity of their democracy[20] and criticisms of the fairness of the electoral process, change remained a noble aim to the eyes of the population of São Tomé. Influences from the outside world (of which people were now more aware, through the emergence of greater interaction among myriad players, and not just States) and greater access to information and consequent cultural opening, led to a crescendo of demands for definition of minimum human-rights standards, applicable also on the archipelago, as life began to take on features quite unlike those of the period of single-party rule.

The truth is that the entrenched incumbent party was overwhelmingly defeated by change, personified by former-exile Miguel Trovoada,[21] upon whom the population pinned hopes for a new era of post-Independence redemption. In such a political and social context, any attempt by the MLSTP to control the process of democratization or secure victory at the polls was doomed. Whatever the intentions may have been at the onset of the democratization process, omens of implacable defeat led Pinto da Costa to withdraw from the first election. In this way he avoided the political punishment of founders and rulers, uncommon in Africa, that the São-tomenses inflicted upon the MLSTP, the party of Independence.[22] Thus, the path to socialism imposed since independence, had been soundly rejected.

With the weakening of social subordination and obedience inherited from the colonial era, community life on the archipelago was molded by the corrosion of social regulations of the previous period. Increasingly, political disputes were held hostage to a web of minced words and social conveniences, on the one hand, and the personalization and consequent aggravation of conflicts, on the other. Instead of presenting competing political and social programs, the inflammation of political discourse reflected unhealed traumas[23] in the political struggle. Political party structures began to be perceived as vehicles for promoting personal ambitions.[24] While president, Miguel Trovoada created his own party, the Independent Democratic Alliance (ADI).

20. In 1999, Seibert (1999, p. 244) considered that the democratic institutions had become compromised by appropriation of resources by special interests (a phenomenon which had also been common under the single-party system) and propounded that the democratization process ran the risk of being limited to creation of institutions that were only formally democratic. Without prejudice to the accuracy of his considerations, one can hardly overlook the vivid political competition. In view of the interests at stake, contenders become committed to the "*banho*" [bath - bribery], a form of redistribution of favor at election time, an issue that will be taken up later in the text.

21. Differently to other MLSTP former-militants, Miguel Trovoada has remained totally averse to any conciliation with Pinto da Costa that was, allegedly, to be mediated by President Bongo in the second half of the 1980s.

22. It should be noted that, owing to disillusionment with management outcomes brought on by *change*, which led to conflict between Trovoada and the PCD-GR government, this latter party was also subsequently punished in the 1992 *autarquia* [local] elections established under the new Constitution.

23. According to Seibert (1999, p. 99) the conflicts of the 1990s were a resumption of unresolved issues dating back to the time of the Committee for the Liberation of São Tomé & Príncipe, the organization that preceded the MLSTP.

24. Despite recent pronouncements of ideological affiliation and identity, the parties remain institutions related to personalities who, not rarely, underwrite them. Such is currently the case of the *Movimento Democrático Força da Mudança-Partido Liberal* (MDFM-PL) the life cycle of which is closely linked to the political prospects of its founder.

Nonetheless, transition to democracy brought the guarantee of civil and individual rights, and freedom of the press. Significantly, the power of rumor did not decline, as a form of counter-fire with which the population wrought symbolic vengeance upon politicians. The most common manifestation of this phenomenon is the caricature on the front page of *O Parvo*, a newspaper which, with rudimentary means, has been published without interruption over the past fifteen years.

Political liberalization brought an end to the support of Angola, whose army had remained in the archipelago for more than a decade, supposedly to defend it against foreign aggressors but, in practice, to lend support to the MLSTP. The People's Armed Forces for the Liberation of Angola returned home soon after inauguration of the first constitutional government, thus severing the hitherto umbilical link with Angola. The "whiff" of oil[25] hastened termination of this relationship, as it led to rapprochement with countries of the nearest African coast. In 1998, negotiations were launched to discuss maritime borders with Equatorial Guinea and with Gabon, and a final settlement was reached in 2001. Also under the administration of Miguel Trovoada, the maritime border with Nigeria was settled. In 2001, a solution was negotiated for the most promising oil field, with the establishment of a common oil exploration zone, covering 28,000 square kilometers. In the wake of this solution, these countries signed cooperation agreements (Santo, 2009, p. 178) or special partnerships[26] which relegated relations with Angola to a secondary level.[27]

For many years, oil appeared to presage a new cycle and the hope for that bright new future to which politicians were no longer alluding. It has been amply demonstrated that, aside from longed-for positive economic effects, oil is also apt to bring with it rent seeking and so-called "Dutch disease", an inflationary spiral triggered by the incapacity of other sectors to survive in an economy flooded by oil revenues. Fears of rent seeking are manifested in the agreement signed in 1997 with the Environmental Holding Remediation Corporation. Alongside

25. In the midst of an especially difficult decade (the 1990s) overshadowed by low prices for cocoa exports, caused by progressive degradation of the plantations, added to the socially disruptive effects of structural-adjustment policies, the glorious prospect of oil arose, bringing with it, once again, promises of redemption.

26. Under the agreement, 60% of the revenues of the joint oil field would belong to Nigeria, and 40% to São Tomé & Príncipe. Preparations were made to put blocks in this area up for tender. Many years ago, it was calculated that, between 2005 and 2025, this exclusive zone could provide 800 million barrels of oil (Menezes, 2002, p. 104). By 2010, no oil exploration had taken place.

27. Regardless of the political volatility of the archipelago, at one point it seemed that Nigeria had replaced Angola in the position of special partner which the latter had enjoyed since the Independence era. This alignment with Nigeria, forged in the aftermath of the attempted coup of 2003, appeared to be reaffirmed by the government formed after the elections of August 2010, in counterpoint to the affirmation of the outgoing administration that Angola was a strategic partner.

It was after the "discovery" of oil that São Tomé & Príncipe turned toward the northern coastline, with which it had maintained close ties one and a half centuries previously, during the era of the transatlantic slave trade.

others (also deemed unfavorable to São Tomé & Príncipe) the terms of that contract were subsequently renegotiated.[28] In view of the feared economic distortions that oil exploration might cause, safeguard measures were introduced to ensure prudent management of oil revenues, among them, the Petroleum Revenues Management Law, approved in 2004. Among economic and social pressures, the efficacy of this instrument for management of oil revenues would be tested.[29] Aside from fears that rent seeking brought on by abundant oil revenues might undermine the dynamics of the local economy, there were also accusations of undue transfers of oil. Indeed, for many years, issues relating to oil were shrouded in silence and contradictory information.

In compliance with legislation, the investment of oil revenues is confined to education, health, and social welfare. It was believed that the availability of funding would contribute toward overcoming of certain social problems, and to the outlining of a strategy for sustainable development, based upon enhancement of human resources, increased employment, and wellbeing of the population.[30] Once having achieved the prosperity promised by black gold, some expatriate São-tomenses could be induced to return to the country.

While the São-tomense diaspora has spread to many parts of the world, recent years have also witnessed the arrival of immigrants from the nearby coasts, attracted by prospects of making money in various fields of economic activity in a country that enjoys relative social peace.

Comparatively speaking, this perception is undoubtedly accurate, despite the attempted coups d'état of the last decade of the past century. The presidents are not, strictly speaking, responsible for day-to-day government, but it is they that are targeted by popular demands that, to some extent, are manifested by such attempted coups.

Both coup attempts, in 1995 and in 2003, were put down by the international community.[31] But the accompanying demonstrations had popular support and restoration of the constitutional order took several days. Due in part to the nature of the small-island country and its dependence upon others, on both occasions contributing factors

28. Trade agreements were signed with companies in the oil sector, whereby São Tomé & Príncipe gave up a substantial portion of prospective oil revenues. Under renegotiation, these agreements have become less onerous for the archipelago. For a historical account of the oil exploration agreements, terminated and subsequently renegotiated by São Tomé & Príncipe, see Menezes (2002, p. 100ss).

29. On August 30, 2010, the Association of Economists requested that the new government institute an oil inspection agency. Though created in December 2004, this agency has not yet gone into effect. See *Repórter África* (2010).

30. Significantly, successive government authorities have sought to draft development projects that do not rely on oil revenues, as these increasingly are perceived as a mirage. On the *streets*, there is much mistrust with regard to misappropriation of such revenues by members of government.

31. On the coups d'état of 1995 and 2003, see Seibert (1996, 2003). On March 8, 1988, there was a coup called the '*golpe das canoas*'. The authorities had been forewarned and the coup was pitifully organized. Following the transition to democracy, the plotters were pardoned. At no time did they constitute a real threat.

to the negotiated solution came from abroad. Notwithstanding divergent interests, the international community restrained the coup makers. However, despite containment of the more disruptive forms of violence, there has been a gradual increase in low-intensity violence, which remains both contained and unpunished, not in the name of causes (as in the past) but, presumably, as a form of retaliation.[32]

Open political competition brought on by the return to multi-party democracy did not appear to usher in a new crop of leaders or political parties, nor even a new political elite. This void made way for hope of a solution from outside the realm of politics. Pinto da Costa announced his candidacy for the presidential elections of 2001. The country was facing particularly difficult circumstances and, by the end of the decade, disappointment with the failure of much-heralded *Change* appeared to open up the field for one who, despite rumors as to his instigation of the 1995 coup attempt, had remained aloof from the political fray since the period of democratic transition, of which he too had been a protagonist. Nonetheless, in 2001, the cause of *Change* gained a new face, Fradique de Menezes.

Fradique de Menezes appeared to embody the virtues of one who had come in from outside, and had a background of economic success. He appeared to be the ideal candidate to dispute the election against Pinto da Costa. Crudely speaking, the ideas he embodied were of swift and efficient corporate-style government. Not lacking in personal offenses, the election campaign featured posters reminding voters of the 1979 census, of the instability of the early years of Independence, and warned of the danger of return to single-party rule. More to the point, the efficient and attractive choreography of Menezes' political rallies promised the hope of a future under better economic management. Though Pinto da Costa vainly tried to emulate this style at his own rally in *Praça da Independência*, in a glaring marketing flaw he struck a regal pose, thus demonstrating his incapacity to make populist gestures of empathy and complicity needed to convince swing voters.

Much more at home under the spotlight, Fradique de Menezes won the presential election. Setting out to maximize his own power, he appointed and dismissed prime ministers, and forced renegotiation of oil contracts on more favorable terms for the country. Like his predecessor, he created a political party, the Democratic Movement Force for Change (MDFM) with an acronym incorporating the initials of his name, (thereby subliminally associating *Força da Mudança* with Fradique de Menezes) to which he later added the name Liberal Party (PL). To expand his powers, Fradique de Menezes revived the idea of a constitutional review. In this, however, even his own congressmen rejected his draft, which, he

32. Some of the new owners hired guards, who were sometimes ordered to defend the property using forearms. Resort to such methods would have been unimaginable in the past and just after Independence, and they are considered a symptom of economic segmentation and manifest incapacity of the State to apply the law.

claimed, would bring the constitution into line with the prevailing mentality on the archipelago which, as in Africa, requires a strong hand at the top, the division by branches of government being poorly understood. He impressed George Bush, at a breakfast with African leaders in September 2002 in New York, when the United States was seeking sources of oil other than the Middle East. Nonetheless, American support in the field of security has been restricted to minor actions, since the Americans do not appear disposed to assume active commitments to the security of the islands, in a complex regional scenario. Little by little, enthusiasm for Fradique de Menezes waned, and his party (which, amidst much political controversy, he had formally presided while still president) lost support until, in the elections of August 1, 2010, it elected only one congressman.

The country went on changing while maintaining continuity, spellbound by a hope of redemption from abroad that might bring an end to its apparently insolvable impasses. Unquestionably, there are now more opportunities for making a living than in past decades and, despite growing economic asymmetries, essential goods are no longer in short supply. Nonetheless, economic changes notwithstanding, huge problems persist in the fields of education and healthcare, while job prospects remain scarce. Over the years of democratic regime, political and social disparities between rulers and the ruled have deepened,[33] as demonstrated by the outcomes of the August 2010 elections, in which members of the opposition party did well.

4 POLITICAL AND SOCIAL FISSURE

The common-sense perceptions of the street are now worth examining. Based upon their experience of abysmal economic disparities, São-tomenses unfailingly subscribe to the view that misgovernment it the major factor underlying their impoverishment.[34] But, in the light of the huge disparities between the rulers and the ruled and, like heads and tails of the same coin, while a significant portion of the population claims to despise politicians, this does not mean that such people are unwilling to take as much advantage as they can of patronage, in the form of the *banho*.[35]

For the common people of São Tomé, the government's continuous failure to fulfill promises and satisfy basic needs is undeniable, and the rapid enrichment of those in power is resented as unfair and unjustifiable, especially since every-

33. Predictably, this chasm is greater among the newly-formed diasporas, looked down upon, on the one hand, by the rulers and those who stayed put or who hold mid-level positions, and who resent the ties established freely and with impunity abroad. This reflects the difficult relations that the country maintains with its diaspora, whose leaders, removed from the opportunities of the homeland, make themselves heard by raising the banner of civic demands for better governance.

34. Citing, Santo (2009, p. 147), among others. This author reproduces data examined by international institutions on the rise of poverty up until 2001. See Santo (2009, p. 148-149).

35. From a foreigner's standpoint, the "*banho*" or buying of favor by distribution of gifts may appear irrational. Observers do not perceive links between illegal vote buying and beneficiaries of the *banho*. According to Seibert (1999, p. 412) gifts distributed during campaigns do not ensure votes but, nonetheless, have an effect, in view of a cultural tradition for reciprocity.

one knows where their wealth comes from. These are conclusions drawn when, without recourse to complex sociological theories, the people of São Tomé seek to explain the blighted destinies of their country, for which they blame their rulers, when not blaming themselves.[36] The ideia of an inexorable destiny, inferred from individual experiences of loss is extended to the entire course of history of São Tomé & Príncipe. Underlying the good-natured atmosphere lies a sentiment of irremediable despair at missed opportunities of a better life.

Against a background of poverty and marginalization suffered by a portion of the population, slogans of *Change* intone themes of salvation and miracle working. Such themes proved politically effective in 2010, and were especially well received by younger voters. On the one hand, they lack memories of the *changes* launched in the early 1990s and of the disappointments they subsequently engendered; on the other, they deem the country capable of a rebirth, by removal of corrupt and thieving *politicians*.

Anyone walking through the heart of the City of São Tomé during the campaigns for local and legislative elections (on July 25 and August 1, respectively) could perceive how the young tended to vote for the ADI (as the outgoing prime-minister Rafael Branco, acknowledged when conceding defeat). In political terms, this party proved much more aggressive and better organized than is usually the case in the country.

The *street*[37] disdained the MLSTP's contract with "civil society",[38] interpreting it as a cooptation sustained by nebulous and shady deals. Whether or not this view was justified, it seemed a plausible reading in a country in which, to the present day,

36. By running counter to the promises of the period of Independence and the agenda of all politicians, rising poverty engenders loss of self-esteem, with effects that are as socially corrosive as the old racial stigmas stemming from a sense of innate racism and the paternalism that underpinned the colonial system. Among such effects is the low trust of islanders in politicians, and even of themselves.

37. The *street*, a social actor that is difficult to describe or characterize, is the main target of political action in the archipelago. In view of the way in which information and controversies circulate, and their susceptibility to vagaries of individual perception and ear-to-mouth communication rather than conventional media content, scrutiny of politicians is literally conducted in the street, where all social problems are voiced. A major portion of economic activity and of circulation of information takes place in the *street*. It is in the *street* that opinions are molded. Such opinions affect everyone, except those who are not obliged to seek livelihoods in the *street*, and who are thus able to cultivate a certain detachment.

As in other contexts, the response to difficulties may assume greater or lesser degrees of violence. But more serious than the episodic violence in itself is its corrosive effects in terms of a breakdown of social cohesion, which raises the costs of the islands' economic and social performance. Increasingly, informal and precarious forms of organization have become ingrained in the social fabric of São Tomé. At the same time, people are reduced to seeking means of ensuring survival, while the costs of building a fair society steadily increase.

38. There is no confusion between civil society and non governmental organizations (NGOs) but, alongside the *street* and the newspapers, NGOs are probably the most organized players, apart from the State. Though there are over one hundred such organizations, their social activities and political representativeness are undeniably weak. Some make valuable social contributions, but they have failed to produce a diagnostic study of society that is distinct or independent of the public authorities. In the absence of any local tradition of initiatives and independent protagonism (unquestionably a vestige of colonial hegemony, later exacerbated by the hegemonic instincts of the MLSTP) many NGOs keep close ties with, or are accredited by the State. This is partly due to foreign influence, as they lack deep roots in the country. Few of them can show constant, independent and visible performance; which, curiously, are attributes associated with foreign financing, revealing another source of dependence.

civil society is practically unheard of,[39] and where everything is dependent upon the State, or upon opportunities and means that only the State can provide.[40]

Unquestionably, electoral proposals were of only minor significance and, in comparison with other countries, placed less binding obligations upon the newly-installed government. One of the ideas of the MLSTP was to rebuild the social fabric on a rural base, by creating opportunities in agriculture. According to the party's platform, rebuilding of the social fabric in the countryside [*mato*] would result in improved living conditions in so-called *communities* which, in turn, would result in improvements in macro-economic indicators. This strategy, however, proved electorally worthless,[41] in part, owing to the party's failure to keep up with the fast rate of social change taking place in the towns. The crowd [*mole*][42] concentrated in the towns, has little interest in the countryside [*mato*]. Ostentation of the *politicians* is the tuning fork by which the young assess their own privation. The young want immediate *change*, and distain the nebulous offer of economic opportunities in the unprotected countryside.[43]

Curiously, in an expression of tainted moral judgment, part of the São-tomenses subscribe to the view that theft has become "a cultural fashion or lining, a veritable plague for the small economy of São Tomé & Príncipe, a plague that is very hard to combat" (Santo, 2009, p. 184).

Belief in the virtues of work seems like infantile naivety in a land where all wealth is associated with the exercise of political power. Any attempt on the part of the outgoing administration to impose demands must have seemed an affront, when no one believes that politicians do, or have ever done, any work. When compared with efforts under colonial rule to inculcate body and soul into correct political and social paths, the similarity of discourse (taking, for example that of the outgoing prime minister, who said "*tlabá só ka da tê*"; i.e., "only through

39. The author does not examine the intentions and content of this contract, the details of which he is unfamiliar with. As most São-tomenses have no knowledge of the contract, they are instinctively against it, in gut reaction to the theatrical way the signing was staged just days prior to the elections.

40. At one stage, NGOs appeared to be a sort of breeding ground for budding government leaders, who would, unlike the incumbent politicians, lead the country on a better path. This stemmed from an inference by analogy of the idea that, sometimes, in the informal economy, entrepreneurial capacities are revealed in even the worst social settings. Even without delving into the social implications of the informal economy, such an inference is an illusion, since the role of civil society as a training ground for politics, in itself, reflects a biased outlook. From the standpoint of the *street*, the signing of a pact during election week in 2010 between the MLSTP and civil society, personified by one of its foremost protagonists, signaled a surrender to the incumbents, and thus failed to achieve the effect the party had desired.

41. Though such moves should not be attributed solely to electoral motives, outcomes of voting in less populated districts could result in a MLSTP victory, in view of the structure of the electoral system and expected polarization. Nonetheless, the results in rural districts proved insufficient to compensate for losses in the more populous urban areas.

42. *Mole* = Dense and numerous crowd (Editor's Note).

43. Effectively, land tenure depends upon the capacity to defend the property, rather than upon law or institutions. Today, protecting property may imply building of walls or hiring of guards, options that were unimaginable only a few years ago. The capacity to defend land holdings is limited, for example, for the elderly or the poor, who are often deprived of the benefits of their property owing to constant thefts.

work can we achieve anything") one begins to perceive the difficulties faced by governments, especially when (as appeared to be the case) they are under pressure both from the *street* and from the State. The scale of difficulties in redirecting such social behaviors makes it impossible to overlook the fact that, all to often, they are spurred by erroneous political proposals, and are unlikely to be resolved by applying a firm hand.

In the absence of clear ideological or programmatic content, outflanked by demands of the *street* and pent-up promises, the winning electoral program prescribed only that the way accounts are settled with the corrupt be changed. In the *streets*, symbolized by voter registration attached with a safety pin to t-shirts, the young described the contest as "a weapon for blocking thieves on election day".[44]

With its aggressive rhetoric, the ADI won the elections. Its campaign entailed a considerable degree of media mobilization. For example, the polo shirts worn by its activists were of better quality than the t-shirts of those of other parties, a factor implicitly reinforcing promises for a better future. From the start of the campaign, the ADI sought to attract the uprooted and urban youth. On the morning of July 10, during preparation of the rally in front of the *Mercado Novo*, the following slogans were among those heard: "*Mercado Novo, ADI! motoqueiros, ADI! candongueiros, ADI! corruptos*… (pausa) *rua*!" [*Mercado Novo,* ADI! bikers, ADI! van-drivers, ADI! corrupt officials … (pause) out!"] The tone implied alignment of the will of the *streets*, oblivious to the party's statements that, once in office, it would respect international commitments. In line with the desire for change, its performance at the rallies proved effective.

In this regard, it is interesting to note how different parties chose venues for their rallies that reflected memories and political associations of the social groups they sought to attract. As usual, the MLSTP chose *Praça da Independência*; whereas the ADI chose the *Mercado Novo*. This juxtaposed promises and the historical record with realities of the informal economy and lack of prospects. Youth, it seems, were less attracted by the theme of independence than by the promise of material goods, based upon the irrefutable logic that the latter were not in short supply for politicians. Beyond evocation of memories and past attachments, this reading of the election campaign is indicative of a breach that would have been unthinkable on the eve of April 25, 1974[45], and which in no way is conducive to the (purportedly desirable) aims of political concertation and social cohesion.

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44. The author quotes [in Portuguese] from memory, but is sure that the meaning has been faithfully conveyed.

45. From time to time, this climate of emotive disruption is deplored, especially by the São-tomenses themselves. In effect, it feeds the fissures which, significantly, coexist with successive instrumental realignments of the various groups and individuals in the struggle for power.

The desire for change, so evident in the streets and nurtured by resentments accumulated over the years, periodically erupts as uprisings against those in power. To the more exalted expressions of the *street* (like those cited in relation to MLSTP and PCD-GR politicians) must be added those that, tomorrow, may be raised against others, just as bold as the alarming statement of economist Teotónio Torres. He, having described the Prime Minister as low-class,[46] then accused him of making a deal with Angola and Portugal under which these countries were stealing São Tomé's oil.[47] From the standpoint of São-tomenses, the recent message that oil revenues are not just around the corner[48] and the condescending (some might say overbearing) response of the outgoing Prime Minister, who had chosen Angola and Portugal as strategic partners, may have lent credence to Teotónio Torres' words. Moreover, in the prevailing political environment, predisposition to such beliefs was already rampant, especially in the *streets*.

In effect, the virulence of that attack was nothing new. Earlier election campaigns had also featured libel of the same type, mostly in the form of anonymous pamphlets targeted at eliciting emotional responses against opponents. On this occasion, however, the assault upon the character of the sitting Prime Minister was broadcast live on television. Circumstantially, the virulence of the attack may have helped bring to the surface, if not a conviction with respect to the oil then, at least, with respect to performance of the prime minister, who had come to office through a negative coalition with the PCD-GR, a party that had abandoned a governmental alliance with the ADI, to form another with the MLSTP. Thus, another step was taken in the disruption of political and social relations on the archipelago. Nonetheless, following announcement of the election results and formation of the new government, former members of the government stated their intention of serving as responsible parliamentary opposition.[49]

46. On July 15, 2010, just a few days prior to the Summit Meeting of the Community of Portuguese Speaking Countries (CPLP) and the elections, on *Fórum–África* (a program of the Portuguese Radio and Television broadcaster - RTP) former-Minister of Economy, Teotônio Torres accused the Prime-Minister, Rafael Branco, of having arranged for the sale of São Tomé's oil with Angolan and Portuguese oil companies. "Prime-Minister Rafael Branco is selling the country. I do not accept that you should collaborate with this sale. Talk him out of it, president of Angola. Talk him out of it, president of Brazil. Do not let him steal the only thing we have: our oil. This Prime Minister is a low individual. I do not know how to describe him. He was my colleague, but I have no respect for this man". According to Teotónio Torres, "Rafael Branco is selling this country. He has connived with Galp and with Sonangol to form a group to exploit the oil of São Tomé & Príncipe on behalf of Portugal and Angola". Teotónio Torres also stated that part of the money for Rafael Branco's election campaign had been donated by oil companies (Teotónio, 2010).

47. The apparently heart-felt indignation of veteran politician Teotónio Torres validated accusations against Portugal and Angola, whose instrument had been Prime Minister Rafael Branco. In the tone of a broadsheet, and a discourse presented as irrefutable, with accusations of vague (or perhaps no) substance, corroborated only by his indignation and which, without knowing the facts, might be considered mistaken, though not necessarily duplicitous or malicious. Curiously, his remarks on the ruinous deal which would deliver São Tomé's oil to Portugal and Angola form part of a collection of allusions to usurpation of the rights to this resource. On some points, almost everyone appears to agree, one of these being that the country is being robbed; though rarely are any concrete facts presented to corroborate this.

48. Moreover, the assertion was repeated by the Prime Minister elect, Patrice Trovoada, at his inauguration.

49. It is doubtful how long their commitment to consensual government will last, in the event of a breach between the MLSTP and the PCD, as proclaimed by the recently-inaugurated Prime Minister, or when the vicissitudes of day-to-day politics will jeopardize party loyalties in parliament.

Some older people, and those who grew up in a more peaceful and rule-based society, look back longingly to the values of a past era. They long for consensus among politicians, whose performance has proven how difficult it is to restore behaviors once the limits of a rule-based society have been breached. Clearly, the commitment to rules and transparency is not quite so consensual[50] as it is volatile, since no one would be prepared to risk their popularity or reputation for preeminence and political and social ascendency, by exposing it to the disregard (or disdain) of the *street*.

For the present, (until the 2010 elections) social and political pressures directed toward unseating the MLSTP and PCD government have been contained. The recently-installed government thus enjoys understanding and support. For now, because rules and predictability are still prized (and because they are aligned with the desire for a strong hand) initial measures for bringing order to the streets of the City of São Tomé appear to have been well received. These will gain binding force once the government is able to forge an environment of social discipline and applies it not solely to the *street*. Otherwise, once again, the government will have to resort to an array of encumbrances and restrictions upon people's lives, blame for which will be laid at the door of the politicians.

Having regarded the elections as an opportunity to punish thieves, the door remains half open for demands of the *street*. These may be of greater or lesser vehemence, or even accompanied by violence, in the event that privations and social rifts persist. Such scenarios are, indeed, possible. In the near future, the *street* will want to see the politicians punished and, when appropriate, will remember the promises of oil. Possibly, those in power will have to accept a repositioning of State authority, the weight of which has fallen disproportionately upon society's weakest members.

Only very recently were the first steps taken to strengthen the authority of the State vis-à-vis the powerful, with whom it is highly unlikely that accounts will ever be settled. This perception notwithstanding, certain judicial bodies have taken up the cause. Backed by pious oaths (to some degree attributable to the proximity of local and legislative elections) and promises to combat corruption, this impetus came to a head with the launching of the government program on September 17, 2010. However, in an interview published on Independence Day (July 12) of the same year, President Fradique de Menezes stated that he did not consider that the offer of payment to expedite the passage of paperwork through

50. A commitment expressed upon the death of Francisco da Silva, leader of the PCD-GR and president of the National Assembly, who enjoyed a reputation of being beyond reproach. At one particularly tense moment, Francisco Silva serenely urged the President of the Republic to stop referring to his fellow citizens as *escumalha* [scum]. It should be noted that political commitments announced at such times tend to be summarily forgotten.

a government office constituted a case of corruption.[51] It would be different, presumably, were it a case of millions paid to favor high-level business. In this case the President made light of (allegedly common) cases where at issue is the payment of sums or stipends. In effect, he cast aspersions upon an entire array of social and institutional relations and offers a loophole for, and tolerance of, corrupt practices.

Even when corruption is purportedly founded upon African “traditions”, complicity with it must entail endurance of its political, social and economic costs. The alternative is to enforce laws, casting aside dubious and idiosyncratic interpretations which, based upon condescending relativism, conveniently provide justification for depredations of common property. Compliance with the law ought not to hinge upon considerations as to its western (or other) roots but rather, and above all, upon the fact that the law stems from political choices assumed by the people of São Tomé.

Inevitably, civil society will continue to be invoked by government leaders, but current political and social architectures grant it little space and, as things stand, it appears unlikely to attain relevant status[52] or accredit itself as a politically significant voice, capable of matching the clamor of the *streets* in the upcoming elections.

Civil society is not the only element lacking. A number of potential protagonists abstain from public duties, broadly regarded (from their perspective) as irrelevant to political and social performance. After Independence, the single-party regime induced many to flee abroad[53] and, practically to the end, annulled the diaspora’s potentially positive and innovative contributions, thereby reinforcing negative features of the colonial legacy. Renewal and continuity of the political class is effected, preferentially, by exclusion of opponents and cooptation through patronage. Alternatively, some renovation occurs when the political system is breached from outside, generally, through aggregation of new sources of patronage.

Such factors blemish the exercise of politics, incite permanent indignation in the *streets*, and denigrate the reputation of politicians.

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51. The common view among São-tomenses differs from the lenient attitude of Fradique de Menezes. In São Tomé, tales of innumerable episodes similar to those related by Santo (2009, p.181) are told.

As in other countries, perception of the social importance of the applicant is a crucial factor in the standard of service provided. This gives rise to a culture of social relations that tends to be overbearing with subordinates and obsequious with superiors. At different levels, opportunism has replaced responsibility and civic commitment.

52. A somewhat similar phenomenon occurs among the diaspora. The inhabitants of the land are notably disdainful of ideas expressed by the emigrants.

53. On the political exile of elites, see Cahen (1991, p. 134).

5 MARKS OF THE POLITICAL CULTURE

A visitor to São Tomé during an election period, upon seeing masses of bills posted in the market place in the City center, has the impression of healthy political and civic participation. Such political contests are not to be disparaged, even though the spirit of free competition is rarely a feature of the discourse of politicians.

Rather than aspiring to defend the interests of fellow citizens with whom they share a common heritage, those citizens of São Tomé that enjoy even a modicum of choice appear, above all, to compete for untold privileges.[54] The concept of a common destiny is frequently invoked (alongside the assertion that poverty is unacceptable) but the content of political discourse – like the social policies for promoting gender equality, combating domestic violence, achieving the Millennium Development Goals (MDG) and reducing poverty – is heavily influenced by the agendas of foreign agencies.

Though any observer will perceive that political discourse bears little resemblance to reality, freedom of the press is truly remarkable. Indeed, *O Parvo*, a newspaper that championed change[55] has not suffering harassment. Such press freedom provides an outlet for criticism, but is really quite tame when compared to the acerbic mouth-to-mouth *radio* which, indubitably, plays a much more incisive role in forming political views.

This apparent political freedom stands in contrast to other trends, such as the deep silence that envelopes proposals of an economic and social nature; and overlooking of ideological outlooks in favor of emotional appeal when judging politicians. Sparse ideological differentiation[56] combines with a lack of discussion on economic and social issues.[57] Add to this attacks upon, and/or unfulfilled expectations in relation to, leading political figures, and you have an explanation for the vertiginous fall of the MDFM-PL, caused by the alleged political demise of President Fradique de Menezes after less than one year in office.

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54. Among holders of political office, the veiled self-justification is that they would be regarded as inept by society should they prove not to have taken advantage of the opportunity. An inversion of values, at odds with local political discourse and not merely a relative external subjectivity, becomes the implicit justification for depredation of common property.

55. For a summary of the journalistic career of the director of *O Parvo* see: <http://www.cstome.net/oparvo/1º%20 Pessoa.htm>. Accessed on: September 4, 2010.

56. In the latest campaign, the MLSTP-PSD exchanged support of the PSD for that of the Socialist Party (PS) of Portugal, without anyone on the islands paying much attention.

Relations with the two major parties in Portugal (PSD and PS) as parties of Portuguese former colonies, are not governed by ideological affinity; but rather, by ties and personal relationships among their leaders and the pragmatism of inter-state relations.

The PSD, allied to the European Liberal Party, lent its support to the MLSTP in the late 1980s. For this reason, on the eve of the first elections, the MLSTP became the MLSTP-PSD. The PS, affiliated to Socialist International, found friends among parties governing the former colonies after Independence.

57. One exception was the systematic presentation during the Football World Cup final, organized by the MLSTP in the square of São Tomé, at a time when the local broadcaster (*Televisão São-tomense* TVS) was on strike.

The most important factor is the way in which sentiments are handled, the manipulation of which brings into play expectations, symbolic vengeance, and the *banho*, *i.e.*, the graft whereby consciences are bought. In view of the scope of this phenomenon, its spread and (today) its almost institutional nature, though all parties deny that they attempt to buy votes, all plead that it is normal to provide motorcycles to be used for campaigning, and that television sets are not given to individuals, but rather, donated for the benefit of poor communities. Candidates unable to win by handing out gifts urge the electorate to "take the *banho*, but do not sell your souls". The truth is that no political group seriously considers the imposition of measures to do away with the *banho*, or wishes to discuss how election outcomes are warped owing to graft.[58] Nobody is interested in doing away with the *banho* because no other mechanism for attaining power has yet been conceived.

These are marks of the country's political culture and outcomes of its recent history. More than any abstractly and fondly-invoked cultural values – with little significant impact upon political and social change – these are marks that comprise the local political identity, leaving aside strained and increasingly unattainable ties of brotherhood and shared destiny among the people of São Tomé.

With rare exceptions, money and power are the criteria for assessing the status of an individual on the archipelago, and such characteristics in the day-to-day lives of the people appear intimately related to patronage.

Africanization, taken as meaning a drift toward social disorder – regarded, not as an intrusive value from abroad, but rather, as a facet of the São-tomenses themselves –contributes toward the yearning for rule by a strong hand[59] which some regard as the only way of ensuring any degree of stability and predictability in everyday life. The recently-inaugurated administration of Patrice Trovoada is responding to this sentiment, when it says it will not tolerate anarchy in the *streets*.[60] Whether or not fully aware of the parallel, it is following the authoritar-

58. On the contrary, reciprocal accusations focus upon who first launched the *banho*.

Seibert (1999, p. 300/307) has described election campaigns as occasions when the population gains access to certain material goods, such as televisions. As has occurred in recent campaigns, when such goods were offered to a community, party leaders did not regard this as *banho*.

59. Years of privation, social upheaval and lack of decent alternatives led some são-tomenses to hanker for a strong hand, and for a restoration of values, meaning that they longed for a firmer and more direct link with authority.

Some claim that a subliminal cultural trait favors a strongman and the need for a strong hand at the top. The author of this article suspects such theories, but the prevalence of these ideas in society and the memory of forbearers always paid deference to such authority as the most decisive factor in social regulation.

60. Such intransigence carries a heavy political liability, as it may become unfair and arbitrary by falling most heavily upon the weakest. Unquestionably, such intransigence helps to form opinions and consolidate support for the government of Patrice Trovoada. However, such conditions face a deadline, depending upon a series of factors, including the consequences of government action and perceptions as to the progress of the economy, especially as it affects the poor and the young.

ian path taken by the MLSTP during the period of transition to Independence[61] and which, to some degree, prolonged the effects of colonialism. Often, the outcomes of this strategy were quite different to those intended.

6 THE HORIZONS OF CHANGE

Notwithstanding recent improvements in macroeconomic indicators, most notably lower inflation, achieved by application of austerity measures which resulted in dull economic prospects for urban youth, the overwhelming sentiment was a desire to punish the thieves (i.e., politicians). In such a setting, Patrice Trovoada's wealth, remote posture and reputation as a zealous protector all favored the ADI (a party founded, it should be remembered, by his father Miguel Trovoada in 1992) which won the August 1 elections with a plurality of votes.

Though hardly symptomatic of political volatility, it should not be forgotten that Patrice Trovoada's background included loss of an election in 2006,[62] and that he did not inherit power directly from his father, as so often happens in African countries, a practice viewed with disdain on the archipelago. This time, however, Patrice Trovoada's appeal was successful.

Disdainful of shallow rhetoric of commitment to authenticity and to realities of the *land*, the *street* preferred to bet upon a less verbose political platform. In this manner, Patrice Trovoada, a politician whose focus was not on the *land*, and perceived as having been born abroad and thus outside the context of the Independence struggle, now has his chance.

Mostly young and unfettered by ties or loyalties of their forbearers (forged in colonial times or pledged to founders of the republic), the *street* desires the long-promised fruits which globalization offers to all peoples. Such promises appear especially attractive to the young of São Tomé, whose

61. Though not wishing to speculate as to what would have been the result of a popular referendum on the archipelago in that scenario, the São-tomenses were left without choice. The MLSTP wished to be the only political force in São Tomé. Firstly, with complicity of the outgoing colonial power, it scared and co-opted skeptics and more conservative elements in relation to Independence. Later, still with support of the Portuguese authorities, it rallied the population against the *Associação Cívica*, considered more radical and, thus, upsetting to those who, thought they accepted Independence, wished to continue living as they always had, if possible, in better economic conditions.

62. Against Fradique de Menezes, referred to in its rhetoric as the sworn enemy, the MLSTP lent its support to Patrice Trovoada, thus enabling him to achieve broader political base.

Later, some months into the Patrice Trovoada administration, the MLSTP presented a motion of censure with the support of the PCD. By this time, the latter party was part of the government, and for this reason the vote of censure was viewed as traitorous.

Patrice Trovoada came to power, not by direct vote, but by his party's participation in a coalition. Rafael Branco also came to power, not by direct vote, but through a coalition with the PCD, which switched from one coalition to the other.

The unexplained fortunes of STP-Trading (an ad hoc company formed to import consumer goods, thanks to a US$ 5 million grant from Brazil, a sum that did not appear compatible with the value of the goods imported) and the unshakable conviction that the persistent difficulties were due to corruption and diversion of funds, led to a wave of demand for *change*.

opportunities, due to political and social factors, have always been sparsely and unevenly shared, and whose resentment of the politicians stems from feelings of being deprived.

For the present, from the government's pronouncements and from the line-up of personalities chosen to take part in the administration, there appears to be some consensus as to development options. These include diversification of agriculture with technological enhancements; tourism;[63] and, above all, provision of services for other countries of the region[64] based upon establishment of a modern and secure logistics platform. Essentially, this proposal is in line with textbook prescriptions for development of small island states, which are considered appropriate as tourist destinations or logistical platforms associated with free-trade zones (Santo, 2009, p. 152). In São Tomé and Príncipe, mirage scenarios have been built up around these projects which, it is hoped, will enthrall public opinion, until such time as the (illusive) oil revenues begin to flow in.

From the government are heard exhortations to effort, rigor and, above all, crack-downs on corruption and restrictions on the privileges of holders of high office. The parliamentary opposition, for its part, reiterates promises to act responsibly in the National Assembly. The figurehead of the MLSTP, the first president of the archipelago, Manuel Pinto da Costa urges national unity.[65] Though it holds only a minority in parliament, the government enjoys a state of grace, and positive expectations abound with regard to the country's assuming a path toward development.

The greatest problems stem from weakness of institutions and of the State. Its ineffectiveness notwithstanding, in the light of historical factors, it is generally acknowledged that, as the only beneficiary and channel for foreign aid, it is the State alone that can impose the necessary social regulations. In face of prospects

63. Prospects for rural and ecological tourism have been mooted as alternatives to mass tourism, considered a threat to the environment. This stems from two false premises: firstly, that the beaches are not large enough to accommodate any significant tourist volumes; and secondly, that removal of sand has damaged their capacity.

Besides, failure to observe land-use standards on the seashore has spoiled access to some of the more attractive beaches. Such failures of territorial planning are illustrative of the fragile balance between compliance with the law and the public good, on the one hand, and misappropriation of assets by individuals, on the other.

64. Relations between the archipelago and the Gulf of Guinea had practically ceased by the mid 1800s, the time of re-colonization (Nascimento, 2000a). See also prospects for relations with neighboring countries by Hodges and Newitt (1988, p.120-122).

Currently, rather than seeking markets for its exports, the archipelago wants to serve as a logistics base, an aspiration that would appear coherent with the prospects for maritime security in the region.

65. Pinto da Costa showed signs of attempting to overcome a conflict of decades with the Trovoada family. Seibert (1999, p. 125) for example, considers the main differences between Pinto da Costa and Miguel Trovoada to be personal, rather than political. However that announcement was regarded as an attempt to clear the field for a political candidature in 2011.

of violence and social upheaval[66] the need for a strong, effective, and fair State authority has become imperative. However, though sustained by recurring hopes of *change*, increasingly, there is a sensation that behaviors can not be altered. The persistence of bureaucratic hurdles and red tape that govern social conduct according to institutionally autonomous and binding mores, attest to the herculean scale of the tasks at hand, most notably in the justice system.[67]

Action programs targeted at ensuring fulfillment of basic needs are managed and driven by foreigners. When left in the hands of São-tomenses, some institutions and projects perish, reinforcing an impression that the archipelago is constantly starting out, and incessantly distant from a safe haven. This reflects less upon the capabilities of São-tomenses as individuals than upon their position as hostages to a web of dependence, loyalties and conveniences. Built up over the years, this political and social edifice hampers assimilation of new ideas, conditions processes of social reproduction, and frustrates economic growth.

In speaking out against anarchy in the streets[68] the new government showed signs that, finally, political action is to be freed from the fetters of society and from pernicious practices and the shameful effects of micro-insularity that hamper the exercise of fair and effective governance. However, the balance of relations among the political and social spheres is highly complex and must take into account efforts to impose regulations on urban areas which, though potentially useful from a symbolic standpoint, would imply raising the political and social bar, and thereby running the risk of setting the government on a collision course with the *street* that voted it into office. The street, in turn, would then demand immediate fulfillment of the promises of opportunities and of well being that it chose to believe, and which form the informal basis of its contract with the newly-elected government.

66. Just as, upon witnessing the luxuriance of nature, no visitor for one second doubts the fertility of the land, people also tend to be captivated by the simplicity and friendliness of the natives.

Though not completely illusory, such views are relative, and may obscure factors that are not immediately apparent. It is not so much the fertility of the land as the climatic conditions that account for the exuberant vegetation. These may be placed in check by deforestation that has mostly affected the northeast of São Tomé. With respect to the character of the São-tomenses, the ideia of a colonial varnish may well apply. Some would claim that peaceful society is a positive feature of the colonial legacy, overlooking the violence, the illegalities and racism under colonization, factors that exceed the scope of this article. It should be noted that social control exerted under the final decades of colonial rule produced an idea of social peace and simplicity that was often considered intrinsic to the people of São Tomé when, in fact, it was a historic consequence.

A few decades of political competition are sufficient to explain the abysmal difference between the behaviors of today and those of past decades, none of which bodes well for the political management of the archipelago.

67. For example, Seibert (1999, p. 240) expresses the view that there is no independent judicial branch. There are various reasons for this, ranging from the web of relations of family, patronage and proximity, or the course that institutions have followed since Independence.

68. See the news item at *Téla Nón* (Governo..., 2010).

This social theme, built up over the decades since Independence, requires a multifaceted approach that encompasses renovation and the adequate management and performance of institutions. Pragmatically, the veiled promise of changing everything must be avoided because, if later abandoned or overruled, it would breed disillusion and alienation. For this same reason, individual and collective acquiescence, albeit gradual and silent, to the status quo should be avoided. Nonetheless, there is no assurance that such aims will be achieved.

7 FINAL NOTES

Leaving aside that fraction of the population of São Tomé whose own demise is deemed closer than that of their country, an overwhelmingly young majority has no alternative other than to hope and have good will.

Over the decades, successive vague hopes and pledges to change from abroad have molded a fatalistic attitude to politics. Political programs are minimalistic and recurrently amount to little more than pinning hopes upon someone from outside. On this tiny island, with its legacy of different cultural traditions, where society is fragmented and the State weak, what can be expected as a follow-up to the attempt of August 1, 2010 to, once again, invert the untoward course of events of recent decades?

Will the response be incessant local unrest, or is it finally possible that a realignment of political interests can be achieved, uniting all in favor of the common good of the people of São Tomé?

Without casting aspersions upon the applicability of simplistic messages to the complex regeneration or recreation of institutions, it would be well to apply the aphorism of a foreign observer: do what is good, and have neither fear nor shame of being honest.

Pacification of social life has little relation to the alleged character of the São-tomenses, but rather, depends upon the political wisdom and performance of institutions, these being the crucial factor for determining behaviors and the course of history.

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THE ECONOMY OF ANGOLA: FROM INDEPENDENCE TO THE 2008 WORLDWIDE CRISIS

Jonuel Gonçalves*

ABSTRACT

Since abolition of slavery, the Angolan economy has been dependant upon production of primary goods. Throughout most of the 20th Century, coffee and diamonds were the main exports. With the discovery of offshore oil fields in the early 1970s, Angola became a major oil exporter. Since then, the Angolan economy has revolved almost entirely around oil, which now pays for everything, including food imports to compensate for lost domestic production, machinery replacement for industry, and the war effort. Against this background, the 2008 crisis left the Angolan economy in an extremely critical condition, owing to the drop in oil prices. This article undertakes an historical analysis of Angola, from independence up until the 2008 crisis and its aftermath.

1 INTRODUCTION

After independence, on November 11, 1975, Angola spent most of the intervening period plunged in warfare, and only in the past eight years[1] has it enjoyed peace. This had grave repercussions on the Angolan economy which, currently, is the second-largest in southern Africa. Angola's Gross Domestic Product (GDP) is second to, but much smaller than, that of South Africa. It has surpassed the GDP of Zimbabwe, the economy of which is in a deplorable state.

Aside from the effects of war, other elements that hamper Angolan economic performance are a lack of qualified human resources and the persistence of extractive activities.

According to domestic and international forecasts, by the end of 2010 Angolan GDP will amount to US$ 87.5 billion (calculated by the official exchange rate TCO). This implies a resumption of double-digit growth, following (according to the government) a rise of 2.9% in 2009, or (according to international sources) a 0.9% decline (EIU, 2010).

In the overall structure of the GDP in 2008, when the growth rate reached 13.4% (World Bank, 2009): agriculture accounted for 6.6%; industry (essentially extractive activities) for 67.8%; whereas manufacturing accounted for only 4.8%; and services for 25.7%.

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1. Text written in November 2010.

Regardless of the discrepancies in these figures, comparison with 1998 is significant, bearing in mind that, at that time, Angola's GDP amounted to only US$ 6.4 billion. From 1998 to 2010, two great changes occurred, which explain this difference: the end of the long civil war in 2002, which reduced military spending; followed shortly after by a rise in the price of oil, the product that accounts for 60% of Angolan GDP and 90% of its exports.

This macroeconomic progress had but modest repercussions on the overall living standards of the roughly 18 million Angolans. Angola's worldwide ranking in terms of GDP is disproportionately higher than its Human Development Index (HDI) ranking, reflecting a historical maldistribution of wealth.

The Angolan Government's People's Well-being Index [*índice de bem estar da população* – IBEP] (Angola, 2010) shows that 36.6% of the population live below the poverty line, reckoned to be an income of US$ 2 per day (Angola, 2010). Casting doubts as to the pertinence of this internationally-used measure for assessing poverty, other authors believe that this percentage is even higher.

These two facets of the Angolan scenario stem from a long history going back to the period when Angola was first organized as a territorial unit, in 1576, with the founding of Luanda. As a hub for the transatlantic slave trade for almost three centuries, Angola's essential borders were established by colonial agreements in the late 19th Century, at which time it gained recognition as an exporter of primary goods, such as diamonds and coffee, which remained its main exports until the 1960s.

It was in the 1960s that the war of independence broke out; and also, that incipient oil production, later augmented by discovery of new offshore deposits, began to dominate the economy. To the present day, the oil fields are the most important feature of Angola's economy.

On November 11, 1975 independence was declared, thereafter economic data underwent changes as a consequence of the new political context.

2 POLITICAL CONTEXT

The final schedule for independence was set under the Alvor Agreement (Portugal) of January 1975, gaps in which culminated in post-colonial civil war. At issue was the determination of the three forces acknowledged under the Agreement, not only to hold a monopoly of power, but also to maintain their right to political expression. This undermined their willingness to apply the terms to which they had agreed.

The lack of effective electoral mechanisms, and denial of the representativity of dissident voices among those forces and of political independents, led to a climate of mistrust and armed confrontation which, in itself, greatly undermined the confidence necessary for pursuit of economic development.

Further exacerbating this situation was the fact that the Agreement made no provision for economic transition measures.

> Thus, since independence, the Angolan economy has displayed signs of weakness stemming from the colonial legacy and from political and military ambitions over 27 of the past 35 years.
>
> Two characteristics of the colonial economy continued to exert strong influence in the post-colonial period:

- absolute primacy of extractive activities in the composition of GDP; and
- absolute primacy of corporate property and the performance of all technical functions by foreigners, whose ties to the country were so tenuous that, with the change in the political regime, they fled en masse.

The political and military environment caused destruction and frustrated all possibility of productive activity in various geographical areas while, at the same time, establishing a new social order entailing new forms of distribution (in relation to the colonial period) of jobs and wealth.

This was not merely the superimposing of a new layer atop of the pyramid, but rather, replacement of the whole structure. Along with this came the emergence of powerful informal and parallel markets, which became increasingly ingrained and highly influential in the new context.

Until the fall of the Berlin Wall, Angola had been a stage for confrontation of protagonists of the Cold War. The new international political scenario, enabled by the New York Accords on Southern Africa led, in 1989, to withdrawal of Cuban troops from Angola and of South African troops from Namibia.

In 1991, the first free election in the history of Angola led to the victory of the Popular Movement for Liberation of Angola (MPLA). This party which, since independence, had held sway over most of Angolan territory, renounced Marxist-Leninism to espouse the principles of International Socialism. Its armed opponent, the National Union for Total Independence of Angola (UNITA) had greater difficulty in adapting to the end of the Cold War and in understanding the changes the Angolan economy had undergone in the 16 years since outbreak of the post-colonial civil war.

UNITA, without presenting evidence, accused the MPLA of electoral fraud and, despite a UN Declaration confirming that the elections had been generally free and fair, refused to accept the results.

In October 1991, the country was once again enveloped in war, this time affecting populous areas of central importance to the economy. The scale of destruction, in 1992-1993, caused a 23% drop in GDP (Angola, 1993).

To finance the war, the government mobilized a major portion of its oil revenues, while UNITA intensified its control over the diamond fields thus, like other African insurgent groups, becoming a major source of illegal gemstone exports.

The diamond fields were the scene of intense fighting and, when government troops overran the area, the economic base of the rebellion was crushed. The government, with the international legitimacy endowed by its victory in the 1991 elections and its shift of international alliances, succeeded in isolating UNITA, finally inflicting military defeat in February 2002, thus laying the bases for the peace agreement signed two months later.

This agreement provided safeguards for UNITA as a political party and scheduled new elections, which duly took place in September 2008. Strengthened by having won the war, by a favorable international economic and financial environment brought on by high oil prices as of 2004, and by the weakening of UNITA and other non-armed opposition groups, the MPLA increased its electoral majority, which had been 52% in 1991, to just over 80% in 2008.

3 THE FORMAL ECONOMY

During the phase stretching from acknowledgement of the right to independence (June, 1974) to its proclamation (November, 1975) mechanisms for economic control (both State and corporate) gradually lost force, thus opening up space for parallel activities. Ilegal transfers of property abroad (by former colonists) and "savage" seizures of property (by national citizens) were the two most evident economic features of the period.

By November 1975, the former productive structure had reached an alarming degree of paralysis, and the new authorities had failed to find any way of restoring even those sectors that should have been easier, such as food-production agriculture, fisheries and small businesses.

The mass exit of Portuguese owners provided additional justification for the economic authorities to advocate state ownership, in line with their Marxist outlook (only formally declared in late 1977) that regarded the State as an "instrument of the working class and its allies, the principal factor for development and fair distribution of wealth", as was stated in the final declaration of the 1st MPLA Congress in 1977.

Just a few months after coming to power, at the beginning of 1976, food stocks had reached emergency levels. While responsibility for new imports was in inexperienced hands, a National Supply Committee was created within the (then) State Secretariat for Commerce, with representatives from various ministries and strong support from Cuban advisors.

The surviving private sector was neglected, and companies abandoned by their owners were nationalized. *Importang*, a vast central import corporation was established to assume a monopoly of practically all import trade. This corporation was later broken up into specialized units, but the State monopoly remained in effect until 1990.

Dogmatism and management inexperience led to chaos among the incipient trade and port-handling authorities, whereas links between town and countryside became increasingly strained. Initially, all critical observations and proposals for greater economic flexibility were dismissed as "bourgeois deviations".

The national currency, the kwanza (named for the largest river flowing entirely through Angolan territory) was first issued in 1976, at parity with the colonial escudo and maintaining the same exchange rate in relation to the US dollar (roughly 30 escudos to U$1.00). Exchange operations at that time revealed how little cash people possessed: only 2% exchanged more than 200,000 Angolan escudos, according to information disclosed by high officials of *Banco Nacional* and the Ministry of Planning. This percentage corresponded to a relatively affluent segment of the population and reflects the exodus of holders of large fortunes, the so-called *metropolitanos*.

However, within a short space of time, a vast amount of cash came within reach of a significant number of citizens, as a consequence of free or low-cost services (rents, transport, healthcare and medical drugs) and, for those at the apex of the new social pyramid, that J. Bayard (1989) has classified as the "Class-State", of privileges in such fields as housing and general spending.

These factors, and a drastic reduction in the supply of essential goods, caused a huge imbalance between the money supply and the availability of goods (including basic staples) thereby creating pressures that rapidly led to rationing. Such rationing was socially segmented since, aside from the afore-mentioned privileges, a special supply system was set up wherein prices bore no semblance whatsoever to real market conditions.

The currency underwent constant corrosion, making it necessary to launch successive new issues of bills, each discarding some of the zeros that had appeared on the previous issue.

Following a brief interruption in the months immediately after independence, oil extraction was resumed and underwent expansion while, at the same time, in all other sectors of the economy, there was a 90% fall in production, whereas trade in general declined by about the same proportion.

Angola took on features of a single product economy. Oil financed everything: food imports, to compensate for lost production; replacements of equipment; and the war effort, which escalated in the 1970s and 1980s. Warfare did not, however, affect the areas of greatest importance to the economy.

Poor economic and social performance during these years was blamed, by many in public administration and in corporate management circles, on the war. However, even some of the top managers rejected such explanations, generally presented merely to mask the underlying problems: i.e., excessive state ownership and a lack of qualified human resources.

In 1986, Angola suffered from the drop in oil prices, which caused a US$ 700 million shortfall in relation to forecast revenues. Its capacity to import food was drastically reduced, which inevitably led to a rise in absolute poverty and overall prices increases.

In 1987, the Government launched the Economic and Financial Cleanup [*Saneamento Econômico e Financeiro* – SEF] and applied for membership of the International Monetary Fund (IMF), but reluctance to abandon its ideological dogmas stood in the way of urgent reforms, perceived as necessary even by certain more realistically-inclined segments of the governing party.

Against this background, as Peter Meyns (1984) observed:

> the MPLA government came to realize that ending the war, including activities carried out by dissident organizations, would be the only way to achieve a successful economic future. The analyses herein presented, however, lead to the conclusion that though an end to hostilities is a necessary condition, it is most certainly not, in itself, sufficient to ensure development of the Angolan economy. Structural characteristics of the economy will remain after hostilities have ceased (...) at issue, essentially, is a problem seen not only in Angola but also in various other countries, i.e., the phenomenon of bureaucratic encumbrance of economic systems dominated by the State.

Until the price liberalization of September 1990 (and the issuing of new bills with a reduced number of zeros) price spirals were a common feature of both the informal and parallel markets.

In comparative terms, a 1984 text produced by the union confederation of the regime (Unta, 1984) stated that an urban family with an income of Kz 8,000 per month actually needed Kz 13,000 to cover essential expenses.

Four years later wages had improved hardly at all, and the cost of a basic basket of food, at parallel-market prices, had risen to Kz 150,000. In Luanda, the need to make up the shortfall led practically the entire population to engage in *esquemas* [schemes] and *candongas* (local expressions used to designate the search for income) under which everything could be sold and everything could be exchanged. Activities considered illegal in any country were, in Angola during this period, merely ways of ensuring survival.

Officially, the dollar remained worth Kz 30, while on the parallel market, in 1988, the quotation reached Kz 2,000. The money supply was so out of proportion to the availability of goods that, according to the diagnosis of SEF, "the population is in a pathetic situation whereby the currency it holds can not be spent".

In September 1990, the MPLA was preparing to accept a multi-party system and a market economy; negotiations for a ceasefire were moving forward, and the soviet block had disappeared. Angola was already a member of the IMF, which was demanding that it urgently adopt structural adjustment measures.

This was the background against which the new kwanza was issued (in effect, just another issue of bills with removal of depreciative zeros) the main objective of which was to take 95% of the money supply out of circulation, by means of a compulsory deposit upon changing currencies.

The effect upon prices was immediate and devastating, in view of the sudden illiquidity of consumers.

However, absence of regulatory stocks and payment of wages for the following months were, once again, to set new and harsh asymmetries, even though the Government had issued new a price list, setting prices at higher levels than before.

In September of the following year, the situation appeared to have reverted to the way it had been prior to the currency reform, but with one exception: the dollar now fetched no more than Kz 1,000 on the parallel market.

In 1990 and 1991, the outcomes of official inquiries on price rises and on consumer brackets began to become available. Though merely indicative, these provide valuable figures, not only for those two years, but also for the preceding period.

A study conducted by the United Nations Children's Found (UNICEF) in the capital and disclosed at the end of 1990 established ten consumer brackets. It set a *per-capita* income of Kz 30,000 as the poverty line, and of Kz 16,000 as extreme poverty. Only those in the tenth bracket appeared to be in a position to purchase an entire basic food basket at market prices.

Given that a wage of Kz 30,000 was unusually high for the period, obviously, wages were not what ensured the livelihood of an overwhelming majority of the population.

Thus, recourse to activities other than normal employment became commonplace, ranging from negotiation of all manner of services and from the most insignificant to the highest favors, to monetized exchanges of goods.

Part of the purchases effected at subsidized prices from official shops in the 1980s were resold on the informal market to compensate for low wages.

However, when examining this type of transaction, it is important to make a distinction between "normal" and "complementary" official shops.

The latter offered the 400,000 supply-card holders of Luanda (and some 500,000 in the rest of the country) a smaller array of goods, and the advantage was not very great (Gonçalves, 2010).

The Consumer Price Index CPI (INE, 1992) indicated that 78% of consumers in Luanda in the early 1990s purchased supplies at informal markets; 16% at official shops; and 5% at "complementary shops" where purchases had to be paid for in hard currency.

Unofficial surveys (used principally by government bodies and NGOs) in the early 1990s, describe 35.4% of the labor force in Luanda as "self-employed"; whereas 30.2% were employed at State companies; and 10.9% worked in private companies (Stenman, 1992); thereby revealing an unemployment rate in Angola's capital city of around 23.5%.

The CPI in the first nine months of 1991 indicated overall price increases of 94.91%. The most significant increases were in the hard-currency shops (205.93%) and these had little effect on the general index, in view of the small number of consumers affected. At official shops, price increases were of the order of 97.82%; and at the "parallel" markets, were prices rose least, the increase amounted to 86.3% (INE, 1992).

In November and December 1991, the Government brought two financial 'packages' into effect, one establishing a new official exchange rate for the kwanza (Kz180 per US$) and the other authorizing purchase, by the *Banco Nacional de Angola*, of hard currency in the hands of private citizens at a rate similar to the parallel market rate (which, in December, hit a peak of Kz 1,000 per US$).

Excepting five items that remained subsidized, prices were unfrozen, causing them to soar at the official shops. Nonetheless, prices at such shops remained lower than on the informal market, where they remained subject to supply fluctuations.

At the end of 1991, on average, wages at government institutions and at many private companies rose by factors of five or seven. The main effect the MPLA Government sought to achieve was a re-monetization of wages, i.e., to put an end to the resale of subsidized goods as a complement to wages. The currency, however, still had to undergo a re-issue and stamping to indicate the change from the "*novo kwanza*" to the "*kwanza reajustado*". Only on December 13, 1999, after removal of six zeros (one million) did it resume its original name – kwanza – and regain some stability.

4 INFORMAL AND PARALLEL

For purposes of this chapter, "informal" activities are those that rely upon provisional or makeshift facilities only remotely connected with the tax system, and which supply goods for the mass market. "Parallel" activities are those that seek to generate income by illicit means.

Though these definitions are vague and not fully accepted by socioeconomic theory, the distinction is important in view of the differences in financial volumes that such activities entail and of the different effects they produce.

In the composition of the parallel market, throughout the course of the war, diamond smuggling accounted for sums equivalent to the entire legal trade in this product. Such sums declined significantly in later years, though some informal mining activities remain highly profitable.

Another component of the parallel segment is embezzlement of public resources, through overbilling of supplies and other financial crimes, that also involves significant sums.

The informal sector in Angola is longstanding and, at certain times, has been the object of protests from formal-sector merchants. Historical research would be needed to determine the origins of the phenomenon but, clearly, it was present throughout all phases of colonial rule. However, it can be affirmed that large-scale "informalization" of economic activity in the colony really took off in the aftermath of abolition of slavery.

Informality grew owing to a lack of both fiscal authority and business structures, manifested through a great many commercial exchanges carried out by peddlers (known as *pombeiros*).

In the early 20th Century, *quitandeiras* [women selling food] (*quitanda* meaning grocery) became a widespread social phenomenon which, on the one hand, maintained certain characteristics of local traditional production but, on the other, posed competition to colonial traders in various products.

As is still the case today, women played a leading role in the informal economy, and sometimes in the formal economy as well. (Reis, 1985). This economic prominence of women in urban areas has its counterpart in the role played by women in agriculture in many Angolan ethnic groups.

The challenge posed by the size and scope of the informal sector spurred the colonial authorities to take "disciplinary and integration measures", first in the 1940s and, subsequently, with more emphasis in the 1960s.

Expansion of the colonial administrative and commercial networks enabled the regime to impose and to collect taxes more generally or to call in the police, prior to expanding and modernizing urban markets or creating rural markets.

In the year of transition to independence, the informal sector was small, but the trend to adopt informal practices spread throughout the small-business sector, which included handcrafts and *quitandeiras*, where accounts were often deliberately incomplete, the amount of labor involved unquantified, and no records of peddling were kept.

Roughly two years after independence, this context had become the norm, with a discrete and shame-faced informal market arising initially from three elements, namely:

1) Official travel abroad proliferated, with the respective expenses and grants, enabling acquisition of goods not available domestically, most of which were consumed by family members, but some serving as objects for exchange.

2) In state-owned companies, management and union committees appropriated a portion of the goods produced, for their own use and for exchange or sale among friends.

3) At the ports, major companies and warehouses, theft assumed gigantic proportions.

In the first two of these circumstances, the formation of a "Class-State" is in evidence and though, in most cases, it was deemed prudent to conceal possession of such goods, there was apparently little difficulty in obtaining them. In the third, it was on-site workers that engaged in such practices, and stringent efforts were made to rein them in.

In all these cases, however, sale of goods took second place to own consumption, although barter had, by now, taken on such proportions as to be considered a way of mutual assistance [*entreajuda*].

Luanda and the North were the first areas to suffer shortages, and the need to supply foodstuffs to the main towns of the South gave rise to a system of exchanges that can indeed be described as mutual assistance [*entreajuda*]. In this case, the goods exchanged were mostly local produce, and this situation continued at least until 1979.

The first four years of independence are crucial for understanding the economic trajectory of Angola and of the role that the informal market has continued to play to the present day although, over the years, it has assimilated certain formal standards, resulting in a hybrid situation, characteristic of African towns in many countries. For example, the number of registered informal companies has grown, some even pay taxes, but their income declarations remain full of gaps.

The informal impetus of those years is a consequence of the poverty that has become widespread. The shortage of bread led to requisitioning by government departments or public companies, and its distribution at workplaces. A rumor that "things are to be distributed" at a given place could cause stampedes and absenteeism from work, causing consequent productivity losses. The distribution of ration cards and establishment of shops where they could be used would lead to schemes for "getting hold of a little more".

The word *esquema* took on a connotation of parallel activity, whether it referred to clandestine exchanges or sales of goods, or even the arranging of sponsors [*cunhas*]. Subsequent generalization of these phenomena led to the emergence of the *candonga* in current colloquial parlance, or what was referred to as "*matança*" (derived from the expression "the prices are killing").

Another component that strengthened the informal market arose in 1980, when many companies instituted *autoconsumo*, i.e., distribution of goods to employees as a complement to their wages. Some such goods would be consumed by workers' families, however, increasing proportions were put up for sale. Two categories of goods, namely, cigarettes and beer, were particularly used for this purpose. At the same time, the parallel hard-currency exchange rate reached a point of no return. Thus, the importance of tobacco, beverages and the US dollar became a constant element in the entire process of "parallelization".

In this way, in less than five years, the material and social bases for the informal and parallel markets were laid down. These would flourish throughout the 1980s until they became dominant. The *candonga*, previously a feature of rudimentary markets, soon proliferated throughout the streets.

In 1984, the police launched an operation under which various informal markets of Luanda were torched, thus causing increased supply difficulties in the capital. A few days later, the same markets reappeared in other places, after which they were no longer harassed.

In the same year, in a spectacular trial (case 105) whereby various sectors of the regime attempted to assign blame for economic crisis, diamond smugglers and foreign-exchange holders came to judgment.

This trial brought to light certain details of the most profitable of parallel activities i.e., the illicit diamond trade, and revealed some of the measures certain private companies had to resort to in their dealings with high government officials. The trial also left it quite clear, however, that such practices could not elucidate the causes of the economic crisis.

By 1985, ten years after independence, the commercial center of Luanda had moved from the *Baixa* to the suburbs, where *mercados* were set up.

By this time, road transport for goods and passengers had been overrun by the informal sector, as a response to shortfalls of public transport, stricken by lack of maintenance and by being targeted during the civil war. In Luanda, rapidly, the informal sector began to provide transport for most passengers and goods, at prices sometimes one hundred times higher than official fares and freights.

Using all types of vehicles, some restored in local workshops, most acquired secondhand from abroad (especially from Belgium) to the present day, transport is one of the most profitable informal-sector activities, the popular *candongueiro* [vans that make up the public transport system] becoming indispensible to urban mass transport.

The informal sector has proven less capable of penetrating other areas of transport, owing to the capital-intensive nature of the railway, shipping and airport sectors. Nonetheless, at the airports, the effects of informal activities are felt in the form of significant supplementary payments required for validation or issuing of airline tickets.

In the housing sector, parallel building arrangements have become a general rule, since the war led to massive migration from the countryside to the cities, and the Government's response has been less than adequate.

This has led to a proliferation of unplanned owner-built housing, with the *candonga* prevailing for acquisition of building materials and no urban-planning or sanitation criteria, resulting in the emergence of new suburbs with populations in the thousands. Water, in such places, is a commonly sold commodity traded by the tank-truck, the price of which rose 63.9% between November 1990 and May 1991, according to the latest CPI for the latter month.

National borders have always been venues for significant informal and parallel market activity. At the border with the Congo (Zaire, as it then was) Angola exchanged goods such as milk and medical drugs, for Congolese beer and (notably) sound equipment. In the south, despite the war, the border with Namibia never impeded contact between populations of the same ethnic background, and the main commercial activities consist of the sale of Angolan cattle in northern Namibia and purchases, using South African Rand thereby acquired, of garments, bicycles, etc.

After Namibian independence, exchanges of this type have become more intense, expanding in the general direction of the province of Huíla, 400 km from the border.

During the war, UNITA created 'sanctuaries' in the southeast from which to intensify its activities, and the *de facto* State thereby created sought also to dominate all economic activity. Supplies for populations under UNITA control were subject to its monopoly and no free exchanges of traditional property were permitted. All exchanges of goods had to comply with UNITA rules in support of the war effort.

With respect to economic relations with the outside world (excluding the support of its allies) UNITA established trading systems to enable acquisition of goods and of hard currency. To this end, it traded diamonds, timber and ivory in exchange for assorted goods.

The most notorious of these deals were conducted through Portuguese businessmen settled in South Africa, whose personal fortunes were greatly increased by means of such trade.

5 THE POST WAR PERIOD

The decisive hold of oil on the economy, acquired in the final years of colonial rule, was maintained. Especially in the post-war years after 2002, oil revenues were an essential factor for achieving greater integration, underwriting the national budget, repairing roads and expanding the domestic market.

Meanwhile, another phenomenon that had caused great social strife was proving an important factor for integration. Vast numbers of displaced persons (some say as many as 4 million by the mid-1990s) experienced one of the greatest tragedies of the war that ensued after the 1992 elections. Displacement forced communities into greater contact and gave rise to a whole generation born far from ancestral homelands. It also forced around two thirds of the population to crowd into towns and suburbs.

The rise in oil revenues was proportional to increases in production, which climbed from an average of 450,000 barrels per day in the 1980s to 1.8 million in 2009, and to increases in prices, especially between 2004 and 2008.

During this same period, diamond mining came under tighter control, and production rose back to the levels of the late colonial period; around 2 million carats per year.

Double-digit economic growth between 2003 and 2008, and a drop in inflation from three to two digits, enhanced the value of such revenues. Even the currency, which had dropped vertiginously in value during the 1990s, began to show lesser signs of instability. Prior to the 2008 worldwide crisis, the official exchange rate stood at Kz 75 per dollar; whereas, by the end of 2010, the rate was Kz 90 per dollar.

Angola's GDP rose from US$ 11 billion in 2001, to some US$ 60 billion in 2007, according to the Ministry of Planning's Economic Report (UCAN, 2007) and, by 2010 (as already mentioned) amounted to US$ 87.5 billion.

Exports, which in 2002 had amounted to some US$ 8.3 billion, rose to US$ 39.6 billion in 2007 (Ucan, 2007, quoting figures from the Ministries of Planning and of Petroleum and *Banco Nacional*). As a percentage of GDP, the foreign-trade balance ranged from around 27% in 2005 and 2006, to roughly 25% in 2007 *(op. cit.)*.

Construction, an important indicator in any economy and which, in Angola, had come to a virtual standstill, grew by 30% in 2006, and by 37.1% in the following year *(op. cit.)* thus more than doubling, in terms of percentage growth, in relation to the two previous years.

During the same period, non-oil sectors experienced greater growth than at any time since independence. However, the percentage improvements recorded are against an extremely low base (as pointed out by William Easterly - 2004). In other words, the imbalance in relation to extractive activities remained very strong, and the weakness of manufacturing in general (including processing of agricultural produce) persisted. Figures on the performance of agriculture and manufacturing (two indispensible sectors for diversified growth) remained modest up until 2008. Market figures for the two subsequent years do not appear to indicate that much improvement can be expected in relation to supplies for the consumer market. Only rarely did one or another product, for example, mineral water, corn [maize] or *massango* (a traditional cereal consumed in certain regions) have any impact on the market.

Poor industrial and agricultural performance stem from weaknesses of the business model. Since the colonial era of "rural markets", farmers have rarely produced much beyond what they need for their own subsistence, and the supply situation has been exacerbated by the fact that the rural population today is less than half the size it was before war broke out.

A major portion of the informal-sector businesspeople has yet to make the transition (in terms of knowledge and capitalization) toward small or medium-size industrial businesses. The informal sector remains strong in the exchange segment, but weak in production. In such a scenario, there are two fields in which, in countries such as Angola, only the State can take the lead: namely, infrastructure and social development.

Immediately apparent are insufficient and intermittent supplies of electric power and water. Frequent power cuts and water shortages, aside from causing discomfort, lead to higher prices. Even though families and businesses invest in alternative sources of supply, reduced production caused by frequent shortages of these utilities end up generating real price increases. These are background factors that have a perverse effect on the market, especially when they coincide with wages in arrears.

Building and repair of roads also, unquestionably, has an important influence on growth, whereas investment in housing, even when it does not reach the entire population, tends to produce similar effects.

The percentages of post-war budgets earmarked for social spending underscore great strides achieved, when compared to the 1990s. But, once again, the historical baselines are so low that, even with 8% of the budget allocated to education, human-resources shortfalls will not be overcome in the short term.

With respect to the labor market, more conservative estimates for the country as a whole point to an unemployment rate of around 25% (similar to South Africa) and underemployment of around the same level. The oil sector generates few jobs and, thus, it is "non-oil" sectors that must foster opportunities.

In that job creation is the key to social development, the Angolan economy is undergoing the same challenge faced by other oil-based economies: i.e., it must transfer resources produced by oil so as to ensure sectoral diversification.

At the beginning of the first half of 2010, the most significant factor was a US$ 9 billion liability in the form of payments in arrears for budgeted works, of which, US$ 6.8 billion had been confirmed by the Ministry of Finance. The Ministry then published a payment schedule for debts contracted between October 2008 and August 2009. This stems from the global crisis, which started in the United States in 2008, and which blighted Angolan accounts in the two subsequent years.

The sudden fall in revenues caused by the drop in oil prices, aside from causing liabilities related to debts incurred with service providers and wages in arrears, also led to significant alterations in the General State Budget (OGE) which, in 2010, following review, amounted to the equivalent of US$ 43 billion dollars, in relation to a GDP (as stated earlier) of US$ 87 billion.

With a view to meeting its civil-service payroll obligation in 2009, that year's budget included cuts in spending on gross fixed-capital formation (FBCF) from 35.5% to 31.4%, while personnel expenditures rose from 14.5% to 26,7%.

> This situation has become a problem when we perceive that the 2010 budget, which is clearly better funded than that of 2009, reduced the weight of FBCF expenditures to 23.8% of total expenditure, against increases in personnel expenditure which now account for 27.7% of total spending (Adra, 2010).

According to the same source, this "reduction in the sum of investments in infrastructure may lead to delays in the process of bringing structure to the country, causing reduced potential, slower economic growth, and a lower structural employment rate".

According to another source, the worldwide crisis underscores domestic distortions: reducing the availability of funding for importation of goods for final consumption, the effects of which are amplified by an insufficiency or lack of domestic production of such goods, in a great many of which the country could be self-sufficient.

This is one of those factors which spur speculative impulses, and which end up affecting the inflation rate, currently foreseen to reach some 13% for 2010.

6 CONCLUSION

This historical trajectory has placed Angola in second place on the ranking of the Southern African Development Community (SADC) and made it the second largest oil exporter in Sub-Saharan Africa, just after Nigeria.

The Angolan economy has maintained extractive characteristics from the colonial period, giving rise to a national class of owners, holders of significant financial assets, capable of affecting business at various levels, often through partnerships with foreign capital.

The relationships between this class and the State were of fundamental importance in the initial establishment of the State, and have remained important for its consolidation to the present day. It is for this reason that, in a major portion of the sociology of Africa, the term “Class-State” is used.

Income levels, however, vary considerably within this segment, and methods of capital accumulation also display quite substantial differences; these being two indications that this segment does not constitute a homogeneous class.

This process of social stratification has established an additional layer, within which are various levels of income, professional training, and status within the hierarchy of the vast structure of public administration and state-owned companies: civil-servants, employees and technical staff, enjoying the strongest job-stability and employment ties that the current phase of capitalism permits.

At the base of the pyramid, the vast majority of people living in suburbs and practically the entire rural population has low income and poor access to essential services. Though 36.6% of the population is classified by IBEP (Angola, 2010) as being below the poverty line, the true proportion rises to over half the population, if the international definition is altered slightly, from 2 to 3 dollars per day.

Nonetheless, even without such an adjustment, the figures are revealing: 90.9% of the population live in ‘inadequate’ housing. In towns, 66.3% of households are served by electricity; in rural areas, only 8.6%. Piped water supply reaches 59.7% of urban households, and 31.1% of rural households, but consumers must effect their own treatment of the water.

Not much comparative data is available for preceding decades of the colonial or post-colonial eras, thus making it difficult to assess the kinds and rates of progress achieved.

Angola thus presents a largely failed economy, in terms of the social effects it produces, current vulnerabilities, and unfulfilled potential. These three interconnected aspects were, in recent decades, regarded as characteristics of the “third world” and, today, are features of the block described by the UN as “Less Developed Countries” (LDCs).

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INTERNAL MARKET LED GROWTH MODEL IN LATIN AMERICA AFTER A CRISIS: AN INSPIRING UTOPIA?

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1 INTRODUCTION

After decades of strong growth, the crisis of the eighties left Latin America deeply bruised. It took 14 years to restore its 1980 level of GDP, while rising poverty rates during the eighties decade were such that only 25 years later has Latin America recovered the level of wealth it had in 1980 (Jimenez, 2010). A continent marked (with few exceptions) by high inequalities, regressive taxation, small social transfers as compared to those effective in Europe, and modest trade openness (except for Mexico and a few countries of Central America), was interrupted in a phase of relatively high growth since 2003-2004 by the international crisis of 2008.

Unlike the crisis of the eighties, the 2008 crisis is less the product of internal difficulties than the contagion of a crisis that originated in developed countries. In this respect, it resembles the Great Depression of the thirties. Also unlike the crises of the eighties and thirties, the crisis of 2008, although severe, appears to be of short duration – since recovery was relatively strong at the end of 2009. However, one should be careful not to confuse a cyclic period with a trend, particularly in referring to a structural crisis. In the current state of international crisis, the sustainability of recovery remains in doubt so as long as the international architecture has not been redefined. It is certainly a fragile recovery, but as with the crisis of the eighties and especially that of the thirties, the " experience " of the crisis is characterised by a mutation of production structures, which, though difficult to read at present, is likely to change existing modes of governance.

The purpose of this paper is to question whether, after years of increasing openness, a new growth plan, focused on a more equitable distribution of income and subsequent expansion of the domestic market, has a serious chance of contributing to a sustained recovery of growth. This investment in the domestic market, following the bet made on the external market with the Washington Consensus in the nineties, seems utopian given the depth of inequalities and powerful conflicts of interest opposing fiscal reform and a redistributive policy that would

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be costly to the high social strata. But it is clear that in some countries, like Brazil and to a lesser extent Argentina, this "utopia" has had some early implementation. The counter-cyclical policies decided in the aftermath of the global crisis are different from those of previous years, which were inspired by the Washington Consensus and characterised by a reduction in social spending at the outset of a currency crisis, thus precipitating a recession. The new policies, inspired by a "pragmatic Keynesianism", seek to promote support for demand and lead to a decrease in primary surpluses. These measures have mitigated the social cost of this crisis rather than increased it, at least until the early 2010s.

In at least one respect, these counter-cyclical policies are, to some extent, part of a continuity that can be observed in some countries since the early 2000s: small decline in inequalities, more sustained social policy, and growth recovery. Can we consider then that the international crisis, in an underground way, is accelerating a process that had already begun? Or, more pessimistically, should we think that this process is shaky and that a somewhat reshaped version of the previous excluding model will be back in full force, once the illusion of recovery is confirmed? A return of the domestic market, a mobilising utopia, or a return to the previous model, more open, less vulnerable "primarily the increase in international reserves" and after more fragile, but more fragile "primarily due to increased opening rate and content of exports"? (Salama, 2009a, 2009b) The first part of this paper will review the effects of the thirties crisis on the industrial structure of the major Latin American economies. The second part will try to assess the likelihood of success of the "domestic market bet" by focusing on two factors: the degree of openness in that market, and the importance of income inequalities.

2 FROM ONE CRISIS TO ANOTHER

2.1 Unexpected consequences of the 1930 crisis: an original mode of industrialisation in Argentina, Brazil and Mexico

Because it was assigned to an international division of labour pertaining to the exploitation of primary products by dominant powers, industrialisation was a threat to jobs in the firms of dominant countries. Not only did it complicate the social formation of these countries, it also opened the door to challenges of their domination. This explains the hostility to the industrialisation of the exploited countries and the subsequent small scale of their domestic markets. This relationship of domination was deeply altered, however, first by the 1914-1918 war, and then by the Great Depression of the thirties. Finally, there was a change of hegemony: The United States, in seeking to take the place of a weakened and declining Great Britain, created a more favourable environment for the industrialisation of developing countries.

The crisis of 1930 was a major one, and its impact on developing economies was significant almost everywhere. With the deterioration of trade agreements and the sharp drop in exports of primary commodities, the import capacity of these countries was strongly affected. The duration of the crisis, unforeseen by policymakers, had different consequences in different countries. Some did not experience profound mutations and continued, in a "traditional" way, to take part in the international division of labour while others, after a more or less prolonged crisis period, experienced a phase of "unplanned industrialisation", an expression aptly used by the United Nation's ECLA (Economic Commission for Latin America). This unplanned industrialisation was the result of a series of conditions: *i)* the existence of a minimal industrial structure produced by the exporting activity itself (e.g. workshops for repairing steam engines used in the transportation of raw materials, agglomeration economies arising from the construction of ports and cities); *ii)* a more or less important demand, depending on the nature of exports, arising from the spread of market, and even monetary, relations; *iii)* finally, the support of exporter incomes through the purchase, in local currency, of a part of their production. Once these conditions were met, the unanticipated extension of external restrictions led to an original mode of industrialisation: a virtuous circle of import substitution of light consumer goods (of low capital intensity) allowing the resumption of strong growth within a context of international crisis, and, in the process, creating a coherent domestic market.

The size of the domestic market increased as the process of import substitution took hold. Investment played a large part in creating jobs, since the capital intensity of goods produced was low. Workers came in part from international migration but also, in an increasing proportion, from an internal migration from the countryside to the cities. Their employment led to a process of monetisation, since as peasants their labour had had little monetary value. This process was at the source of an increasing demand for what became known as "worker goods". The increasing monetisation took over the demand of exporters and augmented it, valuing production for the growing domestic market. In this sense the circle was virtuous. The dynamic for growth came from increased demand, but unlike the classical Keynesian process, this increase was more a product of the growing monetisation of a workforce that had hitherto been little monetised, than of an increase in wages. This essential aspect of the process of light import substitution in the years 1930-1940 is often ignored by economists.

The structural crisis of the thirties gave birth to a new growth regime that was "pulled from within", in the words of the ECLA. In this sense, the crisis opened up a process of restructuring and surpassing, in which "the old, not wanting to die (the export economy) gave way to the new, trying to be born (industrialisation by import substitution)."

In provoking this unplanned industrialisation in certain countries of the Periphery, the Great Depression led to the emergence of specific political regimes. The growth of industry changed the social formation, and gradually, new conflicts of interest appeared between the social classes and within them. These were exacerbated when the light import substitution slowed down. On one hand, import capacity did not increase much, if at all; and the international crisis persisted. But on the other hand, the structure of imports became increasingly rigid. To produce equipment goods and intermediate products that could not be imported in sufficient quantities became increasingly difficult for two reasons. On one hand, production of goods is more capital-intensive and requires substantial investments; on the other hand, there is no stock exchange to accumulate the capital that small individual entrepreneurs cannot raise alone. That leaves the State as an agent capable of investing in these sectors. But it is not because the State should (objectively) intervene that it will necessarily do so. Everything depends on the configuration of social conflicts, and how these are overcome and given meaning. In Argentina, Brazil and Mexico, the emergence of Caesarist political regimes (Péron, Vargas, Cardenas), initiated a passage from growth driven by light import substitution to growth propelled by heavy import substitution, resulting from the State's direct intervention as an investor in these sectors. In a certain way, the State took the place of the private contractor, who found himself in deficit because of insufficient size and absence of financial market (Mathias and Salama, 1983).

Heavy industry, along with the energy and infrastructure sectors, could continue to grow insofar as the necessary political conditions were in place, which made it possible, for some time, to overcome the quasi-insurmountable obstacles produced by the previous growth model. Thus, the impact of the thirties crisis on Argentina, Brazil and Mexico was very important from both the economic and political perspectives. Is the crisis of 2008 likely to cause effects of similar magnitude?

2.2 The 2008 Crisis

The crisis that began in 2008 is different in its causes from the crisis of the thirties. Financialisation, this time, appears to takes precedence over other causes. The consequences of financialisation on sluggish labour incomes and household debt in some developed countries are now known. However, we cannot classify the 2008 crisis as a realisation crisis on the grounds that wages do not rise much in developed countries over a long period, because the taking on of debt kept up demand, which would otherwise have been sluggish. Nor can we classify it as a crisis of over-accumulation, because the rate of investment remains generally poor in all developed countries and idle production capacity is low.

The effects of the globalisation of trade and finance on wages and productive investment were instrumental in precipitating the 2008 crisis. The globalisation of trade and external constraints from low-wage countries in Asia led to a dissociation between productivity growth and wage increase, causing the latter to stall, not only in developed countries but also in the emerging economies of Latin America. Financial globalisation led to a new organisation of business firms to raise their immediate profitability. If we ignore the soaring incomes of managers, the share between profit and salary has tended to be at the expense of the latter, and, within profits, the share of financial profits (or costs) has increased. This means a two-fold effect on earnings: an external constraint, the financial constraint in the distribution of value added, and the temporary positive impact of the "construction" of securitised financial products (shares) that have become very attractive.

If the present crisis is structural, as we believe, a cyclical upswing will not overcome the causes that produced it. Only a thorough reform of the international financial architecture and the imposition of new rules governing international trade – that take into account the ethical and environmental conditions of production – can overcome the crisis of 2008. In light of what happened during the Great Depression of the thirties, with the emergence of a new model of industrialisation and the resumption of growth in major Latin American countries, we can consider that the crisis of 2008 may allow for new growth opportunities in the emerging countries of Latin America. We must be cautious, however, as to the duration and meaning of the recovery in these Latin American economies. Is this a cyclical upswing in a downward trend? Or is it the beginning of a sustainable decoupling: the continuation of a structural crisis in industrialised countries and the beginning of sustainable growth, the premise of a new pattern of growth in emerging Latin American economies. It is difficult to answer these questions because the answer depends, as in the thirties, on the political responses given to conflicts of interest, especially to distributive conflicts, that arise.

The more or less pronounced openness of Latin American economies to trade and financial flows has created "transmission channels", promoting the effects of contagion between developed countries, and between them and developing countries (WTO/OECD, 2009; OECD, 2009; IMF, 2009).[1] The 2008 crisis was severe, causing growth rates to drop between five and ten points in emerging Latin American economies (Salama, 2009 and 2010). This was followed by a fairly rapid recovery, dependent mainly on a boom in the domestic market

1. Let us recall that in emerging economies in general, banks had few high-risk assets. The beginning of the crisis, triggering a credit crunch in developed countries, led in turn to a drying-up of liquid assets in emerging economies. This occurred mainly because capital « fled » these countries in order to supply liquid assets to parent companies, multinational banks and international investors, causing a drop in their respective currencies against the dollar. The return of capital, attracted by high returns in emerging stock exchanges, has not however led to a significant increase in loans, because state banks are now compelled to take over from failing private banks.

of these countries and their continuous supply of exports to Asian economies (China and, to a lesser extent, India). However, should a crisis occur again in developed countries, such as the one now threatening the sovereign debt of some European nations, the recovery of Latin American economies could be problematic. The effects of such a crisis would be more or less devastating for emerging economies, depending on their degree of trade openness, the type of goods exported, the intensity of financial globalisation, the stock-flow structure of foreign capital (bonds, equities, direct investments),[2] and the magnitude of their actual net reserves.[3] This is not only because there would be a drop in external demand, a depletion of liquid assets and a scarcity of international credits for export, but also because the possible consolidation of market dynamics in some emerging economies depends on the length of time between crises. The longer this interval, the stronger the opportunities to resist an external crisis.

The scope of this article does not allow us to concern ourselves with this eventuality, which seems unlikely to occur in the near future. Our hypothesis is that developed countries will continue to experience low growth so long as structural reforms have not been undertaken. Within this context of weak recovery in industrial countries and potential financial turmoil, we analyse the possible emergence, in the major Latin American economies, of new growth plans focused on boosting their domestic market.

2.3 Can history repeat itself?

In the twenties, the share of exports of major Latin American economies in world exports was greater than it is at present, despite years of continued openness. It is common, moreover, to characterise the twenties as a period of liberalisation of markets and to conclude that economies were more globalised than they are today. This, however, fails to take into account the fact that the world at that time differed from today's world on a key point: *the degree of monetisation*. In developed economies, self-produced consumption was still important in the countryside, where most of the population resided. In Latin American economies such consumption was even more significant. Therefore, the ratio of exports to GDP had only minor significance, as it related entirely to monetised values at a time when a very important part of domestic production was passing through non-monetised channels, and hence not being counted in the GDP. Nowadays,

2. The impact of a crisis on developing economies depends on the extent of the globalisation process in different countries. Synthetic indicators can help to assess this. International institutions (IMF, 2009) have been trying to do this with varying degrees of success, since according to the OECD indicator (2009, 42), Mexico should suffer less than other countries from the effects of the crisis, which is far from being the case.

3. This is an important point, but little analysed. The reserves are made up of trade balance surpluses and/or capital balance surpluses. Only the former correspond to actual reserves, while the latter are highly sensitive to economic conditions and may be truncated by a partial return of capital, as was the case in late 2008. On this point, see Bradesco (2009).

monetisation is almost complete and this ratio is more relevant than it was in the twenties. The domestic market already exists; the only way to improve it now is to increase wages and social transfers, which, in today's context of globalisation of trade, can only be done if a country's relative competitiveness is maintained. In the absence of sustained competitiveness, imports replace domestic production. Unlike the thirties, growth today that is centred on the development of a domestic market will have to respect the constraints of competitiveness – unless we assume a significant return to protectionism. Protectionist measures could in fact be "legitimised" by considerations of respect for ethical and environmental production conditions, even with incentives to buy " national " products as can already be observed. It is from this dual context of globalisation and of near-complete monetisation, which was quasi-inexistent in the thirties, that today's "bet on the domestic market" must be analysed in terms of two variables: the contribution of foreign trade to growth and the extent of inequalities.

2.4 A stronger (but still relatively weak) contribution of foreign trade to growth

The contribution of foreign trade to growth can be analysed from two perspectives: one a strictly accounting perspective, the other emphasising economic mechanisms and snowball effects.

In the accounting perspective, the assessment of the contribution of trade to GDP is concerned with the growth of exports and imports, i.e. exports net of imports. The former are positively involved in the growth rate, the latter, negatively. External trade may not contribute positively to a country's growth when its trade balance is negative, even if it is open to the global economy. Conversely, a positive trade balance of exports over imports will have a positive effect on growth. The case of Asian countries, and especially of China, is interesting because it is often given as an example to highlight the beneficial effects of export development on growth. If we consider the period between 2000-2008, the average contribution of net exports to the growth rate in China was 10,2%. This means that for a 10,2% average GDP growth rate, this contribution is only 1.1 points, while the contribution of investment is 5 points and total consumption represents 4.1 points. Nonetheless, with China's increasing trade surpluses during this period, the proportion has grown: The contribution of net exports rose by about 5% between 2001 and 2004 to more than 20% between 2005 and 2007, according to Goldstein and Xie (2009).[4]

Contribution in the accounting perspective is not entirely the same as economic contribution, which can sometimes be significant even in situations

4. For example, South Korea's net contribution throughout this period is higher (28.6%) and Singapore's also (27.3%); Germany's was 64% (strong trade balance surplus) while in the U.S. it was -4.3% (trade deficit).

where, from an accounting perspective, the contribution of net exports to growth is weak or negative. In this way, exports can play a coherent role in growth or, conversely, have little or no effect on it, even if the rate of trade openness is high. Let us consider two examples of highly open economies: Mexico and Korea. In the first case, growth is not pulled from the outside, in the second, it is.

In Mexico, unlike Brazil and Argentina in recent years, the trade balance remains in deficit. The structure of Mexican exports consists by 10-15% in the export of oil, the price of which is volatile, with the remainder divided roughly equally between products primarily for the Mexican domestic market and products intended wholly for external markets (almost exclusively the United States). The sharp increase in Mexico's rate of trade openness over the last thirty years is explained by the growth of exports of manufactured assembled goods, produced in " *maquiladoras* ", where the value added is low, and there is very little cluster effect (Palma, 2005). Here, we see that the economic contribution of exports to growth is reduced: GDP growth remains sluggish despite the vitality of exports. Thus, the multiplier effect is weak (Ibarra, 2008).

In Korea, growth is driven by booming exports, but the relationship is more complex than is generally believed. Following the work of D. Rodrik (1995) and, contrary to the liberal *doxa*, it was not the development of exports and the marked opening of the economy that allowed the acceleration of growth in the sixties. Imports of capital goods grew faster than exports, consisting mainly of intermediate products and sophisticated capital-intensive equipment.

The sharp increase in these imports mirrored the increase in investments. The latter, therefore, were the real drivers of growth. An important portion of these investments was in fact intended for the production of goods to be exported, which would in turn bring in foreign currencies. The sequence is thus: increased investment rate leading to import growth leading to export growth; and it was only later that the balance of trade became positive. From an economic perspective, it is clear that the positive contribution of exports to growth is explained here by the government's industrial policy of encouraging local production of the inputs needed for the manufacture of exported products. It is this policy, designed to increase the value added locally, which explains both the increase in investment and in imports of capital goods. Indeed, efficient investment practices, as reflected here by the imports of sophisticated capital equipment, were equally instrumental in bringing about the desired growth. We are in a scenario, therefore, that is radically different from the Mexican case. The contribution to export growth comes from an intensification of related industry, through a direct increase of investments in the sector producing goods for export, and an indirect increase in sectors producing inputs for these products. From a Keynesian view-point, the multiplier effect of increased investment outweighs the negative effect of imports and enhances the positive contribution of exports. This analysis of the Korean case can be applied to many other Asian economies. Boosting the domestic market through a redistribution of income does not mean neglecting the role played by the foreign market. It is not "a zero sum game".

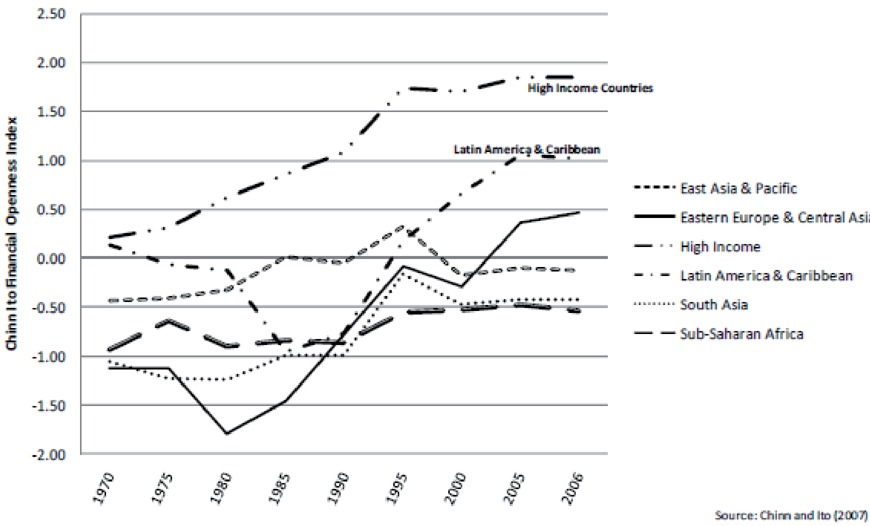
The relationship between external market and internal (domestic) market is therefore more complex than appears at first glance. To speak as philosophers, we are dealing with two data that are "separate but interdependent". It is a point often overlooked by economists.

This being said, trade openness has been moderate and the contribution of exports to growth in Latin America has been weak over the past twenty years. Contrary to what one might imagine, the emerging economies of Latin America have not experienced an exceptional process of trade liberalisation. Though Mexico and some small countries in Central America are exceptions, Brazil, Argentina and many other countries have maintained their overall participation in world exports.[5] As these have grown on average twice as fast as world GDP during this period, globalisation has increased, of course, but at a rate more or less equivalent to the global average. Thus, despite a substantial increase in Brazil's degree of openness between 1990 (11.7%) and 2004 (26.9%), its weight in international trade remains at a marginal level and relatively stable, hovering around 1.1% between 1975 and 2005 (Kliass and Salama, 2008), although it has since gone up slightly due to the significant rise in the cost of raw materials. By contrast, the growth of exports from China is much faster than the global average. Its share in international trade, which was roughly equivalent to that of Brazil in 1975 (0.9%), has risen sharply: 1.9% in 1990, 3.9% in 2000 to reach 7.4% in 2005 and now soaring at 8.9% (Instituto economico do desenvolvimento industrial and WTO-OECD). The globalisation of trade is therefore faster and more important in China than in Brazil. Although Brazil and Argentina have opened up to the world economy, they are not yet what could be called open economies. However, unlike what can be observed in Asian countries, the globalisation of finance in Latin America has been substantial, much higher in fact than in Asian countries, as is shown in the chart below.[6]

5. As noted by N. Birsall Birdstall and Hamoudi [2002] in their criticisms of the work of Dollar and Kraay (2000), this is far from being a perfect indicator for economies whose exports are largely, and even exclusively, made up of primary products, as is the case in the least developed countries (LDCs). Indeed, commodity markets are highly volatile. The numerator of this ratio, and hence the indicator itself, are strongly affected by the fluctuating cost of raw materials. To define certain economies as « Globalizers » or not, depending on the evolution of this ratio, and seek to establish a relationship with the growth rate of GDP, is therefore inappropriate from a scientific perspective.

6. See Galindo, A., Izquierdo, A. and Rojas-Suarez, L. (2010, p.12). Today, there is abundant literature on this topic; we cite for its especial interest the article by Titelman, D., Perez-Caldentey E. and Pineda, R. (2009).

CHART 1
Financial openness



Obs.: image displayed in low resolution due to the technical characteristics of the original files provided by the authors for publication (editorial note).

However, financial openness did not bring about a significant development of high-risk financial stock share products in banks. For this reason, the latter suffered from scarce liquidity due to the repatriation of capital at the beginning of the crisis, more than from the need to "clean up" their balance sheets. Although their balance sheets have only been slightly affected by high-risk financial products, the behaviour of private banks in these countries has adapted to that observed in developed countries: credits to the economy have declined, and the financing of investments and exports has become more difficult. Credits to the economy have not entirely collapsed, however, because governments have sought to facilitate access to credit and to charge low interest rates (multiple subsidised rates for the purchase of cars and homes, for export, etc.), through their public banks. This policy has been facilitated in some places by the existence of large state banks such as BNDES in Brazil, and made more difficult elsewhere by their absence, or smaller size.

2.5 Strong inequalities as barriers to recovery of growth by the domestic market

Income inequalities are particularly high in the vast majority of Latin American countries (Salama, 2006), though with three exceptions, they have declined slightly in many countries between 2002 and 2008 (ECLA, 2009; Lopez-Calva and Lustig, 2009; Hopenhayn, 2009; Salvatori Dedecca, 2010).

This development is important, and its causes numerous: change in how the labour market operates, greater social transfers, less regressive fiscal policies, population decline and increase in the employment rate of women – though the contribution of these last two factors to the decline in inequality is relatively modest according to Lopez-Calva and Lustig (2009: p. 40 et seq.). Indeed, the number of adults per household accounts for 6.6% of the decline in inequality between 2000 and 2006 in Brazil, 8% in Argentina and 10.3% in Mexico. The reduction of inequalities mostly comes, in fact, from improved working conditions (employment, salary) and only in a relatively small proportion from increases in revenue not generated by labour[7] (26% in Argentina, 15.1% Mexico). The exception is Brazil (45.2%). More precisely, we observe in Brazil that the improvement in labour incomes is stronger for low incomes than for high incomes. The earning ratio of the richest 5% to the most modest 50% of the population went from 14.3 in 1993 to 13.5 in 2008, while the ratio of the richest 5% to the poorest 25% went from 23.6 to 18.6 (Salvatori Dedecca, 2010: p.16). These data may be surprising.[8] They are partly due to the strong increase in the minimum wage, and thereby the amount of pensions paid by the public sector,[9] and partly also to employment growth and the changing structure of jobs (Salama, 2007 and 2008). But the bottom line is that social transfers, contrary to common belief, play only a small role in the transformation of inequalities. We shall examine this last point more closely.

The works of the OECD (2008) and of Goni, Humberto-Lopez and Serven (2008), from which the chart below is borrowed (p.7), clearly show the very weak influence of social transfers on the concentration level of incomes, as measured by the Gini coefficient. In considering the difference between gross income (including social transfers) and market income in Latin America and Europe, we observe that the impact of these transfers on the concentration of incomes is high in Europe but very low in Latin America. If we consider the available income (including transfers and direct taxes) and gross income (including transfers), we observe that the impact of taxes on the reduction of inequality is much higher in Europe than in Latin America.[10] The only effect of remittances in Latin America

7. This is a very heterogeneous category, consisting in social transfers as well as rent and income on capital.

8. Two comments :*i)* Income of 0.01%, 0.1% of even 1% of the richest population grew much faster than the rest of the population, as indeed in all Western countries *ii)* Income on capital (interest, dividends) is very poorly recorded.

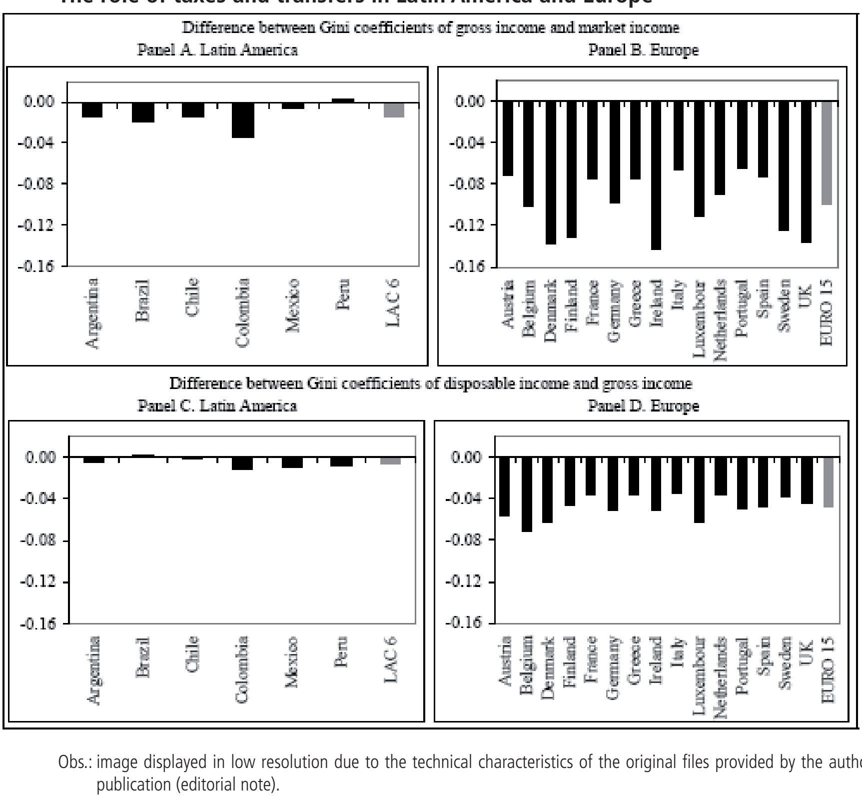
9. In many countries, there appears to be a link between the minimum wage and amounts paid into pensions. A relative increase in the minimum wage tends to raise total pensions. On a more general note, social policies, as defined in Latin America (education and social transfers as well as social protection, which mainly consists in pensions and health care) are still relatively weak, although increasingly strong in some countries like Brazil. According to research by Afonso and Dain (2009), there are only 3 countries (Argentina, Chile, Costa Rica) in which social spending exceeded 13% of GDP between 1985-1990. There were 9 such countries in 2006-2007, including Brazil (24.4% of GDP), but no longer Chile. In Mexico, social expenditures were less than 9% of GDP during the first period but increased during the second period to11.2% of GDP.

10. The difference would probably be greater still had this research taken indirect taxation into account – this being higher in Latin America than in Europe (ECLA, 2009; Gómez Sabaini *et al*., 2008). Indeed, indirect taxes are usually more regressive than direct taxes, because all individuals pay the former at a constant rate, contrary to direct taxation.

is low compared to European countries. The Gini down slightly by 2 points on a scale of 1-100, while it decreased much more sharply in Europe on average (see the first two tables). The effect of direct taxes is extremely low in Latin America on average (less than 1 point on the Gini), while it is also much higher on average in Europe (see the last two tables). Therefore these differences are much more important once transfers, net of taxes, are included (on the order of 20-25 points). On average, the Gini in Latin America goes from 51.6 to 49.6 while in Europe it goes from 47.6 to 28.2.

From these data, we can readily understand why many economists, following the work of Celso Furtado, have seen the trend of economic stagnation as being caused by these levels of inequality and low social spending (Salama, 2006: chapter 1) and, conversely, why the slight reduction in inequalities and increase in social expenditures may have boosted growth in the years 2000 and revitalised the domestic market.

CHART 2
The role of taxes and transfers in Latin America and Europe



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3 CONCLUSION

It is difficult to discuss the possible futures of Latin American countries without distinguishing the different paths they have followed during the last ten to fifteen years. Brazil, Argentina, and Mexico have certain features in common: high income inequality, higher in Brazil than in Argentina; slight reductions in these inequalities; a modest openness to international trade (with the exception of Mexico); primary exports once again making up an important proportion of total exports in Argentina and Brazil; a difficulty in exporting sophisticated industrial products, less pronounced in Brazil than in Mexico or Argentina; and finally, a trend towards appreciation of the real exchange rate, with the exception of Argentina in the 2000s. These countries also have different backgrounds. In Brazil and Mexico, the average growth rate of GDP has been modest in the 2000s. While Brazil's growth rate increased somewhat in 2004, Argentina's appeared to take off in Asian style. In 2009, the drop of the GDP was very sharp in Argentina, but still less pronounced than in Mexico and much less so than in Brazil. Inequality has fallen more significantly in Brazil in the 2000s than in Mexico or Argentina, and, while social expenditures have increased in proportion to GDP in Brazil and Argentina, they have stagnated in Mexico (Alonso and Dain *op.cit.*).

These developments, as well as accelerating growth from 2003-2004 onwards, raise questions as to whether the beginnings of a new growth regime in Brazil (and more tentatively in Argentina), started even before the crisis erupted in 2008, carried by a boom in domestic demand. This boom may have been hidden by the simultaneous growth in primary product exports caused by the rise in their prices.

These countries are at a crossroads. Economic recovery and countercyclical policies,[11] decided in the aftermath of the breakout of the international crisis, could serve as a springboard for defining a new growth regime. In so doing, these countries, building on what appeared timidly in the 2000s, would " benefit " from the international crisis to further reduce their income inequalities and promote the contribution of their internal market to economic recovery,– somewhat like what happened in 1933-34 after the Great Depression of the thirties.

The massive return of capital into the so-called "emerging" markets of Latin America, the resumption of GDP growth, the difficulties in sustaining demand insofar as it could increase labour costs – all these factors strengthen the political

11. These were characterised primarily by policies to support domestic demand, both at a tax level (reduction of certain taxes), a monetary level (artificially low interest rates for the purchase or sale of certain products), and even a budgetary level (due to the increases in the minimum wage, pensions and social transfers). Countercyclical policies were relatively little characterised by policies of major public work on infrastructures, such as occurred in China (Khatiwada, 2009; Jimenez, 2009).

weight of those who would like to "close the parenthesis of the crisis" and return to the previous excluding growth pattern of the early 2000s. This temptation is even greater now that the return of capital translates into a new trend of appreciation in national currencies, after their sharp decline in 2008-2009. This trend is favourable to foreign investors but bad for exporters of industrial products, because the decrease in competitiveness caused by rising labour costs, expressed in dollars, is not always compensated for by the decline in value of their imports of intermediate and capital goods.

One might think that Mexico will probably be most tempted by this route, as its foreign trade is almost exclusively directed towards the United States and Canada, and foreign ownership in its banking system is very powerful. Conversely, a resumption of the international crisis would promote the continuation of an anti-cyclical policy favouring demand, stimulate the search for alternative trading partners and enable a further depreciation of the peso, thereby offsetting increases in labour costs.

A continued policy supporting domestic demand is more likely to occur in Brazil and in Argentina. But it suffers from many handicaps. As we have seen, the reduction of inequalities is weak and these inequalities remain at an extremely high level. The absolute size of Brazil's population (which is greater than Argentina's) and the existence of Mercosur allow it to have a sufficiently large domestic market, in terms of capital development, for a wide range of products. This in itself seems insufficient, however, to inspire sustainable market-driven growth as long as the weight of finance and its effects on income distribution have not been contained. Increasing the wages of the least paid social strata, however desirable it may be given the extent of poverty, is not sufficient. The obstacle of regressive taxation must be lifted, which cannot be done without deepening serious conflicts of interest that have been at work for some years already.

In the thirties, the market was created through a "forced march" of monetisation, produced by industrialisation and giving it impetus. Today, the domestic market can contribute to sustainable growth only if a true Welfare State is established. This alone will make it possible for the domestic market to offset the sluggish external demand for industrial products. Not to choose this path is to accept a return to international specialisation in primary commodities on the pretext that the international demand is strong. This is choosing the easy way out today, but also a fragile economy for tomorrow. It is opting for a return to the years preceding the thirties – a strange reversal of History.

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BRAZIL IN SOUTH AMERICA: INTERNATIONALIZATION OF THE ECONOMY, SELECTIVE AGREEMENTS AND THE HUB-AND-SPOKES STRATEGY*

Ricardo Sennes**

ABSTRACT

Over the past 20 years, the importance of South America for Brazilian strategic interests has increased dramatically. More recently, burgeoning Brazilian trade flows with South American countries have been accompanied by a surge in direct investment. This has occurred despite meager domestic political support for Brazilian participation in regional integration projects and cooperation structures. As a consequence, increased Brazilian economic presence in the region has taken place independently of official regional integration efforts. This article presents and discusses Brazil's agenda for the region, focusing on strategies formed in the light of regional agreements, Brazilian diplomatic activism in relation to South American, and recent expansion of Brazilian trade and investment activity in the region.

1 INTRODUCTION

Since the early 1980s, Brazil's policies and presence in South America have changed dramatically. The main features of this change, on the one hand, have been the increasingly positive nature of the Brazilian regional agenda, in strong contrast to previous periods when countries of the region were considered of lesser importance or even as threats to Brazilian interests. On the other hand, there has been a tremendous increase in the intensity of Brazil's political and economic ties with countries of the region. Such ties were initially of trade but, more recently, have developed into Brazilian direct investment in these countries.

In the late 1990s, Brazil's regional diplomatic agenda gained clearer perspective and outlines. The rhetoric of regional integration and of a South-American framework received a boost with the inauguration of President Luis Inácio Lula da Silva, in the context of the new administration's ambition to raise the nation's international profile, previously perceived as being "unassertive in defending national interests and unassuming in definition of its goals."[1] Within this context, South America (in place of the traditional notion of Latin America) became a

* This text benefits from research and discussions in recent years with a group of academics including Ricardo Mendes, Carla Tomazini, Thais Narciso, Paula Pedroti, Juliana Cozar, Débora Miúra and Gabriel Kohlman.

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1. President Lula cited South America and Mercosul 8 times in his inaugural speech in 2003, thereby underscoring the importance of the theme for his plan of government.

priority and, upon this new basis, a number of integration and political coordination initiatives were prepared. As will be explained later in this text, the first effective efforts in this field concentrated on certain industrial areas, whereas later initiatives enjoyed only limited success. From an economic standpoint, it was in the 1990s that trade flows began to soar, and in the 2000s that Brazilian investment in the region[2] took off, both developments being only remotely linked to regional integration initiatives.

Some authors have identified distinct steps within the broader cycle of Brazilian regional activism but, generally, these are based upon developments within the scope of the Common Market of the South (Mercosul/Mercosur) rather than on the broader scope of relationships between Brazil and South America.[3] Be that as it may, all agree that they start with the laying down of the Mercosul framework, between 1991 and 1996-1997. During this phase, there was an attempt to combine the sub-regional integration process with economic reforms and trade liberalization. In the next phase, a more conflictive dynamic began to prevail within the block, stemming from external economic shocks and domestic emergency adjustment policies. At this point, agreements signed and partially implemented in the earlier phase began to crumble, especially those pledging commitment to free trade within the block and deployment of a Common External Tariff (CET). This phase is generally associated with the period from 1997-1998 up to 2002. Finally, the third phase (after 2002) was characterized by a resumption of economic growth in countries of the region, but also by a deepening of divergences among their economic strategies and a widening of economic, institutional and public-policy asymmetries between Brazil and other countries of the region. Although this division into periods is not a consensus in literature, main authors would agree with this description of the cycle.

These developments in the nation's regional agenda are related to assessments and perceptions of a portion of the Brazilian elite. According to Souza (2009) among the ten greatest international threats to Brazil, as perceived by the Brazilian political elite, six relate to global issues (global warming, trade protectionism on the part of the wealthy countries, proliferation of nuclear weapons, international terrorism, and economic inequality) whereas the other four were regional in nature (drug trafficking, authoritarian governments in South America, international meddling in the Amazon region, and arms smuggling).[4] Thus, though not regarded as the most important issues, regional themes are, nonethe-

2. See Ribeiro and Lima (2008).

3. See, for example, the work of Pereira (2007) and Hoffmann, Coutinho and Kfuri (2008).

4. This survey used a sample of 400 people considered influential in policy formulation and decision making on international themes in Brazil, including diplomats, military officers, academics, journalists, and business and union leaders. The survey was carried out in 2001 and repeated in 2008.

less, always present. Also based upon this survey, defending democracy in South America, strengthening Brazil's regional leadership, and fostering infrastructure integration in the region were ranked as prime goals for Brazilian foreign policy. In other words, in recent years a reasonable consensus has been reached, among the group that accompany international themes in Brazil, on the strategic importance of South America for this country. There is little evidence, however, that this perception is shared by the rest of Brazilian society, nor that the dominant strategic vision favors political and economic integration.

Nonetheless, conversion of this perception of the strategic importance of South America (and of the need for greater economic interaction with neighboring countries) into a broader South-American policy is still somewhat dubious. Such dubiousness has been variously manifested, not only by weak political support for Brazilian engagement in a regional economic-integration and political-convergence project, but also through poor capacity on the part of the Brazilian Federal Government to implement programs and internalize decisions and agreements of regional forums. Thus, Brazil's regional strategy remains hardly in evidence, and most certainly fails to live up to the promises of upbeat diplomatic discourse. The truth is that the diplomatic dimension is just one of the relevant vectors of this process.

It would thus appear that (at the same time but with little coordination) in Brazil there is: a perception of the growing importance of South America for the nation's strategic interests; a positive trade and investment cycle with neighboring countries; and weak political support for Brazilian engagement in economic integration projects or regional political coordination mechanisms. One possible explanation for this phenomenon is that the prevailing sentiment in Brazil favors a form of regional relations based upon projection of Brazilian political and economic prowess, rather than on regional integration. This implies a pattern of regional relations based on a hub-and-spokes model (of the type employed when analyzing relations between the United States and countries of Latin-America, or even between the United States and countries of Asia) rather than the European model of regional integration manifested by relations of France and Germany with surrounding countries.[5] If, from the standpoint of regional political strategy, the hub-and-spokes model prevails, from an economic standpoint, growth of regional trade and investment is an outcome of internationalization of the Brazilian economy, for which countries of the region provide a privileged space for boosting business; but not as a consequence of deployment of a regional economic integration strategy.

5. There is extensive literature on this theme, and particularly on trade issues. See Blyde (2004), Coe and Helpman (1995), Coe, Helpman and Hofimaister (1997), Schiffe Winters (2003), Das and Andriamananjara (2004) and Mindreau (2001). Minister of External Relations, Celso Amorim, made critical mention of the United States' posture in the region (Amorim, 2007).

According to this hypothesis, Brazil's actions in relation to South America are oriented by significant diplomatic activism (including engagement at the presidential level) but are conditioned by a preference for a weak institutional structure and low levels of engagement with regional policy bodies and frameworks. The outcome is that such arrangements are hardly effective, and may not even be applied domestically. Examples of themes in this category are tariff and non-tariff issues[6] (which tend to characterize the region by trade preferences, rather than as a free-trade area or as a customs union, in view of huge current tariff distortions[7]) and technical cooperation arrangements.

On the other hand, more robust agreements and projects in the region involving Brazil tend to take place on bilateral bases, *i.e.*, they are derived from Brazilian governmental and/or private decisions, enjoying support of Brazilian government agencies and negotiated with public and/or private players in the neighboring country. Typical cases in this field are: the Itaipu power plant and agreement; the Brazil-Bolivia energy agreement; the Brazil-Bolivia gas pipeline and Petrobras' investments in that country; the payments system using local currency between the Central Banks of Brazil and of Argentina; and infrastructure projects financed by the Brazilian Development Bank (BNDES) in countries of the region. Only a small group of agreements and programs are indeed regional and effective, with shared governance and operating mechanisms that substantially affect economic operations. Examples are the Fortaleza Agreement in the field of civil aviation, and the Mercosul Automobile Regime, among others.

Some authors, when discussing this theme, have suggested hypotheses as to the ranking of South America in Brazil's international strategy. Vigevani *et al.* (2008) who examined Brazilian foreign policy, affirms that:

> two highly important concepts in foreign-policy formulation – namely, autonomy and universalism – are deeply rooted in society and in the State, and merge in the construction of a vision of regional insertion which hampers deepening of Mercosul.

Generally speaking, however, there have been no broader efforts toward coordination and convergence. This low level of Brazilian effort to further the regional integration program, according to Vigevani and Ramanzini Júnior (2009) is linked to a dilution of the initial impulse in favor of common development, although pursuit by each member of potential economic advantages persists. Lima (2006) suggests that the composition of the schools of thought (autonomists and prag-

6. See the works of Kume and Piani (2005).

7. Approval, on August 3, 2010, of the Mercosul Common Customs Code, which provides the bases for elimination of double taxation on imported goods circulating among the member countries, if actually put into effect, may imply a change in the standard of effectiveness of Mercosul tariff rules.

matic institutionalists) is what provided the bases for the progress of the integration process in the early years, both of these groups being reticent with regard to the advance of regional commitments. Groups more favorable to institutional deepening of Mercosul (the progressists) briefly had the upper hand at the onset of the Lula Government (LIMA, 2006) however, their achievements were quite limited.[8]

According to Lima (2007) there is a weak domestic coalition in favor of the strategic alliance with Argentina, in relation to Mercosul and to Brazil's engagement with South America. In this researcher's view, after 20 years, this project has failed to produce sufficient integration policies. Taking a more pessimistic view in relation to Brazil's engagement in integration projects, Veiga and Rios (2008) having examined the most trade-intensive sectors within Mercosul (automobiles and chemicals) stated that:

> the mantra of 'complementation among production chains' adopted by the Brazilian government as a strategy for enhancing intra-industry relations between the two countries failed to demonstrate any capacity to go beyond rhetoric, either for these, or for any other sectors of industry.[9]

In this manner, Brazil's enhanced economic presence in South America in recent years appears to have occurred independently of the advance of projects and agreements of an integrationist nature in the region. In other words, regionalization (*i.e.*, the increase in regional relations not derived from policies and agreements between States) appears to have advanced more rapidly and with greater depth than the official regional integration process coordinated and negotiated among the States.[10]

Based upon these premises, this article is divided into seven sections. The first discusses Brazil's strategy in the context of existing regional agreements; the second presents a profile of Brazil's regional agenda; the third characterizes South-American and Brazilian diplomatic activism; the fourth discusses recent increases in Brazilian trade and investment in the region; the fifth presents the South American Regional Infrastructure Integration Initiative (IIRSA) as an example of a project very much in line with Brazilian political preferences; and the sixth section pursues an argument similar to that of the fifth, but more specifically applied to the theme of energy. Finally, the seventh section seeks to draw some overall conclusions.

8. For a less critical view of the goals of Brazilian integration with South America, see Amorim (2009) and Erthal and Magalhães (2007).

9. Other texts include discussions on this theme, among them Kume and Piani (2005), Vaz (2002), Veiga and Rios (2008), Veiga and Rios (2006).

10. On the concepts of regionalization, regional cooperation and regional integration, see the discussion in Bouzas (1999).

2 BRAZILIAN STRATEGY AND THE REGIONAL CONTEXT

The regional strategy predominant in Brazil, based on participation in shallow regional arrangements and effectively operating in line with the logic of a hub-and-spoke model, appears to be quite adequate, in view of the myriad trade policies of the South-American countries and of the various current regional economic arrangements. One remarkable characteristic of the South-American region is the overlap of innumerable regional agreements of thematic scope, with varying degrees of importance and different institutional and regional focuses. Agreements of a regional nature, such as the Latin American Integration Association (LAIA), the Latin American and Caribbean Economic System (SELA)[11] and the South American Regional Infrastructure Integration Initiative (IIRSA) stand alongside sub-regional arrangements such as Mercosul and the Andean Community of Nations (CAN), besides a number of bilateral agreements, foreseen either within the scope of the Latin American Integration Association (LAIA) (as is the case of the Economic Complementation Agreements -ACEs)[12] or outside this scope as, for example, agreements on themes such as energy, transport and telecommunications. Some countries of the region (for example, Guiana and Suriname) though not party to the more effective agreements, do participate in IIRSA. Though all of these agreements are intergovernmental, some have an institutional structure, with Secretariats-General that provide support to councils of ministers (as do LAIA and Mercosul)[13] whereas others (such as IIRSA) have no institutional structure and essentially consist of a forum for coordination of infrastructure projects. Some, like Mercosul[14], have dispute-settlement mechanisms, whereas others rely entirely upon arbitration and mechanisms beyond the scope of the agreement. Some countries of the region apply very low tariffs, as is the case of Chile which, though an associate member of Mercosul, in 2009 had an average tariff of 1.1% and a tariff cap of 7%;[15] in contrast to the external tariff profile of Mercosul where the average is 14% and the cap 35%[16]. Unlike Europe, where various regional arrangements underwent different phases of accommodation and merging,[17] in South America such arrangements have continued to coexist and, at times, to compete with each other.

11. Created in 1975 by the Panama Convention, SELA has 27 member countries and seeks to coordinate economic strategies and promote integration among countries of the region.

12. ACEs are voluntary and successive bilateral agreements, among LAIA members to deepen trade through preferential trade agreements.

13. Created in 1991 as the Administrative Secretariat of Mercosul, but in 2002, it became a Technical Secretariat. The Protocol of Ouro Preto of 1994 transformed Mercosul into an international corporate entity.

14. Created by the Protocol of Olivos, signed in 2002, and went into force in 2004.

15. Bulletin of the Chamber of Commerce of Santiago, July 2009.

16. Bulletin of the National Confederation of Industry (CNI). *Unidade de Negociações Internacional.* 2009.

17. See Menezes and Penna (2005).

Problems have emerged within the scope of LAIA (the main regional trade framework agreement) when the group determined that its members should extend to regional partners tariff treatment similar to that granted to extra-regional partners. This issue came to the fore when Mexico signed the North American Free Trade Agreement (NAFTA) in 1994, thereby reducing its import tariffs for goods from the USA and Canada to zero. At the time Brazil protested, and even suggested that Mexico should leave LAIA. However, subsequently, other countries of the region launched free-trade negotiations with the USA and also with European and Asian countries. Chile and Peru succeeded in signing broader and deeper agreements (encompassing lower tariffs and such themes as trade in services and intellectual property) with countries outside the region than those maintained with countries of the region.[18]

Thus, throughout the region today, an overlapping web of agreements prevails, which, as a general rule, detracts from the benefits that a homogeneous common preferential South-American economic area could offer. From the Brazilian standpoint, this process has eroded trade-preference margins enjoyed in the region up until the mid-1990s but, at the same time, has not required that Brazil open up its markets to the same extent that its regional partners have. In other words, Brazil would rather lose its preference margins on access to these markets than relinquish its room for maneuver on trade and tariff issues.

Against this background, it is interesting to note that, from the economic standpoint, Brazil's official strategy has been to lead efforts to expand Mercosul[19] with a view to the incorporation of the Andean countries,[20] retaining original characteristics of the Common Market's inter-governmental structure, while maintaining a reasonable degree of flexibility in relation to agreements signed, through a low level of macro and microeconomic coordination and tariff levels very close to those applied domestically.[21] Brazil has not managed to establish trade negotiations with neighboring countries that are any more comprehensive than those that such countries have signed with third parties. This has weakened Brazil's leadership role in the regional economic integration project. Though it raises problems for the trade in goods, this is of particular

18. The Chile-US Free-Trade Agreement was signed in 2003 and went into effect in 2004, and the Peru-US Agreement was signed in 2006 and went into effect in 2008. Chile has more than 40 free-trade agreements with European and Asian countries.

19. Though essentially an economic agreement, Mercosul also has a political dimension, as evidenced by approval of the Political Consultation Mechanism in the Presidential Declaration of the Democratic Commitment of Mercosul in 1996, the Ushuaia Protocol on Democratic Commitment in 1998, and establishment of the Mercosul Democracy Observatory (ODM) in 2007.

20. In 1996 Bolivia and Chile became associate members of Mercosul and, in 2004 under a framework agreement (Decision CMC N 18/04*)* Mercosul membership of the Andean countries brought in Venezuela, Colombia and Ecuador as associate members.

21. A similar argument was made by Vigevani *et al.* (2008).

significance for trade in services, a field on which Mercosul maintains agreements that are internally very shallow, and only one framework agreement with an associate-member country, Chile.

One of the difficulties for advancing Mercosul in the region is that the block's tariffs are higher than those of other countries of the region. This, for new member countries joining the block, implies adoption of higher tariffs than they currently practice. Even for Venezuela, which has average tariffs similar to those of Brazil, joining Mercosul implies raising tariffs on various industrial sectors.[22]

Nonetheless, Brazil has not relied on trade agreements to expand its exports substantially to these countries in recent years. A study by the National Confederation of Industry (CNI, 2007) shows that Brazilian exports to South America grew at a rate higher than growth of total exports between 1990 and 2006, the most significant increases being in sales to Argentina, Venezuela and Colombia, followed by Peru and Guiana. In this group, only in the case of Argentina can such growth be clearly associated with a project for economic integration with Brazil. On the other hand, the growth of the exports from countries outside the region to South-American countries has been even greater than the growth of Brazil's exports to the region. This growth of extra-regional exports may, even in the short term, significantly undermine Brazil's economic presence in the region, the main threat being from China.[23]

With respect to agreements in the political sphere, the situation is not unlike that which prevails in the economic and trade areas: a web of overlapping agreements, with diverse objectives, geographic scope and institutional arrangements which, in general, are of little practical relevance. Some agreements are of a bilateral nature,[24] others sub-regional,[25] and some agreements are continental,[26] Latin-American[27] and hemispheric[28] in scope. Amorim (2009, p. 21) referring specifically to regional agreements, states that it is not a strategy of "concentric circles", his preferred expression being "*3 levels of integration*". Such regional arrangements compete on various themes with other arrangements of a trans-regional nature, such as the India-Brazil-South Africa Initiative (IBSA), the Ibero-American Summits, the Arab South-American Summit, the Community of

22. See Coelho *et al* (2006).

23. See the ECLAC study (2010). Chinese exports to the region have grown by more than 26% p. a. over the past ten years, whereas Chinese imports from the region have increased by 22% p.a. over the same period.

24. Such as the Brazil-Argentina nuclear accord and the Brazil-Argentina Agency for Control and Accounting of Nuclear Materials.

25. Such as the afore-mentioned political agreements within the scope of Mercosul.

26. The Union of South-American Nations (UNASUL) is the prime example.

27. Such as the Community of Latin-American and Caribbean States, that arose from merging of the Group of Rio and the Latin America and Caribbean Summit (CALC), created in February 2010.

28. The main reference being the Organization of American States (OAS).

Portuguese Speaking Countries (CPLP) and the BRICs Summit,[29] among others. In both economic and trade terms, the level of engagement and commitment by Brazil in these arrangements is low, and is based upon summit meetings and an intense bilateral agenda. Although the very number of these initiatives suggests a degree of dispersion of interests, Brazilian political activities have combined certain non-regional strategies (such as the IBSA and BRICs Summits, or bilateral initiatives within Latin America)[30] with the effort to coordinate South-American political articulation. In the past decade, this effort has sought to transform the Summit of South American Heads of State (held in Brasilia under Brazil's leadership, in 2000) into a permanent intergovernmental political body, with a minimal institutional structure. The combination of these strategies has enabled Brazil to act, sometimes in an individual capacity with significant room for maneuver in pursuit of its own political objectives, and sometimes to lead collective regional actions through UNASUL.

Thus, in both the economic and political fields, Brazil has neither conditioned nor limited its strategies and interests in pursuit of its regional project. Its actions in the region are selective and lack institutional structure, and blend various initiatives of a bilateral and extra-regional nature. Therefore, the growing regional presence of Brazil over the past two decades (both in political and in economic fields) bears no direct causal relation with its regional integration project. Brazil's South-American integration projects are merely a part of its broader international strategy, mobilized according to the measure in which they may enable gains, without compromising the country's room for maneuver nor restricting its capacity for individual action.

The affirmation that Brazil's regional project does not comprise the central thrust of its international strategy in no way implies that Brazil lacks a positive regional agenda. Brazil, in recent years, has constructed an agenda of regional interests which (though selective and poorly mediated by institutions) is nonetheless important, especially for certain economic segments. The next section will present and discuss this positive agenda.

3 THE BRAZILIAN AGENDA FOR SOUTH AMERICA

As explained earlier, Brazil's posture vis-à-vis South America is the outcome of a retraction in relation to the heterogeneous and asymmetric context of the region and, at the same time, a strategic option, whereby the prevailing guideline favors low commitment with the region. In view of this context, any regional actions

29. The first Brazil, China, India and Russia Summit was held in Russia in 2009. The second was held in 2010 in Brazil, and the third in 2011 in China.

30. Brazil's actions in Honduras and in Haiti are illustrative.

and programs in which Brazil becomes effectively involved (*i.e.*, those that go beyond general agreements and letters of intent) are made feasible only by means of political and institutional gaps. Such gaps are defined by spaces in which specific interests on regional themes do not conflict with the broader option of impeding the country's political and economic interests becoming subordinated to regional integration projects. Thus, any projects or programs that affect regional themes (and especially economic themes) can only be deployed by means of specific agreements, involving measures strictly within the scope of those Executive Branch agencies that are more attuned to regional themes, that do not require alteration in Brazilian public policies or regulatory standards and, more especially, that do not compromise national decision-making capacities. Generally speaking, such programs and projects can be implemented without involvement or approval of Brazil's National Congress.

In view of this style of action based on a selective agenda and political and institutional gaps, it is hardly surprising that in Brazil, the only regional themes that are ever contemplated are those which are, essentially: shallow from the standpoint of conditionalities; limited in scope; and predominantly bilateral. Current regional arrangements, or proposals during the course of this period, were often poorly structured or strongly diluted in relation to their original objectives. Some examples of this are the huge restrictions upon use of the Convention on Reciprocal Credits (CCR)[31] in regional trade contracts;[32] approval of the Mercosul Structural Convergence and Institutional Strengthening Fund (FOCEM)[33] "with minimum annual contributions"; and resistance of the Federal Revenue Service to implementation of various customs and tax procedures agreements. Measures that have prospered have enjoyed support of a strong coalition of interests and economic players, in articulation with Executive Branch agencies that have decision-making power on the theme (given that the Ministry of External Relations [Itamaraty] does not have the authority to bring into effect the regional agreements that it promotes). In general, such measures have involved the Ministry of Development, Industry and Foreign Trade (MDIC) or the Brazilian Development Bank (BNDES) and were not subject to vetoes or significant opposition from members of the Legislative Branch.

Consequently, over the past 15 years, the Brazilian regional agenda has molded itself not only to the complexities and oscillations of the South-American context, but also to limited domestic political spaces. The divergence of strategic views

31. This is a multilateral credit system among the LAIA countries, operated by the respective central banks which requires the use of dollars and other convertible currencies.

32. See discussion of the document of the Secretariat of National Treasury (STN) and Secretariat of International Affairs of the Ministry of Finance (SAIN/MF) (BRAZIL 2005) on this theme and especially on the use of CCR.

33. FOCEM was created by CMC Decision 45/04 in 2006.

on South America on the part of the nation's politicized elite, and the extremely limited engagement of Executive and Legislative Branch agencies, has had a direct effect upon the way Brazil engages with more formal regional regimes and in negotiations. Thus, an agenda has been drawn up with a very particular profile under which the following characteristics are underscored: *i)* preference for arrangements with little institutional structure and based upon summit meetings, including the Mercosul summits; *ii)* projects based on the notion of "shallow economic integration", *i.e.*, focused upon trade issues to the detriment of themes relating to productive, financial and logistical integration; *iii)* shallow integration also with respect to commitment to microeconomic initiatives and policies targeted at industrial, research and development, and credit policies, etc.; *iv)* predominance of cooperation programs on themes such as customs, security, drug trafficking, social policies etc.; *v) ad hoc* initiatives in the fields of infrastructure and energy integration, in which bilateral approaches prevail over regional dynamics; *vi)* preference for the strengthening of domestic credit agencies (particularly the BNDES) in detriment to the creation of agencies of a regional nature; and *vii)* increasingly direct support of the government to private green-field direct investment initiatives or acquisitions of productive assets in the region, in detriment to the establishment of regional investment protection and promotion arrangements.

With respect to the preference for arrangements with little institutional structure and based upon summit meetings, including Mercosul itself, there has been a remarkable number of (bilateral, minilateral and regional) presidential meetings in South America, in stark contrast to the lack of a regional body with any degree of authority. Even the more institutionally structured arrangements, such as Mercosul and the Andean Community (CAN) are endowed only with executive secretariats and support staff. The Permanent Review Court [TPR] (approved in 2002) and the Mercosul Parliament (approved by CMC Decision 23/05, and to which representatives are to be elected directly by the population of member countries) represent attempts to endow this project with greater institutional structure, but are, in effect, very limited in scope. In Brazil, the most populous, economically robust, and politically and militarily powerful nation of the region, the theme of setting up supranational regional bodies tends not to rank very high among the interests of any politically relevant group.

Aligned to this Brazilian preference for arrangements with little or no institutional structure is a preference for a "shallow economic integration" model, focused primarily on agreements that reflect trade-preference patterns rather than economic integration. Such agreements have been more focused on negotiations relating to tariff barriers and rules of origin, rather than on harmonization of regulatory, technical, phytosanitary and other barriers. Since Mercosul itself is not yet a consolidated free-trade area but, rather, a partial customs union, the agenda of the block remains bogged down with themes relating to automatic licenses, temporary tariff increases, etc. To move forward with deepening of existing trade agreements, and especially questions relating to non-tariff barriers and regulatory issues, has proven politically difficult. The main obstacle is reluctance on the part of various national agencies to reviewing or adjusting their standards in order to comply with agreements negotiated within the scope of Mercosul, thereby reflecting resistance to the internalizing of such agreements.[34]

Among the contentions raised by Mercosul partners are competitive asymmetries that favor Brazilian companies, especially those derived from support provided by bodies devoted to fostering production, credit, innovation and exports. Actions of such bodies as the Brazilian Exports and Investment Promotion Agency (Apex), BNDES, the Brazilian Innovation Agency (FINEP), Banco do Brasil, Petrobras and Eletrobrás, among others, are perceived as elements that distort competition within the block. Critics argue that there should be similar mechanisms at the regional level. This discussion, to some extent, came to the fore during creation of FOCEM, a fund that aims at promoting structural convergence and competitiveness, since Brazil is responsible for providing 70% of its funding and is, thus, the most important party to the agreement. For the present, such funding has amounted to R$ 100 million per year; a paltry sum for fostering regional integration when compared, for example, to BNDES's annual disbursements of R$ 150 billion[35] This disproportion between domestic development policies and regional projects provides one of the most eloquent demonstrations of the low intensity of Brazil's regional engagement.

Along the same line of argument, direct and indirect participation of public bodies and programs – not just BNDES, but also agencies such as the Export Finance Program (PROEX) and the Export Guarantee Fund (FGE),[36] or even state companies such as Petrobras, Eletrobrás and Correios – in investments, financing or acquisitions in countries of the region, also supports characterization of Brazil's economic projection as being more like the hub-and-spoke model than the integrationist model.

It is thus possible to identify an agenda of Brazilian regional interests that, far from being comprehensive and integrationist is, rather, selective, focused on preservation of domestic decision-making capacities and on maintenance of national development instruments, and that is essentially targeted at advancing Brazilian projects and interests.

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34. A study conducted by Eletrobrás in 2009 indicates that Brazil internalized only two of the 12 regional agreements to which it is a signatory (*Prospectiva Consultoria*, 2009).

35. The sum disbursed on June 31, 2010, accumulated over the previous 12 months. See *Boletim de Desempenho do BNDES* of June 31, 2010.

36. Both are encompassed and monitored by the Export Finance and Guarantee Committee (COFIG), created by Decree 4.993 in 2004.

This approach on the part of Brazil has intensified in recent years, in view of a political and economic scenario that has been highly favorable to a rapid increase of direct investment in countries of the region by Brazilian private and state companies. From a political standpoint, even without any significant new regional agreements, the Brazilian government's political contacts and negotiations with countries of the region have intensified, with direct engagement at the presidential level and involvement of top echelons of the government. From an economic standpoint, Brazil's performance in the 2000s, combined with appreciation of the *real*, has fostered advantageous conditions for Brazilian companies to redefine their regional business strategies and advance rapidly with investment projects and acquisitions of assets in neighboring countries, despite slow progress on the development of integrationist arrangements.

4 REGIONAL DIPLOMATIC ACTIVISM: FROM ALCSA TO UNASUR

In the diplomatic sphere, since the mid-1990s, political arrangements have been pursued, based upon the idea of a convergence of interests among the countries of South America, in replacement of a hitherto more common reference to Latin America. During the Government of Itamar Franco, in 1994, then-Minister of External Relations, Celso Amorim, suggested the creation of the South-American Free Trade Area (ALCSA) perceived at the time as a reaction to the creation of NAFTA[37] (and, more specifically, to Mexico's accession thereto) and to negotiations for establishment of the Free Trade Area of the Americas (FTAA).[38] This proposal outlined a strategy of automatic and linear tariff reduction among countries of South America, over a ten-year period, with the aim of affecting 80% of tariffs, while respecting lists of sensitive goods.

This announcement, which had no practical consequences at the time, was perceived as a move on the part of Brazil to avoid isolation within South America, in view of trade negotiations that various countries of the region were pursuing with the USA, many of which were subsequently concluded.[39]

This proposal also caused some issues already under examination, not only in the Brazilian diplomatic establishment, but also within certain other areas of government and among the national political elite to come to the fore; namely, the idea that Brazilian strategic interests have become South American, and are linked to the quest for a space enjoying a certain autonomy in relation to interests of the United States and multilateral arrangements.

37. In Portuguese, *Tratado Norte-Americano de Livre Comércio*.

38. ALCA in Portuguese. This initiative had already been announced in September 1993, by President Itamar Franco at a meeting of the Group of Rio in Santiago, Chile. However, the official document of the Brazilian Government on the theme only began to circulate in February 1994 at a LAIA meeting.

39. See the interesting contemporary commentary in Intal/IDB (1994).

This, to some extent, entailed alignment of rhetorical and diplomatic strategy, endowed with conceptual geopolitical bases that hitherto had been more in evidence in military and security fields, where adoption of a South-American reference was already more consolidated.

Thenceforth, despite a lack of like-minded engagement on the part of other areas of the Brazilian Government, creation of a South-American political arrangement became a priority for the Brazilian diplomatic establishment, a goal that was finally accomplished, in 2000, with the holding of the Summit Meeting of South-American Heads of State. This was the first meeting of its kind in the history of the region.[40] From this summit a final declaration was issued – the Communiqué of Brasília – calling for greater integration between Mercosul and the Andean Community, though the main focus was upon themes such as strengthening democracy, and the struggle against poverty and drug trafficking. Also presented and discussed at this meeting was a proposal for the creation of the South American Regional Infrastructure Integration Initiative (IIRSA).[41] Since then, South-American Summits have taken place every two years.

The South American Summit and IIRSA, are both clear examples of Brazil's intention to lead the development of South-American integration, through definition of a regional political space that excludes not only the United States but also Mexico (another traditional political competitor within Latin America) (SANAHUJA, 2010, p. 105).[42] On the other hand, the nature of these initiatives also points toward a model of regional interaction based upon summits and spaces for coordination, rather than on arrangements of an integrationist nature. These two characteristics, which were already features of Brazil's actions, became even more evident in the following years, despite Brazilian diplomatic efforts to the contrary.

IIRSA illustrates the finished product of this model. Conceived as a space for coordination of infrastructure initiatives with potential regional (or at least binational) impact, IIRSA provides a base for comprehensive mapping of potential interconnections, referred to as "axes of integration". Based upon such mapping, governments negotiate and coordinate their priorities and seek ways of bringing projects into effect (Tavares, 2009). Though original, this initiative was intended to encompass both physical and regulatory aspects, in terms of actual progress achieved, such projects have been quite limited and have focused mainly on physical interconnections, especially highway transport. Little significant progress has been achieved with the regulatory dimension, which focuses on integration of

40. Summit of South American Heads of State, held in Brasília in 2000.

41. See the full text of the Communiqué at <http://vNJw.itamaraty.gov.br/sala-de-imprensa/notas-a-imprensa/2000/01/comunicado-de-brasilia>.

42. Another relevant event in this context was accession of Suriname and Guiana to this regional arrangement.

supply and demand in markets for infrastructure services. Within the physical dimension, some projects have advanced when the countries involved have mobilized financial support, either from domestic agencies (especially the Brazilian BNDES) or from multilateral agencies such as the Andean Development Corporation (CAF), the Inter-American Development Bank (IDB) and the World Bank. In other words, IIRSA is a highly decentralized coordination initiative with a very limited institutional structure, the aim of which is to establish a space for coordination of infrastructure projects.[43]

With the changes in the political and economic context in the ensuing years, not only in Brazil but also in various countries of the region (acute crisis in Argentina, an attempted coup d'état in Venezuela, political unrest in Bolivia and the election of Evo Morales, among others) Brazil's regional diplomacy has faced a less favorable scenario for its strategy of slowly and gradually building up its political leadership. Nonetheless, in subsequent years Brazilian diplomatic policy would attempt to sustain a series of bold initiatives, despite resistance on the part of Colombia to participation in any regional arrangement that does not explicitly acknowledge its priority of combating the guerrillas of the Revolutionary Armed Forces of Colombia (FARC), competition from the Bolivarian Project of President Hugo Chávez, an assortment of domestic political crises in Ecuador and Bolivia, not to mention constant trade and diplomatic disputes with Argentina.

The dynamics of the South-American summits of the following years illustrate this process. Still under the impact of the Argentine crises (of 2001 and 2002) and of events in Venezuela in the aftermath of the attempted coup of 2002, the 2nd South-American Summit, held in Guayaquil in 2002, limited itself to reaffirming premises of the 1st Summit. With the inauguration of the government of President Lula in 2003, Brazil sought to resume its South-American diplomatic offensive and concentrated its efforts upon approving, at the 3rd Summit held in Cusco in 2004, the creation of the Community of South-American Nations (CASA). Its principal goals on this occasion were: physical integration and institutional integration, both within a 15-year timeframe.

At the following summit, in Cochabamba in 2006, there was a perceptible atmosphere of mistrust as to the feasibility of the regional integration project. In at least three of the presidential speeches (those of Alan García of Peru, Hugo Chávez of Venezuela and Tabaré Vásquez of Uruguay) the theme was brought up. In view of this atmosphere of pessimism in relation to South-American integration initiatives, perceived as political events rather than as spaces for concrete decision making, it became incumbent upon Brazil and upon President Lula to argue that

43. For a summary of the characteristics and performance of ten years of IIRSA, see Araújo (2009).

a common regional project exists, and that it is under deployment.[44] Also at this summit, and with the aim of placating critics, it was decided that a committee of high officials and work groups should be established in such priority areas as infrastructure, energy and social policies, with a view to ensuring implementation of decisions made at the summit. Finally, two new South-American summits were scheduled: one for 2007, with a focus upon energy integration; and another in 2008, in Cartagena, Colombia, that was subsequently transferred to Brasília.

At the 2007 Summit, held at Isla Margarita in Venezuela, Brazil followed a strategy of leading negotiations for establishment of a South-American political forum, despite the prevailing lack of enthusiasm for integration projects. To this end, Brazilian diplomacy submitted a proposal for creation of the Union of South-American Nations (UNASUR). Despite the delicacy of the processes by which political support was enlisted within Brazilian political institutions and among those of countries of the region, UNASUR was created with twenty-one very bold objectives, ranging from eradication of illiteracy to financial integration.[45] Along the same lines, also proposed by Brazil in December 2008, a decision was taken to create a Defense Council and new work groups, despite skepticism both in Brazil and abroad as to the political feasibility and relevance of such a body, and explicit resistance from Colombia to the proposal.[46]

Thus, notwithstanding a lack of strong support and enthusiasm on the part of other countries of the region, Brazil has maintained a considerable degree of diplomatic activism and has successfully approved its proposals for creation of a South-American political framework.[47] It is worth noting that the recently-created and polemic Defense Council proved useful during mediation of the Bolivian political crisis in 2009, and was the framework through which countries of the region, including Brazil, managed to exert influence in favor of a negotiated and peaceful solution to the crisis.[48] UNASUR has played a role in settling other political and security crises in the region, such as the crisis between Colombia and Ecuador in 2008, when the former attacked alleged FARC operational bases, and also when Colombia complained at the Organization of American States (OAS) that the Venezuelan government was maintaining relations with and providing support for the FARC. This illustrates how Brazil's objective of extending its in-

44. See the article broadcast by BBC-Brazil, on December 10, 2006, citing passages from these speeches.

45. UNASUR comprises the Council of Heads of State and of Government, Council of Ministers of External Relations, Council of Delegates and a General Secretariat. Approved in 2007, the treaty was finally signed in 2008. Full text of the Constituent Treaty available at: <http://wvNJ.pptunasur.com/downloads/tratado-constitutivo-U NASU R.pdf>.

46. This debate was widely reported. See, for example, *Jornal Folha de São Paulo*. *Falta de consenso impede a criação do Conselho de Defesa* [Lack of consensus blocks creation of the Defense Council] *(24/05/2008)* and *Jornal Valor Econômico. Organização regional já nasce marcada por atritos* [Birth of regional organization marred by conflict] *(23/05/2008).*

47. For an examination of the South-American process from a Brazilian government perspective, see for example, Biato (2010).

48. See the article: Lula takes the reins of the Bolivian crisis, says El País. In: BBC-Brazil. 16/09/2008.

fluence and capacity for action in South America has advanced in recent years, and how UNASUR has, in an incipient manner, fulfilled its role.

In parallel to these Brazilian efforts, President Hugo Chávez has kept up an initiative which, to some degree, challenges the bases and objectives of UNASUR, in what the Venezuelan leader calls a “conservative initiative”, since it rests upon pre-existing conservative institutions such as Mercosul and CAN. The Bolivarian Alliance of the Peoples of the Americas (ALBA), announced in 2001 at the Summit of the Association of Caribbean Countries, the first meeting of which, with participation limited to Venezuela and Cuba, took place only in 2004. In subsequent years ALBA was expanded with the accession of Bolivia in 2006; of Nicaragua (2007); of the Dominican Republic and Honduras (2008); and of Ecuador (2009). Its broad agenda of development, social-integration, economic, technological, energy, and other themes was promoted alongside oil supply agreements between Venezuela and these countries (Altmann, 2007).

This initiative never represented a real political alternative to Brazil’s regional project and agenda. Venezuela’s lack of tradition as a regional political player, the weakness of Hugo Chávez’s government, and the low degree of economic complementarity among countries of this grouping have weighed against its consolidation as an effective block. Nonetheless, from the standpoint of Brazilian regional diplomatic policy, this initiative represents noise, as it has proven capable not only of attracting regional political interest and drawing attention to events to which Brazil is not party, but also because it uses as bases economic and trade relationships that differ distinctly from Brazilian proposals for the region.[49]

Difficulties of another type arose during discussions on creation of *Banco do Sul* [Bank of the South]. The initial proposal, from Presidents Hugo Chávez, Néstor Kirchner, Evo Morales and Rafael Correa, was for the creation of a bank that combined the functions of development, management of foreign reserves and regional central bank, and that would be capable of providing support for central banks in the event of foreign-exchange crises, and - at a later time - issuing a regional currency. Prior to engaging in this process, Brazil demanded that negotiations go back to the starting point, and managed to secure an agreement from the partners that the bank would be based on the model of a development bank, as it were, a “regional BNDES”. Under the model finally approved by the presidents, Banco do Sul would be launched with limited capital, some US$ 7 billion, of which the Brazilian contribution was to be US$ 2 billion, with similar

49. The diametrically opposed postures of Brazil and of Venezuela in face of the Argentine economic crisis and default, in which Brazil distanced itself politically whereas Venezuela offered help, buying up more than US$ 3 billion in foreign-debt securities at the time when Argentina was excluded from the international financial market, did not go unnoticed by the media nor by countries of the region. See, for example, repercussions in the *Jornal Folha de São Paulo*: *Venezuela pode comprar títulos da dívida do Equador* [Venezuela may purchase Ecuadorian dept papers] 22/02/2007.

sums contributed by Argentina and Venezuela. Moreover, Brazil did not commit itself to any schedule for this contribution, signaling that it might not be effected in the short or medium term. During this same period, Brazil made a US$ 10 billion contribution to the IMF, thus exposing the low level of its interest in the formation of the new bank.

In the same context, the negotiations for reform of the Andean Development Corporation (CAF) were seized upon by Brazil as the most convenient means for establishment of a regional financial agency. Brazil managed to change the focus of these negotiations, by supporting the idea of transforming the CAF into the principal development institution of the region, thereby sidelining discussions on creation of Banco do Sul. Widely acknowledged for its professional and efficient management of financial projects in the region, the CAF is relatively exempt from domestic political intervention, and is considered a low-risk institution by the market (with a triple A rating*)*. Brazilian participation in the CAF, which had amounted to US$ 185 million (R$ 325.4 million) is due to rise to US$ 467 million (R$ 821.4 million) by 2010.[50]

Alongside Brazil's financial strategy of upsetting negotiations on founding of the Banco do Sul and its assertiveness in relation to reform of the CAF, there were attempts on the part of certain governmental groups to strengthen traditional development and regional-integration institutions. Examples of such attempts include the attempt to expand the use of the CCR within the scope of the LAIA, which met with resistance from the Central Bank and the National Treasury Secretariat; creation of FOCEM in 2006; and restructuring of the Fund for Development of the River Plate Basin (Fonplata).[51]

These initiatives, however, have not altered the cautious posture in relation to initiatives in the region, and have left to the BNDES provision of direct assistance to companies and development of trade-support instruments.

In summary, interest on the part of one portion of the Government (namely, the diplomatic establishment) and of the political and economic elite notwithstanding, Brazil's capacity to bring its regional projects into effect has proven quite limited. Brazil's great diplomatic activism in recent years has produced a dynamic integrationist environment. Meeting resistance from within its own public administration and faced with an environment of growing regional instability and lack of political coordination, Brazil has sought to limit the advance of integrationist projects.

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50. See the minutes of the CAF Extraordinary Meeting of *08/12/2009*, during which it was decided that Brazil would become a "special member" (Oliveira, 2009).

51. The two funds had very limited resources. Capitalization of FOCEM amounts to US$ 100 million, whereas FONPLATA amounts to US$ 160 million. As a basis for comparison, BNDES handles over US$ 80 billion in loans each year.

5 REGIONAL TRADE AND INVESTMENTS

Trade provides an interesting perspective for assessing the advances and limits of Brazil's strategies for a South-American framework. From this perspective, also, there has been considerable Brazilian activism. However, at the same time, a series of problems stemming from asymmetries both of trade policies and of industrial and credit policies have come to the fore.[52] Since the 1980s, Brazilian exports to South and Latin America have steadily increased. Today, these amount to some US$ 28 billion. Following a peak in regional trade, in 1999, the Argentine crisis of 2000-2002 led to a setback, but trade flows continued to grow in the following years (table 1).

TABLE 1
Brazilian exports by region
(In %)

	2001	2004	2007	2008	2009
South America[1]	6.4	6.6	9.1	8.4	8.2
Mercosul	2.4	8.6	10.5	11.0	10.3
European Union	7.2	25.6	23.9	23.4	22.2
China	2.6	5.9	6.4	8.3	13.2
Mexico	3.2	3.9	2.9	2.2	1.7
United States	4.2	21.7	16.6	13.9	10.2
India	0.4	0.7	0.6	0.6	2.2
Japan	3.9	3.0	2.8	3.1	2.8
Russia	1.3	1.9	2.4	2.4	1.9
South Africa	0.6	1.0	1.1	0.9	0.8
Others	17.6	21.1	23.6	26.0	26.4
Total in R$ (millions)	**56,703**	**84,941**	**149,228**	**197,942**	**152,995**

Source: Ribeiro and Lima (2008).
NB: [1] Excluding Mercosul.

From the standpoint of regional economic relations, it can be stated that South America fulfills a strategic role for Brazil for at least three reasons. Firstly, the region has accounted for almost 20% of Brazilian exports in recent years. Secondly, Brazil has run up significant surpluses with countries of the region.[53] According to Souza, Oliveira and Gonçalves (2010, p. 23) rather than Brazil serving as buyer of last resort for the smaller countries of the region, the relationship has reversed, and they have become the buyer of last resort for goods from Brazil. Though hardly politically sustainable, this situation reflects the reasonable margin of trade preference and/or of competitiveness which Brazil still enjoys in

52. See discussions on asymmetries and Mercosul integration policy in Souza, Oliveira and Gonçalves (2010).

53. Brazil had a positive trade balance with Argentina, Paraguay and Uruguay, between 2004 and 2008, of approximately US$ 22 billion.

relation to neighboring countries. Thirdly, the profile of Brazilian exports to the region, with a strong concentration of industrialized products (roughly 95%) is significant. In other words, the region is particularly important as an importer for Brazil's medium-technology industrial sector.

Another striking characteristic of Brazil's trade with South America is its sectoral composition. Agricultural and livestock exports are very small, whereas those of high technology goods are quite significant. For some sectors, more than two-thirds of exports of high value-added industrial goods are exported to these markets. This is true of electronic equipment, and especially products of the automobile, chemical, machine, electrical and electronic equipment sectors (table 2).

TABLE 2
Brazilian exports. Total and to South America – by sector (2008)

Sector of activity/product	Brazilian total		Destination South America		South America
	Value	Share (%)	Value	Share (%)	Total (%)
Automotive industry	15,572	12.2	6,250	26.1	40.1
Chemicals and petrochemicals	11,768	9.2	3,347	14.0	28.4
Steel and metallurgy	14,949	11.7	2,433	10.2	16.3
Electronic equipment	3,797	3.0	2,259	9.4	59.5
Machines and equipment	5,492	4.3	1,743	7.3	31.7
Crude oil	5,529	4.3	1,076	4.5	19.5
Electrical material	3,244	2.5	1,020	4.3	31.5
Textiles	1,869	1.5	710	3.0	38.0
Pulp, paper and printed matter	3,764	2.9	693	2.9	18.4
Iron ore	8,123	6.4	341	1.4	4.2
Footwear	1,965	1.5	283	1.2	14.4
Subtotal	76,072	59.5	20,157	84.3	26.5
Other products	51,817	40.5	3,754	15.7	7.2
Brazilian Total	**127,889**	**100.0**	**23,911**	**100.0**	**18.7**

Source: Ribeiro and Lima (2008).

Both Benavente (2001) and Ocampo (2001) argue that the growth of intraregional trade in manufactured goods in Latin America during the 1990s was related, on the one hand, to market-access advantages deriving from integration agreements and, on the other, from a lack of third-party competition in markets for these products. In support of this argument, these authors indicate a dichotomic trend in the international trade of countries of the region, whereby such countries tend to direct their exports of manufactured products to the region, whereas they ship commodities and low value-added goods to extra-regional markets.

This pattern, to a certain degree associated with trade-preference margins granted under LAIA and Mercosul agreements, changed in the 2000s. These margins were progressively corroded during the 1990, owing both to a process of unilateral trade opening on the part of some of the major countries of the region and as a consequence of various free-trade agreements signed with countries outside the region. Chile (that has more than 35 free-trade agreements in effect, including one with China) and Mexico are the most outstanding examples of this development. More recently, Peru and Colombia have adopted similar strategies, both having signed agreements with the United States and with other countries.

Brazil (and to a lesser extent, Argentina) is the country that most strongly reflects this trade pattern. Nonetheless, as table 2 shows, the regional thrust of exports of medium-level technology manufactures has become concentrated in certain sectors.[54]

The services sector is quite different to the industrial sector, but nonetheless equally interesting and strategic for Brazil's penetration in the region. Over the past 20 years, the services sector has become consolidated as the most dynamic segment of international trade and, possibly, the one in which the main trade issues of subsequent decades will be concentrated.[55]

The Protocol of Montevideo (negotiated within the scope of Mercosul and focused on services) was signed in 1994 but only went into effect ten years later, in 2005. However, out of five lists negotiated, only the first is currently beginning to be deployed.

Brazil has various examples of excellence in the fields of services and technology. Engineering and construction are the only services sectors that show a surplus in its balance of payments. Information technology (IT) and business process outsourcing (BPO) services (fields in which India has had outstanding international participation) provide other examples of areas in which Brazil has demonstrated great capacity to compete and is currently increasing its exports and international participation. In some software-development areas, such as voice command and mobile-phone applications, Brazilian companies are at the forefront. A major portion of the mobile phones that Brazil exports (the recent export boom from Manaus has amounted to some US$ 2 billion) contain onboard technology services, even though they are accounted for as goods.

54. The case of the pharmaceutical industry provides a good illustration for this argument. Roughly 80% of Brazilian exports of this sector are to Latin America. Although there had been some reduction of regional tariff preference margins over the 1990s and 2000s, Brazil has managed to maintain a reasonable presence in these markets, especially in those where preferences predate unilateral opening in these countries or where the preference margin has been maintained, especially in the countries of Mercosul. See Barbosa, Mendes and Sennes (2006).

55. See Sennes, Valls and Mulner (2010).

South America is considered strategic for Brazilian infrastructure sectors. Its geographical proximity tends to facilitate operations in logistical terms and for shipment of machines, equipment and materials. Knowledge, on the part of Brazilian companies, of the specificities of markets and of the political realities of these countries, makes operations in the region easy in comparison to those in other parts of the world. Moreover, Brazilian construction companies are comfortable dealing with political risk in the region, a feeling not shared by their European and North-American counterparts.

Evidence of the importance of South America for Brazilian construction companies is to be found in the contribution of South-American activities to their overall billings. Their international activities correspond to no less than 30% of total billings, and in some cases as much as 75% of total corporate billings. Such foreign earnings are rising and practically all stem from activities in the region.[56]

Another significant aspect of Brazil's regional presence is direct Brazilian investments. Only in 2001 did the Brazilian Central Bank begin to keep accounts of production by Brazilian companies outside Brazil (measured by the stock of Brazilian direct investment - BDI). In that year, the stock of IBD amounted to just over US$ 50 billion whereas, by 2006, it had risen to US$ 114 billion, an increase of 129.7%. In this process, countries of the region are in the foremost position. Table 3 provides parameters on the intensity of Brazilian direct investment in the region.

TABLE 3
Direct Foreign Investment: Brazilian investment projects in countries of South America (2007 to 2009)

	Number of projects – carried out		
Quarter	2007	2008	2009
1st	5	6	4
2nd	8	9	2
3rd	10	3	3
4th	10	10	3
Not available.	2	1	-
Overall Total	**35**	**29**	**12**

Source: IndexInvest Brasil, produced by CINDES. Available at: <http://www.cindesbrazil.org/site2OlO/index.php?option= com_ content&view=article&id=1 1&Itemid=16>.

On the list of the largest Brazilian multinationals, the holding of assets in countries of South America is a constant and, in most cases, a dominant factor. Even with companies that have a truly global profile, such as Vale, presence in

56. See *Prospectiva Consultoria* (2008).

the region is significant. In 2007, this group of companies held US$ 56 billion in investments outside Brazil and was present in four countries of the region.

Acquisition of the South-American operations of BankBoston, in Argentina, Chile and Uruguay, by *Banco Itaú* (which already had an association agreement with *Banco Buenos Aires* in Argentina) reinforces the Brazilian presence in a hitherto under-exploited area. Brazil's public banks – *Banco do Brasil* and *Caixa Econômica Federal* – have also indicated interest in following this path and, in 2008, BNDES opened branches in Montevideo.

TABLE 4
Principal Brazilian multinationals operating in South America

Company	Sector	Region	Countries
Gerdau (14 countries)	Steel	America Latina North America Europe Asia	Argentina, Chile, Colombia, Uruguay, Peru, Venezuela, Dominican Republic, Guatemala, Mexico, United States, Canada, Spain, India
Vale (26 countries)	Mining	Latin America North America Africa Europe Asia Oceania	Argentina, Chile, Peru, Colombia United States, Canada South Africa, Angola, Mozambique, Guinea France, Wales, Switzerland, Germany, England, Norway India, Oman, Mongolia, China, Singapore, Indonesia, South Korea, Japan Australia, New Caledonia
Petrobras (26 countries)	Energy	America Latina North America Africa Asia Europe	Argentina, Uruguay, Paraguay, Chile, Peru, Bolivia, Ecuador, Colombia, Venezuela, Mexico United States Angola, Libya, Mozambique, Nigeria, Senegal, Tanzania China, Singapore, India, Iran, Japan, Pakistan Portugal, United Kingdom, Turkey
Votorantim (14 countries)	Various	Latin America North America Europe Asia Oceania	Argentina, Bolivia, Peru, Colombia, Bahamas United States, Canada England, Belgium, Germany, Switzerland China, Singapore Australia
Camargo Corrêa (13 countries)	Various	America Latina North America Africa Europe	Argentina, Bolivia, Peru, Colombia, Venezuela, Paraguay, Chile, Uruguay, Mexico United States Angola, Morocco Spain
JBS (14 countries)	Meat packing	Latin America North America Africa Europe Asia Oceania	Argentina, Chile, México United States England, Italy, Switzerland Egypt China, Hong Kong, South Korea, Taiwan, Japan Australia

Source: IndexInvest Brazil, produced by Cindes. Available at: <http://www.cindesbrazil.org/site2OlO/index.php?option= com_content&view=article&id=1 1&ltemid=16>.

The international expansion of companies from developing countries faces challenges because they tend to be less competitive than their rivals in the developed world. Thus, joint action on the part of the State and the company, through public policies of support and a proactive foreign policy, tend to be essential for reducing such difficulties.

This is an area in which Brazil has little tradition, in part, because the process of internationalization of its companies (as a general and consolidated phenomenon) is very recent. Nonetheless, Brazil has policy and institutional capacities in various areas that could be harnessed with a view to proactively fostering international participation of Brazilian multinationals. In this regard, the South-American economic space gains notable importance.

6 THE IIRSA PROJECT

The South American Regional Infrastructure Integration Initiative (IIRSA), launched at the 1st meeting of presidents of South America in 2000, has a mandate to foster physical union of the continent through infrastructure projects in the fields of transport, energy and communications. To this end, its specific objectives are to enhance bilateral trade by stimulating development in border regions, provide support for consolidation of production chains with a view to fostering competitiveness in greater overseas markets and reducing the "South-America cost" by means of creation of an articulated logistical platform.

Twelve South-American governments participate in the initiative, with technical support from three multilateral international organizations responsible for mobilizing funding: the IDB, CAF and FONPLATA.

In recent years, a portfolio of more than 335 projects has accumulated under this initiative, distributed into 40 groups, amounting to an estimated total of US$ 37 billion. Actions under the initiative are guided by ten integration and development axes, defined in accordance with current flows and potential economic concentration. Another aim of the initiative is clearing regulatory, operational and institutional bottlenecks that hamper effective physical integration.[57]

From a Brazilian perspective, measures to implement integration of physical infrastructure have been underway since the first Multi-Year Plan (*Plano Plurianual* – PPP) of the Fernando Henrique Cardoso Government and were maintained under the Government of Luiz Inácio Lula da Silva. Having assumed the role of regional leader in deployment of IIRSA, Brazil now faces the task of harmonizing its interests in promoting future physical integration with those

57. See the IIRSA Project Portfolio Documents available at: <http:/Awiw.iirsa.org/BancoConocimiento/B/bdp_resumen_cartera_por_sector/bdp_resumen_cartera_por_sector.asp?Cod Idioma=ESP>.

of economic development in the region. Brazilian interest in promoting IIRSA has been explicit; indeed, aside from the involvement of the three international financial institutions, the BNDES has become increasingly involved in financing integrationist projects.

Out of the forty-nine groups of projects currently underway, Brazil is directly involved in ten, and indirectly in some additional nine. These projects are concentrated in the fields of highway and waterway transport on the Guiana Shield Axis, with highway links connecting Venezuela and Brazil. In the field of energy, there is a project to promote interconnection between the Brazilian and Venezuelan transmission networks, with a foreseen budget of US$ 210 million. Integration routes in Rondônia, on the Mercosul-Chile Axis, and on the Paraguay-Paraná Waterway Axis are also the focus of transport investments, in both northern and southern portions of Brazil.[58]

Another significant factor in this program is the high degree of private participation, particularly in terms of funding sources, assuming of risk, and management at various stages. Unlike other regional integration projects, IIRSA has attracted a broad array of support, both in countries of the region and beyond, and has been endorsed by the World Bank and the cooperation agencies of developed countries. Once again, participation of private Brazilian companies in these projects has been quite significant.

Nonetheless, despite this impressive trend toward political convergence and pursuit of common bases for (and setting of) common planning priorities, there has been little implementation of such projects. Of the infrastructure themes, energy convergence is perhaps the one that has advanced most in recent years, paralysis and crises in the field of trade agreements notwithstanding.

7 ENERGY MATRIX

In the field of energy, much progress was made on the sub-continent, especially during the 1990s, when most countries of the region underwent reform and unbundling of their energy industries. In the 2000s, with few exceptions, this process stagnated.

Reassertion of the position of States and of their role as definers of policy; the creation of agencies that are independent of government and of state companies; new tariff structures based on marginal costs and long-term investment and without subsidies; unbundling of the production chain; increased private-sector participation; and formation of consortia to complement technological com-

58. See the IIRSA Project Portfolio Documents at: <http:/Awiw.iirsa.org/BancoConocimiento/B/bdp_resumen_cartera_por_setor/bdp_resumen_cartera_por_sector.asp?Cod Idioma=ESP>.

petencies, have opened up space for various energy-integration projects among countries. Nonetheless, the change in these patterns in the 2000s was accompanied by loss of dynamism of such programs.

The project for building an energy ring, agreed in August 2005 at the Mercosul summit in Asunción, was the first region-wide initiative for supply of gas, amid a number of binational initiatives. Though an important political landmark, the project has faced serious problems of implementation. It foresees expansion of the gas-pipeline network, with a view to supplying Argentina, Chile, Brazil and Uruguay with natural gas from Camisea in Peru. With an initial cost estimate of US$ 2 billion, including construction of a 1,200 kilometer gas pipeline linking Pisco in Peru to the Tocopilla region of Chile. The project also entails complementing the Argentine pipeline network and construction of 500 kilometers of gas pipeline between the towns of Uruguaiana and Porto Alegre in Brazil. This would enable shipping of approximately 30 million cubic meters per day (m^3/day) of Peruvian natural gas to other countries. Attempts to promote institutional improvements have been given space at Mercosul meetings and at UNASUR summits; progress, however, has been limited. In a context in which advancing with regional integration initiatives has become increasingly difficult, Brazil has achieved a degree of progress through bilateral and *ad hoc* agreements.

The feasibility of GASBOL (the Brazil-Bolivia gas pipeline) was largely dependent upon the initiative and support of the Brazilian State. The gas pipeline extends 3,150 kilometers, of which 2,593 are within Brazil; it begins at the Bolivian town of Santa Cruz de la Sierra and ends at Porto Alegre. Public investment includes participation of Eletrobrás, Petrobras, and the BNDES which is the main source of funding for the project. GASBOL, like the seven gas pipelines linking Argentina with Chile and the one between Argentina and Uruguay, represent initial steps toward regional integration, and presage greater energy interdependence among South-American countries. Nonetheless, in recent years, for a number of reasons ranging from political difficulties (nationalization) to management and regulatory problems, practically all of these projects have had to be redesigned.

Diversification of the energy mix, especially since the 2001 energy crisis, has been one of the Brazilian government's objectives. In view of the abundance of natural gas on the South-American continent, the Government plans to increase the share of gas in the national energy mix to above its current level of 10.2%. The role Petrobras has assumed is worth noting. Brazil's state oil company has branches in 15 countries and expansion of the gas pipeline network is among its goals. An agreement signed with Venezuela's State oil company (PDVSA) foresees exploration of an oil deposit in Venezuela and refining at a plant in Pernambuco. However, after several years and various investment announcements, very little progress has been made.

In the oil sector, Brazil's main partner is Argentina. Since the early days of negotiating Mercosul, oil is a theme that has permeated trade relations between the two countries and, initially, led to an increase in Brazilian imports of oil from Argentina. Petrobras has been in Argentina since 1993, in the oil, gas (exploration, refining and distribution) and electric-power sectors, and has made a number of acquisitions. In January 2005, it merged all its holdings under the name Petrobras Energia S.A., thereby incorporating Eg3, Petrobras Argentina S.A. and Petrolera Santa Fé. Petrobras' production facilities and oil and gas reserves in Argentina are its largest anywhere outside Brazil. In Bolivia, Petrobras had been present since 1995, but it sold assets after nationalization by the Government of Evo Morales in 2006. Nonetheless, Petrobras still operates the Brazilian section of the gas pipeline and continues to import the quantities foreseen in the original contract, but now under a partial price adjustment.

Petrobras also maintains a small presence in Colombia. After making an initial investment in 1972, it withdrew from the country, but returned in 1986, basically in the field of exploration. It strengthened its presence in the 1990s and, in 2004, signed a large-scale exploration contract in partnership with Exxon and Ecopetrol, the Colombian State oil company.

Petrobras' strong and growing presence in these countries, for a number of reasons, has been the object of manifestations of political hostility. In Bolivia, nationalization of Petrobras assets took place with strong popular support. In Argentina, political skirmishing has also emerged in relation to the company's activities, and has resulted in restrictions being placed upon new initiatives of the company in that country.

As stated earlier, a significant portion of initiatives in the field of energy integration have occurred on a predominantly binational basis, rather than according to the rationale of regional articulation. This is especially evident in the field of electric-power transmission. Against this background, Brazil has achieved bilateral progress based essentially upon activities of its State companies and bank financing. Also evident is the Brazilian preference for arrangements with little institutional structure and based on summit meetings or general agreements, with strong participation of State companies. Although such initiatives (even those that are essential binational) are increasingly convergent, they contribute toward consolidation of a regional energy matrix without constituting any comprehensive institutional program.

8 SOME CONCLUSIONS

The trend toward emergence of South America as a focus for Brazil's regional activities has become consolidated. However, the country's capacity and interest in leading and sustaining initiatives targeted at achieving economic and political integration in the region, and the means whereby it intends to fulfill this project, remain open to discussion, in view of a lack of consensus on the part of the Brazilian political elite, asymmetric levels of engagement of the various federal government agencies, and disinterest of the Legislative Branch in this theme.

Brazil has been one of the most – if not the most – important of the regional political players. Thus, a major portion of the current configuration of South-American arrangements reflects its preferences and strategy. In other words, the predominance of Brazilian interests and presence in the region is, to a great extent, reflected by: a characteristic web of agreements with different densities and scope; the effort to extend such arrangements to a South-American space, rather than seeking to deepen existing agreements; weak institutional structure; low levels of microeconomic convergence; weakness of instruments to correct asymmetries; and a predominance of bilateral arrangements for energy and infrastructure issues.

In recent years, the growth of Brazil's economic relations within this space, as a major source of direct investment and as an exporter, has brought about a qualitative change in the country's regional presence. Notwithstanding advances in political and diplomatic action, and the timid and incipient processes of energy integration and coordination of the transport network, certain themes remain unresolved in relation to: growing asymmetries in economic and public-policy fields; the crisis facing traditional trade arrangements; institutional weaknesses of existing arrangements; and growing direct participation of Brazilian State agencies in the fields of development, credit and production.

Brazil's regional activities in recent decades provide a set of characteristics that make it possible to delineate its interests, pretentions and limitations for conducting this process. Perhaps with partial exception of Argentina and of some structural regional projects such as Itaipu and (to a lesser extent) GASBOL, Brazil has not opted to pursue strategies with its regional partners that have led to qualitative change, in relation to standards of economic, social or political development in these countries.

The combination of regional sectoral arrangements with weak institutional structure, that bolster the central policy-making role of Brazil in this process, with projects oriented toward a shallow process of integration, highly susceptible to changes in the political or economic context, indicate some very clear limits. At the same time, a fair degree of acceptance of Brazil as the main coordinating hub and instigator of this process, combined with a fair degree of capacity to mobilize resources, as illustrated by achievements in the field of energy integration and the SIVAM program, provides significant indication of the feasibility of its political and programmatic strategies.

Central to this process is the predominance of a Brazilian posture of caution and reserve in relation to policy commitments and a determination to ensure that arrangements in the region remain capable of accommodating its interests and international ambitions, under an integrationist model that endows countries with space to pursue economic benefits and with varying degrees of political autonomy. At the root of this Brazilian ambivalence and of the widening gap between its regionalist diplomatic rhetoric and the reticence of its actual postures, is a lack of domestic consensus as to the benefits Brazil might reap from this regional project.

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POLICY RESPONSE TO THE GLOBAL FINANCIAL CRISIS: KEY ISSUES FOR DEVELOPING COUNTRIES

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1 INTRODUCTION

The global financial crisis triggered by widespread speculative lending and investment in major international financial centres poses two sets of policy challenges. First, it calls for an immediate policy response in order to stabilize financial markets and international capital flows, halt economic decline and initiate recovery. So far major industrial countries have taken a range of measures for these purposes, including bailout operations through infusion of capital into weakened financial institutions and industrial firms and government guarantees for impaired financial assets and bank deposits; significant easing of monetary conditions and speedy and sharp reductions in interest rates; and large fiscal stimulus packages. Developing and emerging economies (DEEs) have also adopted measures to ease credit conditions and stimulate private spending to counter destabilizing and deflationary impulses from the crisis. However, several of them face resource constraints in responding to the crisis with countercyclical policies. There is a strong rationale and some scope for using trade and financial policies to ease the resource constraint. But, in many cases effective policy response depends crucially on the provision of adequate international liquidity at appropriate terms and conditions through multilateral financial institutions.

Secondly, this crisis has indicated once again the need for a fundamental reform of the international financial system in order to secure greater stability and prevent virulent crises with global ramifications. A consensus appears to have emerged among the major players in the world economy on the need for reform and a number of ad hoc initiatives have been launched and proposals put forward in various fora including the United Nations, the Group of 20 and the Bretton Woods Institutions. But to what extent these will result in the kind of changes needed is highly uncertain. The past record in this respect is not very encouraging. Despite a wide agreement on a systemic reform to bring about more effective governance to international finance after a series of crises in emerging economies in the 1990s and proliferation of proposals for reform,

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the *Financing for Development* initiative launched has yielded no significant outcome in this respect in the past seven years.[1] DEEs have a considerably greater stake in such a reform in view of disproportionately large damage that international financial instability inflicts on them. It is therefore important that they lead the process and form a coherent view for real change in a broad range of areas of crucial interest to them, including the mandate, resources, operational modalities and governance of the IMF, so as to reduce their vulnerability to financial instability and crises while preserving adequate policy autonomy in managing their integration into the international financial system, and capital flows and exchange rates.

These two sets of issues overlap in certain respects. In particular many of the shortcomings in the immediate policy response to the crisis by the international community have their roots in the deficiencies in global institutional arrangements for crisis management and resolution. The next section will discuss the constraints DEEs are facing in responding to deflationary and destabilizing impulses from the crisis, making an assessment of the international initiatives undertaken so far to provide support. This is followed by a discussion of the reform of the international financial architecture under two headings; crisis prevention and crisis intervention and resolution. Discussions will focus on issues that are viewed as of particular importance for stability and growth in DEEs, rather than on every issue raised by the current crisis. The final section will give a summary of the policy proposals advanced in the paper.

2 POLICY RESPONSE IN DEES: PAYMENTS CONSTRAINT AND INTERNATIONAL SUPPORT

2.1 Crisis impact and domestic policy options

The fallouts from the global financial crisis are wreaking havoc in DEEs. The combination of sharply declining commodity and manufactured export earnings, collapse of remittances, reversal of private capital flows, rising risk spreads, an extreme degree of credit squeeze affecting even trade finance and losses of asset values is giving rise to a sharp economic slowdown and even contraction in many parts of the developing world. According to the most recent projections by the IMF, average growth in DEEs is expected to be as low as 1.6 per cent in 2009, down from 8.7 per cent in 2007. At more than 6 percentage points, the expected loss of growth in these economies exceeds that in the centre of the crisis, the United States economy where output is projected to contract by 2.8 per cent in 2009 after growing by 2 per cent in 2007. This deceleration will result in

1. See, Akyüz (2002) for the issues raised and proposals made after the Asian financial crisis.

sizeable drops in per capita incomes in most developing regions and countries. Consequently, there is a risk of reversal of many of the benefits achieved in poverty alleviation and development as a result of intense policy efforts and reforms carried out in recent years.

There is now a broad agreement on the need for expansionary, countercyclical macroeconomic policy response to deflationary impulses emanating from the crisis. It is also agreed that under current conditions of extreme liquidity preference and risk aversion, monetary policy would have very little impact on credit expansion and private spending. Consequently, the burden falls primarily on expansionary fiscal policies, particularly increased public spending.

The main impediment to countercyclical macroeconomic policy in many DEEs is the balance-of-payments constraint. Although several middle-income countries have succeeded in building up relatively strong payments positions and large stocks of international reserves during the preceding expansion, the balance-of-payments constraint has generally become tighter with declines in exports earnings and the reversal of private capital flows. Indeed reserves have been falling almost everywhere in the developing world and even strong surplus economies such as China has been experiencing capital outflows. An acceleration of growth based on the expansion of domestic demand would certainly drain reserves further as imports pick up, exerting pressure on the currency and threatening external and financial stability. This means that for resource-constrained DEEs expansionary macroeconomic policies would depend crucially on the provision of adequate external financing. For poorer countries where official flows are directly linked to the budget, injection of additional external financing would also help ease the fiscal constraint which has generally become tighter as a result of adverse effects of declines in exports earnings and incomes on government revenues and of currency depreciations on public external debt servicing.

According to the World Bank (2009, p. 6), external financing needs in 2009 are expected to exceed private sources of financing in 98 of the 102 DEEs. In the absence of adequate official financing to fill the gap, these countries would have to use whatever domestic policy instruments they have under their control in order to weather the crisis with minimum damage. But options are quite limited. Currency adjustments would not be very effective in promoting exports when markets abroad are shrinking. Sharp devaluations in countries with extensive liability dollarization could also create deleterious effects on private balance sheets with large currency and maturity mismatches.

By contrast, selective restriction of non-essential, luxury imports, as well as of imports of goods and services for which domestic substitutes are available, could be more effective in easing the payments constraints and facilitating expansionary macroeconomic policies by allowing increased imports of intermediate and capital goods needed for the expansion of domestic production and income. For some DEEs the space between applied and WTO-bound tariffs can provide adequate room for such an action, but the margins are generally quite narrow and even non-existent for a large number of DEEs. By contrast, under current conditions prevailing in many countries, there is a strong rationale, as a last resort, for invoking GATT (and GATS) balance-of-payments safeguard provisions, notably those of Article XVIIIB which are directed particularly at payments difficulties arising from a country's efforts to expand its internal market or from instability in its terms of trade.

Ideally, when global deflationary forces are at work, it would be highly desirable to avoid restrictive trade measures, particularly those of a discriminatory nature. Indeed the interwar experience shows that ad hoc, discriminatory trade restrictions, together with beggar-my-neighbour exchange rate policies, can aggravate, rather than ease economic difficulties and lead to conflicts. The recent G20 summit pledged not to "repeat the historic mistakes of protectionism of previous eras" and to "refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organisation (WTO) inconsistent measures to stimulate exports" (G20, 2009c, p. 22). However, there was no indication of what kind of actions would be considered as protectionist and what kind as WTO-consistent. Nor was there any specific commitment.

Whether or not a particular trade measure can be considered as protectionism depends on the conditions under which it is adopted. In this respect a distinction should be made between restrictions applied by reserve-currency and reserve-rich countries, and those applied by DEEs facing balance-of-payments constraints. Import restrictions in the former cases would effectively imply exporting unemployment abroad, since by raising net exports such an action would substitute foreign for domestic demand. But this would not be so for restrictions applied by DEEs facing shortages of international liquidity. In this latter case, the alternative would be to face stagnation or contraction, and hence reduced demand for foreign goods and services. Selective restrictions over imports would allow allocation of scarce foreign exchange to facilitate domestic expansion without reducing the overall demand for foreign goods. This cannot be considered as a protectionist action.

Thus, resource-constrained DEEs should not be denied their rights embodied in multilateral trade agreements to use legitimate measures so as to avoid contraction in economic activity. Such trade measures should be distinguished from beggar-my-neighbour import restrictions and subsidies, including those used by some major industrial economies – such as the "Buy American" provisions and industrial subsidies in United States stimulus and bailout packages – which serve to protect jobs at home rather than facilitate expansionary policy actions, and beg the question of conformity to the WTO rules.

A second set of measures that could be employed by countries facing shortage of international liquidity to support domestic expansion relates to the capital account. DEEs are now experiencing net outflows on portfolio investment and international bank lending. Furthermore, residents in several of these countries have joined international lenders and investors in capital flight. This is in large part the outcome of widespread liberalization of resident investment abroad in recent years, often in an effort to relieve the upward pressure of the surge in capital inflows on currencies. Clearly, to the extent that reserves, exports earnings and official lending are used to finance capital flight, international liquidity available for current account financing would be reduced. Furthermore, under present conditions capital flight would also compromise the ability to use monetary policy for expansion. Thus, there is a strong case for restricting capital outflows in countries facing rapid loss of reserves. Restrictions would also widen the space for counter-cyclical monetary and fiscal policy response to the crisis in order to stabilize economic activity and restrain declines in currencies and the consequent dislocations in private balance sheets.

2.2 International liquidity support

The extent to which trade and financial restrictions would need to be applied by resource-constrained DEEs depends on the speed with which international trade, financial markets and capital flows are stabilized and on the availability of adequate financing from multilateral financial institutions. In the latter respect a number of initiatives have been taken in the G20 and the Bretton Woods Institutions in recent months, seeking improvement in three main areas: increased funding for multilateral financial institutions, widened access of DEEs to multilateral financing, and improvements in the terms and conditions of multilateral lending. Some of these initiatives have implications that go beyond matters of immediate policy response to the crisis and could, in fact, entail systemic and more permanent changes in the way the IMF intervenes in financial crises. These features will be discussed in the subsequent section in the context of the reform of the international financial architecture. Here a brief description will be given of the steps so far taken in the three areas, an assessment will be made of their adequacy in meeting immediate policy challenges for stabilizing economic conditions in DEEs and preparing the ground for recovery, and proposals will be made for further action.

Regarding new resources, according to the agreement reached in the April G20 summit, commitments have been secured for an additional $1.1 billion for international support. This includes a decision to allocate $250 billion of Special Drawing Rights (SDRs), approved in the subsequent meeting of the IMF; trebling of resources available to the IMF to $750 billion; an additional $100 billion for multilateral development banks, presumably to be raised through bond issues;[2] and $250 billion trade finance from various public and private institutions including export credit agencies. Of the additional $500 billion for the IMF, only $250 billion is readily available through bilateral lending by some of its major shareholders, to be subsequently incorporated into an "expanded and more flexible" New Arrangements to Borrow.[3] However, there does not seem to be an agreement on how the rest should be raised. While some major shareholders favour increasing the NAB by an additional $250 billion and encourage reserve-rich economies to make bilateral loans, major emerging economies, notably China, India, Russia and Brazil appear to insist that these resources be raised by borrowing from the markets, and have expressed interest in buying short-term notes (bonds) that the Fund could issue for this purpose.[4] This matter is now under consideration in the Fund.

Regarding access of DEEs to multilateral financing, the major recent initiatives include, in addition to the agreement on the SDR allocation noted above, doubling the normal access limits in the IMF; doubling of borrowing limits for poorest countries eligible to Poverty Reduction and Growth facility (PRGF) and Exogenous Shock Facility (ESF); and a new Flexible Credit Line (FCL) established for crisis prevention in emerging economies facing contagion from the global crisis. The FCL is said to be available "for countries with strong fundamentals, policies and track records of policy implementation", to be assessed by the IMF according to several pre-determined criteria. It can be drawn or used as a precautionary instrument. Unlike the Short-Term Liquidity Facility (SLF) it replaces, the FCL has no hard cap.[5] However, it is not clear if this implies that the

2. The World Bank has also set up the Vulnerability Financing Facility for countries hardest hit by the food and financial crises, but its potential contribution to crisis response in DEEs is not very clear.

3. The Fund has two agreements for bilateral borrowing from its shareholders; the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB). GAB was established in 1962 on the basis of the provisions of the Articles of Agreement (Article VII, Section 2) for replenishment of scarce currencies, which gave birth to G-10. It has been renewed ten times, raised from the original amount of SDR6 billion to SDR17 billion in 1983 in response to the debt crisis. NAB was established in 1998 as a set of credit arrangements with 26 members, for a total of SDR17 billion and renewed twice since then. In both GAB and NAB commitments by individual countries are based on their quotas. Between the two the total amount available to the Fund is around $50 billion.

4. See, New York Times, "IMF Planning to Sell Bonds to Finance New Loans", April 26.

5. The SLF was introduced in October 2008 with the deepening and global spread of the crisis for members with "solid policy track records and strong fundamentals" and access was based on ex-ante qualification. Unlike the FCL it had a cap of 500 per cent of the quota and it could not be used as a precautionary credit line. It remained unused until replaced by the FCL. Members who do not qualify for the FCL can use the so-called High-Access Precautionary Stand-by Arrangements (HAPAs) on a precautionary basis, with a cap and frontloading subject to ex-post review; see, IMF (2009a).

Fund will act as a lender-of-last-resort to countries it deems eligible, lending in unlimited amounts and without conditions except for penalty rates. So far a $47 billion FCL arrangement has been approved for Mexico. Poland has requested some $20 billion as a precautionary FCL arrangement and Colombia has expressed interest in a similar arrangement for $10 billion.

Finally, certain steps have been taken for "modernizing IMF conditionality for all borrowers" as part of the overhaul of the IMF lending framework.[6] First, access to the FCL will be based on *ex ante* rather than *ex post* conditionality. Second, decision has been taken to discontinue structural performance criteria in all Fund arrangements including those with low-income economies. This is expected to allow the Fund to focus on core objectives.

It is difficult to make a precise judgment on whether these initiatives would meet the external financing needs of DEEs since this crucially depends on the effectiveness of the measures adopted by the advanced economies responsible for the crisis in restoring stability and growth. According to the World Bank (2009, p. 6), the total external official financing needs of the 98 DEEs with shortfalls are expected to be at least $270 billion, and this figure could go up significantly, reaching $700 billion. According to UNCTAD (2009) the gap could turn out to be $2.000 billion. While the G20 summit is claimed to have come up with a commitment for an extra $1.1 trillion, the real additional amount readily available appears to be lower, certainly much less than the latter figures.[7] It is notable that despite these highly-publicized initiatives for additional financing for DEEs, the April 2009 growth projections by the IMF for these economies show downward revisions by 1.7 percentage points for 2009 and 1 percentage point for 2010 from those given in January 2009 – more or less by the same amounts as for advanced economies (IMF 2009b; table 1.1).

The volume, terms and conditions of additional financing to be made available by the multilateral financial institutions can be expected to show considerable variations among DEEs according to their access limits and eligibility to different categories of financing. Of the $250 billion SDR allocation DEEs would receive some $80 billion of which less than a quarter should be available to low-income countries. These amounts are small fractions of estimated external financing needs of the developing world. Any additional IBRD lending funded by bond issues would not be available to a large number of poor countries, including those in low-income and lower-middle-income categories. On current rules additional IMF lending financed by bilateral and/or market borrowing should in principle

6. See, IMF Press Release 09/85, March 24, 2009.

7. In particular the additional $250 billion for the Fund is not yet in sight, the source of the additional $100 billion for the World Bank is not clear, and the so-called $250 additional money for trade financing seems to be fictitious– see, Giles (2009) and Khor (2009).

be non-concessional. Judging on the basis of the established pre-qualification criteria, a very large number of DEEs, including several market-access countries with large current account deficits, high levels of public debt, high and unstable inflation etc. should not be eligible to the FCL.

It is generally agreed that when the balance-of-payments difficulties of a member of the Fund result from external shocks of a permanent nature, or from excessive expansion of domestic absorption, IMF financing should be accompanied by domestic policy adjustments to reduce the deficits. However, when payments difficulties are due to temporary external shocks, they need to be financed rather than reduced through policy adjustment. The current financial crisis appears to contain both permanent and temporary elements of change. It can be expected that the crisis will bring a durable adjustment to the external deficits of the United States resulting from the long-awaited consumer retrenchment. This certainly calls for an adjustment in surplus countries, including the Asian developing countries, notably China, but not resource-constrained DEEs.[8] This means that deficit DEEs should not be subjected to pro-cyclical macroeconomic policy conditionality for any additional borrowing needed to meet their balance-of-payments shortfalls resulting from trade and financial shocks from the crisis. However, despite the "recent modernization of conditionality", the Fund has continued to impose pro-cyclical macroeconomic tightening in almost all recent standby programs – fiscal tightening in Pakistan, Hungary and Ukraine, and interest rate hikes in Latvia and Pakistan (TWN, 2009). Even though some of these countries may have had large budget deficits when they approached the Fund for loans, recessions are not the best times to undertake fiscal adjustment.

Nor should multilateral financing made available to DEEs to meet their balance-of-payments difficulties due to a global crisis of which they have no responsibility place a heavy burden on them. This means that a high degree of concessionality would be needed. Indeed the IMF had established two highly concessional oil facilities in the 1970s as deliberate countercyclical devices to prevent oil price hikes from triggering a global recession, with countries enjoying almost automatic access without counter-cyclical macroeconomic conditions.

Low-income countries should be compensated not burdened with additional debt and debt servicing because of financing they receive to meet the shocks from the crisis. For political reasons as well as effectiveness ODA grants are not the best way to achieve this. An option would be to make a one-off permanent SDR allocation to these countries, based on some criteria of need.[9]

8. For implications of the current crisis for external adjustment in the United States and China see, Akyüz (2008a).

9. For a discussion of SDR allocation to poor countries as a way of reducing costs of holding reserves see, Polak and Clark (2006).

The cost of drawing on such allocations could be financed collectively from the IMF resources, including gold sales. This should be combined with a moratorium on servicing debt owed by these countries to official creditors, without any additional interest charges.[10]

A no-cost SDR allocation to low-income countries can be combined with a large reversible SDR allocation to other DEEs, to be repurchased when the crisis is over, to provide them with low-cost, no-conditionality resources. Proposals for reversible SDR allocations were made in the 1990s in order to allow the IMF to act as a lender-of-last-resort for financial bailout operations in emerging economies hit by financial crises. The rationale for such an allocation is no doubt much stronger now given the sharp contraction in global output and trade.

A large and reversible SDR allocation would extend the policy of "quantitative easing" to the global level, widely used by some major economies in stabilizing conditions in domestic credit and financial markets and stimulating spending. Reversibility would also provide automatic exit, thereby preventing inflationary pressures once recovery is under way. Furthermore, relying mainly on SDR allocation to meet external financing needs would also help avoid several undesirable consequences of funding IMF lending with bilateral loans from its shareholders, discussed in the subsequent section. Finally, a large SDR allocation could allow surplus emerging economies such as China to diversify their reserve holdings and reduce their vulnerability to dollar instability.

The exact purpose and use of IMF lending under current conditions also need to be scrutinized. As in the past, the existing standby programs of the Fund appear to be premised on maintaining open capital accounts and ensuring that developing country debtors stay current on their payments to private creditors. Of all the countries with IMF stand-by programs, only Iceland has widespread capital controls over resident and non-resident outflows, introduced in the early days of the crisis. None of the emerging markets with IMF programmes has introduced similar measures despite continued capital outflows. Even though the Fund may no longer be actively promoting capital account liberalization, its aversion to restrictions seems to continue unabated.

There can be little doubt that the rationale for capital controls over outflows in countries facing severe balance-of-payments difficulties is much stronger than that for trade restrictions. However, the latter have proliferated both in DEEs and advanced economies after the outbreak of the credit crunch while capital accounts have remained largely open even in countries facing large and continued outflows.[11]

10. UNCTAD has also called for a temporary moratorium on official debt servicing by DEEs; see, UNCTAD (2009).
11. On trade restrictions see, Gamberoni and Newfarmer (2009) and World Bank (2009).

In such cases the Fund should not only support but also recommend use of temporary exchange restrictions, preventing the burden of adjustment falling disproportionately on trade. These restrictions should also include temporary debt standstills. It is true that the international community has not been able to establish orderly mechanism for the protection of debtors against litigation in such cases– an issue to be taken up in section D. But the IMF can express its support by "lending into arrears", thereby deterring potential hostile action by private creditors.

Such restrictions should also be applied in FCL-eligible countries if the precautionary access provided by the FCL fails to stem speculative attacks and there are large and persistent outflows. Outflows can indeed accelerate if emerging economies lag in recovery behind advanced economies. Borrowing from the IMF to finance such outflows could lead to considerable increases in government debt burden, particularly where an important part of foreign claims are on the private sector, as seen in Asia during the 1997 crisis. Besides, there are serious risks in the Fund acting as a lender-of-last-resort to any country– an issue discussed in section D. It would thus be prudent to take up this matter at some length in the context of broader systemic reform of the international financial architecture.

3 REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

For DEEs there are two key issues in the reform of the international financial architecture. The first relates to crisis prevention: how best to reduce their vulnerability to international financial instability and crises while retaining adequate policy autonomy in determining the pattern and degree of their integration into world financial markets and managing capital flows and exchange rates. Prevention of crises with global repercussions requires addressing three major sources of instability: policies, markets and the current international reserves system centred on the dollar. More specifically it calls for:

- effective multilateral discipline over financial, macroeconomic and exchange rate policies in systemically important countries;
- establishment of an international reserves system not based on a national currency or currencies; and
- effective regulation and supervision of financial markets and capital flows.

It should, however, be kept in mind that while effective multilateral arrangements are important for reducing the likelihood of crises with global spillovers, they cannot fully protect DEEs against instability and crises. They are not substitutes for national policies and institutions for crisis prevention. This makes it all the more important to retain adequate national policy space while setting up a new multilateral framework for the governance of international finance.

The second area of reform relates to crisis response. It is generally agreed that regardless of the measures that may be adopted to secure greater stability, crises with global ramifications will continue to occur. The damage they inflict on the world economy and its incidence will depend on policy responses at national and international levels. The current crisis shows that closer multilateral cooperation and tighter discipline are needed to ensure that national policy responses take into account their impact on other countries and to avoid negative international spillovers and beggar-my-neighbour policies. Even more importantly, there is a need to improve international interventions in the balance-of-payments, currency and debt crises in DEEs. This calls for, *inter alia*, a fundamental reform of the mandate, operations and funding of the IMF.

3.1 Areas of reform for crisis prevention

3.1.1 Multilateral policy discipline in money and finance

National policies almost always play a central role in financial instability and crises. Misguided deregulation of domestic financial markets, premature liberalization of the capital account, and unsustainable macroeconomic and exchange rate policies are often the proximate causes of currency and balance-of-payments instability and financial crises. This is true both for DEEs and advanced economies. However, global repercussions of financial crises and currency instability in systemically important countries are much more serious than those in DEEs even though there is often regional contagion from crises in emerging economies, as witnessed in East Asia during 1997.

Boom-bust cycles in capital flows to developing countries and major international financial crises are typically connected to large shifts in macroeconomic and financial conditions in the major industrial countries. The sharp rise in the United States interest rates and the appreciation of the dollar was a main factor in the debt crisis of the 1980s. Likewise, the boom-bust cycle of capital flows in the 1990s which devastated many countries in Latin America and East Asia were strongly influenced by shifts in monetary conditions in the United States and the exchange rates among the major reserve currencies. (UNCTAD TDR, 1998, part II, chap. IV; 2003, chap. II). This is even more visible in current conditions where the boom-bust cycle in the United States financial markets has produced the most serious post-war global financial and economic crisis.

It must now be evident that adverse international spillovers from macroeconomic, exchange rate and financial policies in advanced economies are much more damaging to DEEs than shocks from their trade policies. But unlike trade, there is no effective multilateral discipline in money and finance. The IMF members have the same *de jure* obligations to maintain orderly macroeconomic and balance-of-payments conditions and stable exchange rates. But the Fund's policy oversight is confined primarily to its poorest members who need to draw on its resources because of their lack of access to private finance and, occasionally, to emerging economies experiencing interruptions in their access to private financial markets. By contrast the Fund is totally unable to impose meaningful disciplines over the policies of its major shareholders who exert a disproportionately large influence on global monetary and financial stability.

There are problems regarding not only effectiveness and evenhandedness but also the quality of surveillance. After a series of crises in emerging economies the Fund's Interim Committee (now the International Monetary and Financial Committee, IMFC) agreed in April 1998 that the Fund Ashould intensify its surveillance of financial sector issues and capital flows, giving particular attention to policy interdependence and risks of contagion@ (IMF, 1998). However, the Fund's intensified surveillance over emerging economies was not able to prevent further crises in Argentina, Russia and Turkey, all operating at the time under Fund programmes, in large part because it failed to diagnose and act on the root causes of the problem. Indeed, according to an independent assessment of Fund surveillance, policy makers interviewed had important reservations regarding the quality of the Fund's analysis of capital account issues (IMF/GIE, 1999, p. 13).

Similarly, in the run up to the present crisis the Fund failed to identify the nature and extent of potentially destabilizing speculative build-up and to provide adequate early warning. In its Article IV Consultations with the United States throughout 2005-06 the Fund staff was preoccupied with reducing fiscal and external deficits and maintaining control over inflation as the main policy challenges facing the United States economy, while reassuring that the "U.S. financial sector has proven exceptionally resilient in recent years." IMF (2005, p. 31; 2006, p. 23). Even a month before the beginning of the credit crunch, the IMF staff argued that "the most likely scenario is a soft landing as growth recovers and inflation falls, although both are subject to risks." (IMF, 2007a, p. 26). In the same month, July 2007, the IMF staff assessment of economic conditions in Iceland was also highly upbeat, maintaining that "Iceland's medium-term prospects remain enviable" while adding some caveats about downside risks associated with large current account deficits, increasing indebtedness and high inflation (IMF, 2007b, p. 17).

This failure in adequately assessing the risks of instability and providing early warning appears to be deep-seated in the belief of the Fund secretariat, encouraged by some of its major shareholders, that disequilibria and imbalances generated by freely functioning financial and currency markets are self correcting, without entailing severe social and economic costs of adjustment. It has an obsession with budget deficits and inflation as the main threats to macroeconomic stability and growth, ignoring that inflation in asset markets driven by speculative lending and investment, both nationally and internationally, tends to pose even greater threats, despite mounting evidence from recurrent crises in emerging and mature markets alike.

A key question is, therefore, how to overcome the problems regarding quality, effectiveness and evenhandedness of IMF surveillance. The G20 (2009c) expressed its support for "candid, even-handed, and independent IMF surveillance" without making specific recommendations as to how these could be achieved. Subsequently the IMFC reaffirmed the emphasis on "candor, evenhandedness, and independence" and the need "to enhance the effectiveness of surveillance." (IMF 2009c). However this has little credibility since the IMFC is known to have come up with similar pronouncements in almost every other meeting, particularly those held after episodes of instability in international currency and financial markets.[12]

There can be little doubt that problems regarding the quality, effectiveness and evenhandedness of IMF surveillance cannot be resolved without addressing its governance-related shortcomings. There is no ready-made solution and further reflection is needed on the ways and means of achieving these objectives. Given that the existing mechanisms within the Fund have so far failed to do so despite repeated pronouncements of intention, such a process should best be conducted outside the Fund.

A notable suggestion for improving surveillance, made by a senior British Treasury official, is its formal separation from decisions about program lending and the use of IMF resources so as to establish the Fund as independent from political influence in its surveillance of economies as an independent central bank is in the operation of monetary policy (Balls, 2003). It is rightly argued that the current structure of the IMF treats program design as an extension of surveillance, but the lack of a clear distinction between lending and surveillance activities creates the wrong incentives and diminishes the effectiveness of surveillance. Moreover, there is currently no formal regular mechanism for assessing

12. For instance, in September 2000 the Committee emphasized "enhancing Fund surveillance, and promoting stability and transparency in the financial sector": in April 2002 it encouraged the Fund "to press ahead with the range of recent initiatives designed to enhance the effectiveness of surveillance and crisis prevention, including the Financial Sector Assessment Program": in October 2004 it allocated four paragraphs on "making surveillance more effective and strengthening crisis prevention"; and in April 2006 it proposed a "new framework for IMF surveillance" which included, *inter alia*, making the staff "accountable for the quality of surveillance".

whether the Fund is providing objective, rigorous, and consistent standards of surveillance across all member countries – program and non-program countries. While responsible for ensuring the effectiveness of the Fund's activities, Executive Directors also have responsibilities to their authorities. This creates a conflict of interest where Executive Directors tend to collude in surveillance in defence of the countries they represent, turning peer pressure into peer protection. Surveillance should thus rest with authorities who are independent of their governments and who are not involved in lending decisions, making it impartial, legitimate, authoritative, transparent and accountable.

3.1.2 A stable international reserves system

A reserves system based on a national currency as a means of international settlement and a reserve asset suffers from a major dilemma. This was pointed out by Triffin (1960) almost half a century ago, questioning the viability of the Bretton Woods arrangements based on the United States dollar. In a dollar-based system net holding of dollar assets by the rest of the world depends on the United States running current account deficits. If the United States stopped running deficits, the shortage of international liquidity would stifle global trade, investment and growth. If, on the other hand, the United States runs growing deficits and supplies adequate liquidity to the world economy, the accumulation of liabilities could undermine the confidence in the dollar, depressing its value vis-à-vis other reserve assets – namely, gold under the Bretton Woods system. Restoring confidence and overcoming inflationary pressures would then call for United States interest rates to rise and deficits to fall, depressing economic activity and employment. Therefore, while issuing a reserve currency gives the country an advantage in financing its deficits, it can also become problematic. With the accumulation of liabilities abroad, the country can lose its monetary policy autonomy and be forced to adopt deflationary policies.

Indeed, the Bretton Woods system of exchange rates collapsed as the immediate post-war dollar shortage was translated into a dollar glut with the growing United States deficits, which made it impossible to maintain gold convertibility at a fixed rate, leading to a unilateral suspension in 1971 – the first and the most significant post-war default of international obligations by any country. The move to floating exchange rates, rapid growth of international financial markets and capital flows, and the rise of Germany and Japan as industrial powers did not challenge the dominance of the dollar. As explained by the IMF historian Boughton (2001, p. 937) Germany and Japan "were reluctant to see their currencies 'internationalized' and used as reserves … Moreover, the prospect of a system of multiple reserve currencies was widely viewed, both inside and outside the Fund, as a potentially destabilizing development that was to be avoided if possible. If central banks held several different currencies, then they would be likely to shift the composition of their portfolios to optimize expected returns. Such speculation could magnify the effects of market shifts in confidence or in expected relative returns." At the time of the suspension of gold convertibility, the estimated share of the dollar in all official reserves other than gold was 70 per cent, compared to around 65 per cent at present.

In the post Bretton Woods era instability in the United States balance-of-payments has continued unabated, even aggravated by the absence of effective multilateral discipline over its macroeconomic policies – a discipline that the Bretton Woods System had sought to establish through gold convertibility. This resulted in recurrent gyrations of the dollar vis-à-vis other reserve currencies and played a major role in increased global financial instability.

After the collapse of the Bretton Woods system, the need for reserves was expected to lessen as countries gained access to international financial markets and became more willing to respond to balance-of-payments shocks by adjustments in exchange rates. However, capital account liberalization in DEEs and their greater access to international financial markets has produced exactly the opposite result. International capital flows have no doubt allowed running larger and more persistent current account deficits beyond the levels that could be attained by relying on international reserves. But this has also resulted in an accumulation of large stocks of external liabilities and growing presence of foreigners in domestic securities markets. The debtor countries have thus become increasingly vulnerable to sudden stops and reversals in capital flows, with grave consequences for stability, growth and development. This became increasingly visible after the Asian crisis in 1997 when the only collective insurance available, namely the IMF lending, proved to be highly unreliable and even counterproductive.

Thus, the combination of increased capital account liberalization in DEEs, accumulation of external liabilities, pro-cyclical behaviour of international financial markets, and the absence of effective multilateral arrangements for the provision of international liquidity and orderly debt workout procedures has forced DEEs to look for self-insurance by accumulating large stocks of international reserves, mostly held in dollars. While traditionally reserves covering three months of imports were considered adequate for addressing the liquidity problems arising from time lags between payments for imports and receipts from exports, it has become a common wisdom that in order to avoid a liquidity crisis, international reserves in DEEs should at least meet their short-term external liabilities.[13]

13. This is known as Guidotti-Greenspan rule formulated after the Asian crisis. For a discussion of adequate level of reserves see UNCTAD TDR (1999, chap. V).

At the end of 2008 total international reserves of DEEs reached some $5.5 trillion, or 7 months of imports. Even though DEEs taken together have been running current account surpluses in recent years, only about half of their total reserves are earned from current account surpluses, mainly by China and Fuel Exporters. The rest came from capital inflows – that is, they are borrowed reserves.[14] In a few countries such as China, current account surpluses and reserve accumulation have been associated with rapid growth. But in a large number of DEEs additional reserves came either from capital inflows or from trade surpluses achieved by cutting growth for fear that a possible downturn in commodity prices or reversal of capital flows would necessitate additional international liquidity.

These reserves are invested in low-yielding assets, mainly the United States treasury bills and bonds. On the basis of average historical spreads between the borrowing rate and return earned on reserves, the annual carry cost of borrowed reserves alone to DEEs can be estimated to be in the order of some $130 billion. This constitutes a net transfer of resources to reserve-currency countries, notably the United States, and exceeds total official development assistance to developing countries.[15] The cost borne by DEEs would be greater if allowance is made for foregone growth by putting export surpluses into United States treasuries rather than investment and imports. Furthermore, DEEs could incur losses on their dollar holdings if the large build up of United States government liabilities resulting from bailout and fiscal stimulus packages were to produce inflation and dollar depreciation.

Both the G20 summit and the IMFC remained silent on reform in this key area. There are various options in establishing an international reserves system not based on national currencies so as to avoid these difficulties. One proposal is to go back to the gold standard. Another is to revisit Keynes's proposal, made at the Bretton Woods Conference, of introducing a global currency, *the bancor*, exchangeable with national currencies at fixed rates, issued by a global central bank – the International Clearing Union – to provide countries liquidity for international payments clearance as well as overdraft facilities by amounts based on the value of their trade.[16] However, building on existing mechanisms and institutions

14. "Borrowed" in the sense that they accompany increased claims by non-residents in one form or another, including direct and portfolio equity investment, which entail outward income transfers.

15. The method used here to estimate reserve costs differs from that in the literature in that a distinction is made here between borrowed and earned reserves. Polak and Clark (2006) also refer to borrowed reserves in their estimation of the cost to poorest developing countries.

16. For a recent discussion of this proposal in relation to the current crisis see, Monbiot (2008). Ironically this proposal is now revisited for addressing the problems associated with the dollar-based reserve system and the United States indebtedness while at the Bretton Woods it was opposed by the very same country because it was the biggest creditor at the time and Keynes was proposing taxing current account surpluses. By contrast, in a recent speech on *Reform of the International Monetary System,* proposing adoption of the SDR as a global reserve currency, the governor of China, the country with the biggest surplus, referred to Keynes's bancor proposal as "farsighted"; see, Zhou (2009).

and a gradual move away from the dollar towards the SDR (or expanded SDR) appears to be a more practical solution.

An important advantage of SDRs, particularly for DEEs, is that unlike dollar reserves, holding SDRs does not entail costs; cost is incurred only when they are used. Under present arrangements the IMF may allocate SDRs to members in proportion to their quotas. Members obtain or use SDRs through voluntary exchanges or by the Fund designating members with strong external positions to purchase SDRs from those with weak external position. When members' holdings rise above or fall below their allocation, they earn or pay interest respectively, with the interest rate being determined as the weighted average of interest rates on short-term debt in money markets of the SDR basket currencies.

The cost advantage of SDRs has given rise to calls for regular distribution to alleviate the burden of holding reserves on low-income countries. Indeed, a former Director of Research of the IMF, Jacques Polak, argued in a joint paper that the only principle that should now guide the allocation of SDRs should be "the benefits of permitting low-income countries to acquire and hold reserves at a much lower interest rate than they would have to pay in the market and a reduced dependence of the system on borrowed reserves that are liable to be recalled when they are most needed."[17]

Regular allocations of SDRs on the basis of existing rules cannot promote the SDR to be a major reserve asset and address the inequities and instability resulting from the current system based on national currencies, even if such allocations are done more often than have been the case. A way forward is to make the IMF an SDR-based organization, and to allow SDRs to replace quotas and GAB and NAB as the single source of funding for the IMF. The Fund could be permitted to issue SDRs to itself up to a certain limit which should increase over time with growth in world trade. Under such a scheme the present practice of allocations to countries according to their quotas would be discontinued. Unconditional access limits (the so-called reserve tranche or gold tranche) would need to be redefined and widened considerably based, *inter alia*, on some criteria of need.

In such an arrangement the demand for SDRs (or drawings from the IMF in SDRs) can be expected to be inversely related to buoyancy in world trade and income and the availability of private financing for external payments. Thus, allocations could be altered in a countercyclical way, accelerated at times of global slowdown. This would help counter deflationary forces in the world economy and provide an offset to fluctuations in private balance-of-payments financing.

17. See Polak and Clark (2006) which also addresses whether SDRs should be issued to all members or to low-income countries alone.

Several issues of detail would still need to be worked out, but once an agreement is reached to replace traditional sources of funding with the SDR, the IMF could in fact be translated into a technocratic institution of the kind advocated by Keynes during the Bretton Woods negotiations. Its funding would no longer be subjected to arduous and politically charged negotiations dominated by major industrial countries. Nor would it need to borrow from some of its members in order to lend to others. Such an arrangement could thus bring a considerable improvement to the governance of the IMF, allowing it to stay at equal distance to all its members and help to perform policy surveillance even-handedly and effectively.

Making the Fund an SDR-based institution would no doubt result in a considerable increase in the supply of SDRs compared to the existing stock or the growth that could be expected under current practices. It would allow major surplus countries to invest their reserves in SDRs instead of reserve currencies. It is also possible to supplement this with a mechanism to remove the dollar overhang by allowing countries to rapidly replace their existing stocks of dollar reserves with SDRs without causing disruption in currency markets. Such a proposal was made by the Governor of the People's Bank of China. According to this proposal the IMF would "set up an open-ended SDR-denominated fund based on the market practice, allowing subscription and redemption in the existing reserve currencies by various investors as desired" (Zhou, 2009).

This proposal corresponds to what came to be known as the substitution account, extensively discussed in the IMF in two previous episodes of considerable dollar weaknesses, but abandoned for several reasons; first, in the early 1970s in the Committee of 20 in an effort to replace the Bretton Woods system by something more viable, and then in the late 1970s and early 1980s as the dollar weakened considerably.[18] The idea is a simple one: the IMF would issue interest-bearing certificates denominated in the SDR against dollar reserves handed over by central banks at the market exchange rate, and invest these reserves in interest-bearing United States treasury bills and bonds. The operation would not affect the total volume of international reserves but its composition – thus no "inflation" fears. Countries can use these certificates to settle international payments or to acquire reserve currencies. The substitution would result in a withdrawal of a large stock of dollar reserves from the market and put them into IMF coffers. It would eliminate the risk of monetary turmoil that could result from a potential widespread unloading of dollar reserves by central banks.[19]

18. For an account of these deliberations see, Boughton (2001: pp. 936-43). See also Bergsten (2009)

19. Kenen (2005) suggests that a widespread unloading of dollar reserves into euro could be absorbed by establishing a similar substitution account at the European Central Bank so as to avoid undesirable effects of a flight from the dollar on interest rates and exchange rates.

Several issues of importance to DEEs would need to be sorted out.[20] First and foremost, there is the question of who will bear the exchange rate risk. A change in the dollar/SDR exchange rate would create losses and gains for the IMF since, by definition, a substitution account would mean a currency mismatch between assets and liabilities. A sustained decline in the dollar against other currencies that make up the SDR will imply losses. The exposure of the Fund can be considerable if the account is open-ended, rather than restricted in size. There is no guarantee that interest differentials between the dollar and SDR would provide cover for such losses.[21] This is true whether the interest on SDRs is calculated as at present, or set in the market established for the SDR.

In the previous discussions of this proposal, the IMF gold was proposed to be used for cover. But this would mean pushing the losses onto all members of the Fund, rich and poor alike. If, on the other hand, the exchange rate risk were to be borne by holders of the SDRs, the operation would be meaningless – there would be no incentive for holders of dollar reserves to subscribe to the account. An alternative would be for the United States to bear the risk – that is, to supply more interest-bearing dollar assets to cover exchange losses if the dollar falls against the other currencies. A more equitable solution would be to share the risk between the United States and the Central Banks subscribing to the substitution account, rather than pass it onto the Fund, including its poorer members.

A second issue relates to the privatization of the SDR. Establishing a private market for SDRs by allowing banks to hold them, and using them in currency interventions would certainly improve its liquidity and status as a reserve asset. This is also seen as necessary for the substitution account to be attractive to central banks, not only in replacing dollar reserves but also reserves held in other currencies, including potential ones such as the Chinese yuan. However, this could also make the SDR a new instrument of speculation and a source of instability. In other words, it might be difficult to reconcile a high degree of liquidity with stability of its exchange value. It is therefore important to strike the right balance between the two and to ensure that SDRs are used mainly for settlements of payments linked to international trade and investment.

3.1.3 Regulation of international financial markets and capital flows

Past experience shows that even when monetary and fiscal discipline is secured and a relatively high degree of price stability is attained, unbridled financial markets are capable of generating instability and crises with serious consequences for

20. These are discussed in Boughton (2001, 2007) and Bergsten (2007a, 2007b).

21. An alternative would be for the IMF to invest dollar reserves into long-term Treasury bonds which normally carry higher interest rates. But this would not necessarily cover the exchange rate losses.

the real economy, notably jobs and incomes. The global financial turmoil triggered by the sub-prime debacle has shown once again that the Anglo-American view that financial markets regulate themselves is not only wrong but is also highly damaging.

There is now a broad agreement on the need for tighter regulation than has been the case, but views differ about how best to regulate and the degree of regulation. Moreover, regulation of international capital flows is highly contentious. The dominant view still entertained in the mainstream is that once financial markets and institutions are properly regulated there is no need to restrict international capital flows. However, this does not stand against ample evidence that prudential rules do not necessarily bring greater stability to international capital flows, nor can they prevent such flows from inflicting serious damage on an economy (Akyüz 2008b).

Several reasons are usually given why financial regulation should be international. First, since financial instability often has adverse global spillovers, national regulatory practices should be subject to multilateral disciplines. Second, multilateral rules would provide a level playing field and prevent regulatory arbitrage – that is, business running away from tightly to lightly regulated jurisdictions. Finally, they would reduce the influence of politicians over regulators and give them a certain degree of independence – a concern that is now widely shared after the hands-off approach that the previous United States administration had adopted vis-à-vis financial markets.

While these considerations are basically valid, there are both political and technical difficulties in establishing multilateral discipline in financial regulation and supervision. A supreme international body with fully-fledged regulatory and supervisory powers over all financial institutions is not on the agenda. However, it is increasingly held that global and systemically important institutions should be regulated and supervised internationally rather than nationally. Several proposals have been made for establishing international bodies for credit rating agencies and transnational banks over a certain size.[22]

An option would be to leave the conduct of regulation and supervision to national authorities within a framework established according to the same principles as the WTO.[23] This would involve binding multilateral agreements on a set of rules

22. Several authors in Eichengreen and Baldwin (2008) propose a single global regulator for large highly leveraged institutions and banks with significant border-crossing activities.

23. A proposal made after the Asian crisis was to establish a World Financial Authority (WFA) or to turn the BIS into such a mega-agency "with major powers to establish best practice financial regulation and risk management throughout international financial markets…to enforce regulatory standards, backed by high-profile surveillance … [and] monitor and mediate the imposition of capital controls by national governments"; see, Eatwell and Taylor (1998). For a more detailed discussion see, Eatwell and Taylor (2000) and for an assessment, Akyüz and Cornford (2002).

and regulations for financial institutions including banks, institutional investors, rating agencies, and bond and credit insurance companies. There would be a commitment by governments to implement such rules and regulations through national regulators. Finally, there could be a multilateral body to oversee implementation and impose sanctions for non-compliance, such as denying access of financial firms from non-complying countries to markets of other members.

However, it is still quite unrealistic to expect systemically important countries, including some emerging economies, to give up national policy autonomy to the extent required. It is notable that even the EU has not managed to establish a unified regulatory system. Furthermore, serious difficulties could be faced in reconciling and integrating different legal systems and conceptual frameworks in arriving at a uniform set of rules for economies at different levels of financial development and with different financial institutions and culture.

More importantly, such an arrangement would carry risks and drawbacks for DEEs. It is not realistic to envisage that a global institution with genuine clout over major advanced economies could be established on the basis of a distribution of power markedly different from that of existing multilateral financial institutions. Thus, it may not be wise to create another multilateral body before solving satisfactorily the governance-related problems that pervade the existing institutions such as the IMF, WB and WTO.

Second, there is the familiar one-size-fits-all problem. In all likelihood, rules and regulations to be agreed in such a setting would be shaped by the exigencies of financial markets and institutions of more advanced economies. These would not always be suitable to DEEs. On the other hand, as the experience in the WTO shows, special and differential treatment that may be granted to DEEs may not mean much in practice.[24]

Furthermore, entering into comprehensive multilateral negotiations could open the Pandora's Box of market access in financial services, liberalization of capital flows and multilateral agreement on FDI, resulting in further restrictions over policy space in DEEs. The real danger for DEEs is that a process designed to broaden the scope of global governance over finance may end up extending the global reach of financial markets. It is notable that one of the recommendations of a G20 working group on international cooperation was for Financial Stability Forum (FSF) member countries to "maintain the openness of the financial

24. Eichengreen (2008) proposes creation of a World Financial Organization where members would undertake obligations for regulation and supervision set out in its charter and agreements, but would be free in how to meet them. This would permit regulations to be tailored to the structure of individual financial markets. An independent body of experts would then decide whether the members have met their obligations, imposing sanctions such as denying access of banks from non-complying countries to the markets of other members. However, such a loose arrangement without clearly defined rules and obligations may not provide adequate safeguards for DEEs, or prevent regulatory arbitrage.

sector" (G20, 2009a, p. 7). It is not clear if this is meant to be liberalization of market access in financial services or if it would apply to new developing-country members of the expanded FSF. But it is a clear sign that global arrangements for financial regulations may entail new obligations for DEEs for opening up their financial sectors to foreign firms.

A less ambitious approach would be to extend the mandate and improve the governance of existing bodies such as the FSF, the BIS, the Basle Committee on Banking Supervision, the International Association of Insurance Supervisors, and the International Organization of Securities Commissions. Most existing proposals for improving global governance of finance indeed envisage a voluntary process of closer coordination among national regulators, based on an agreed framework within such institutions, rather than a rules-based system with sanctions.[25]

The G20 also appears to be moving in that direction, emphasising the need for "internationally agreed high standards", "common and coherent international framework, which national financial authorities should apply in their countries consistent with national circumstances" and "systematic cooperation between countries"[26] It proposes "to establish supervisory colleges for all major cross-border financial institutions" (G20, 2009a, p. 5). The Group has also agreed to transform the FSF into a Financial Stability Board by extending its membership to include all G20 countries and its mandate to the regulation and oversight of all systemically important financial institutions, instruments and markets, including the hedge funds and credit rating agencies.

There are also proposals to give a greater role to the IMF in financial surveillance. However, this role should not be extended to setting regulatory standards or overseeing financial markets and institutions. In this area the task of the Fund is to monitor macroeconomic and financial developments and provide early warning of risks of instability and crises. Its ROSC (Report on the Observance of Standards and Codes) exercises, introduced after the Asian crisis and undertaken as part of Article IVC consultations and in conjunction with the joint FSAP (Financial Sector Assessment Program) activities with the World Bank are meant to help promote global financial stability. However, these activities have been highly ineffective because of several shortcomings in the design and application of codes and standards.[27] Therefore, before the IMF may be given new roles in the financial architecture, it is important to have a reasonably good understanding of the factors that have made existing instruments and mechanisms ineffectual and to remove them through appropriate reform.

25. See e.g., G30 (2008) and proposals made in several papers in Eichengreen and Baldwin (2008).
26. G20 (2009b, p. 4; 2009c, p. 13-15).
27. For these shortcomings see Cornford (2001), Schneider and Silva (2002) and Schneider (2005).

A possible guiding principle for DEEs in the reform of the global financial architecture in the area of financial regulation and supervision could be to allow and retain considerable autonomy in setting standards for financial institutions without significant border-crossing activities. A multilateral framework for national regulatory systems or global regulators should be introduced only for transnational financial institutions. The nature and extent of regulations of different transnational financial activities and institutions needed is a highly complex issue that would require considerable deliberations. Even where developing countries do not have transnational financial institutions, they should have voice in setting global rules and standards since they often do business with those from advanced economies. For instance, supervisors from DEEs should always participate in supervisory colleges proposed by the G20, rather than being invited to such bodies as host supervisors "where appropriate", as envisaged by a G20 working group (G20, 2009a).

In the regulation of transnational financial institutions, the main objective of DEEs should be to ensure that the proposed mechanisms address their vulnerability to external financial instability and shocks. This calls for attention to at least the following areas:

First, international lenders to DEEs behave in a highly pro-cyclical way and this increases their susceptibility to external shocks. At times of boom, they lower their standards in lending to financial and non-financial firms in developing countries, and governments are not always fully able to prevent such surges creating serious currency and maturity mismatches in private balance sheets. When the times change and risk assessment takes a downturn, lending is rapidly withdrawn, often leading to currency collapses and widespread bankruptcies, with the state often taking over private liabilities. Therefore, the main interest of DEEs in the much emphasized and fashionable counter-cyclical prudential measures for international banks is their potential impact on pro-cyclical behaviour in international lending.

Second, governments and private firms in DEEs face similar difficulties when they borrow abroad through international security issues. Rating agencies are not only pro-cyclical but are also biased against borrowers from DEEs. Before the outbreak of the sub-prime credit crunch, ratings of many Asian emerging economies with sound payments, reserve and fiscal positions were below those of some advanced economies with serious vulnerabilities on these fronts – e.g. Iceland. Therefore, removing the rating bias and pro-cyclical behaviour should be the primary objective of DEEs in regulating international rating agencies.

Third, DEEs are not only borrowers from international markets. They are also investors in securities issued in advanced economies by both public or publicly sponsored institutions and private firms. Several Central Banks in DEEs are known to have invested large amounts in debt issued by the United States Government Sponsored Enterprises, including mortgage firms Fannie Mae and Freddie Mac. Again, the so-called toxic assets issued by private financial institutions have found their way into the portfolio of banks and institutional investors in DEEs. In fact, because of increased liberalization of capital outflows by residents, such exposure has been on the rise. Therefore, DEEs have a growing stake in greater transparency and objective assessment of quality of such securities. This calls for an overhaul of accounting, regulatory and underwriting standards and a fundamental reform of rating agencies. A Global Financial Products Safety Commission may also be established for this purpose with equal and full participation of DEEs.

Fourth, a growing source of instability of capital flows in developing countries is due to international portfolio investors, including institutional investors and highly-leveraged institutions, notably hedge funds. The task of delimiting the nature and extent of their operations within their borders naturally falls on national governments and regulators. However their task would be greatly facilitated by increased transparency of investors. The minimum requirement is registration with national financial authorities. Access to information on the degree and nature of leverage, the size and composition of portfolios and investment strategies of these investors would also be highly important for financial authorities in DEEs to make a reasonably sound assessment of the risks entailed by their entry into domestic asset markets.

3.2 Crisis intervention and resolution

Regardless of measures that may be taken to discipline policies in systemically important countries and to regulate systemically important financial institutions, instruments and markets, it is almost a certainty that crises will continue to occur. For countries which do not enjoy reserve currency status, notably the DEEs, balance-of-payments and debt crises will also continue to necessitate international interventions, except where there are effective regional alternatives. Under current arrangements this task falls on the IMF.

However, there are several contentious and unresolved issues regarding IMF interventions in crises in emerging economies, including their objectives, funding and policy conditionality. Considerable dissatisfaction was expressed by several developed and developing countries in the way interventions were designed and implemented in the late 1990s, and several proposals were made, both within and outside the Fund, for improvement (Akyüz, 2005). But these were put aside as a result of opposition from its major shareholders and the complacency created by quick resumption of growth in most countries hit by financial crises and a strong recovery of capital flows in the early years of this decade.

The Fund's crisis intervention in the past typically involved injection of liquidity designed to keep countries current on their debt payments to private creditors, to maintain capital account convertibility and to prevent default, accompanied by monetary and fiscal tightening to restore confidence. Rescue packages amounted to several times the accepted quota limits and were often combined with bilateral contributions from major industrial countries. As noted, recent interventions do not diverge in a significant way from this pattern: capital accounts are kept open despite rapid outflows and depletion of reserves, policy conditionality continues to be pro-cyclical and the IMF is increasingly relying on funds borrowed from its main shareholders.

This approach is troublesome for several reasons. Pro-cyclical policies add to contractions in economic activity brought about by external trade and financial shocks, leading to increased unemployment and poverty. Relying on major shareholders for funding increases their influence in the design of IMF programmes and even allow them to pursue their national interests, as observed in Korea during the 1997 crisis. More importantly, bailouts undermine market discipline, create moral hazard and encourage imprudent lending since creditors and investors are not made to bear the consequences of the risks they take. They shift the burden of the crises almost entirely onto debtors, particularly governments in DEEs which are often compelled to assume external liabilities of private debtors which can no longer service their debt. Moreover, the financial integrity of the Fund is jeopardized, particularly as scale of operations increases with rapid growth in cross-border lending and investment.

As these problems became increasingly visible in IMF interventions in recurrent crises in the 1990s and early 2000s, a proposed solution was to bail-in or involve international creditors and investors in the resolution of financial crises and to restrict IMF lending in order to encourage it. This received support from some G7 countries such as Canada, England and Germany. Various voluntary and involuntary schemes were proposed to achieve this, including temporary debt standstills and exchange controls. The IMF Board recognized that "in extreme circumstances, if it is not possible to reach agreement on a voluntary standstill, members may find it necessary, as a last resort, to impose one unilaterally", and that since "there could be a risk that this action would trigger capital outflows … it might be necessary to resort to the introduction of more comprehensive exchange or capital controls", with the Fund signalling its "acceptance of a standstill imposed by a member … through a decision … to lend into arrears to private creditors."[28]

28. For the discussion of this issue in the IMF see, Akyüz (2005, p. 9-15).

The Fund secretariat was also moving towards establishing a formal mechanism for involving private creditors in the resolution of sovereign debt crises through a Sovereign Debt Restructuring Mechanism (SDRM). Countries facing severe balance-of-payments and sovereign debt difficulties were envisaged "to come to the Fund and request a temporary standstill on the repayment of its debts, during which time it would negotiate a rescheduling with its creditors, given the Fund=s consent to that line of attack. During this limited period … the country would have to provide assurances to its creditors that money was not fleeing the country, which would presumably mean the imposition of exchange controls for a temporary period of time" (Krueger, 2001, p. 7). However, because of opposition from its major shareholders and financial markets and lack of strong support from some developing countries, this proposal was first diluted – considerable leverage was granted to creditors and provisions for standstills were dropped – and subsequently abandoned altogether.

In response to the adverse impact of the crisis on trade and capital flows in DEEs, the international community has now chosen to establish a new facility, the FCL, to allow the Fund to lend large amounts of liquidity to certain countries deemed eligible on the basis of some pre-determined criteria. However, this has not been accompanied with measures to meet the consequent risks of moral hazard, unequal burden sharing and potential threat to the financial integrity of the Fund. The latter is a particular cause of concern since the majority of Fund members are excluded from access to this facility. This makes it all the more important to establish parallel arrangements to involve private creditors and investors in the resolution of balance-of-payments and debt crises in emerging economies.

A central component of such arrangements is the recognition of the rights of countries facing large and sustained capital outflows to impose temporary debt standstills and exchange controls, and the provision of statutory protection to them in the form of a stay on litigation. The decision for a standstill should be taken unilaterally by the country concerned and sanctioned by an independent panel rather than by the IMF because the countries affected are among the shareholders of the Fund which is itself also a creditor. There can be little doubt that countries will resort to standstills with considerable prudence and discretion. As noted by a former Deputy Governor of the Bank of England, a "well-articulated framework for dealing with sovereign liquidity problems … would be no more likely to induce debtors to default than bankruptcy law is to induce corporate debtors to default" (Clementi, 2000).

The Fund lending should focus on current account transactions, and there should be limits to lending to countries experiencing large and persistent capital outflows – notwithstanding that money is fungible and in practice it is not always possible to clearly identify the need catered for by a particular loan. Lending at progressively higher (penalty) rates, as the Fund now seems to be practicing, may not dampen the demand for liquidity from the FCL-eligible countries. Instead, the Fund should encourage involvement of private creditors by recommending and even requiring use of temporary standstills and exchange controls where needed.

Such restrictions should be introduced whether payments difficulties have their origin in private or sovereign debt or rapid exit of foreign investors; and whether they are due to liquidity or solvency problems – a distinction which is not always clear-cut. In cases of strong signs of insolvency, limits on IMF lending should be tighter – that is, countries should not borrow from multilateral sources to finance unpayable debt to private creditors, as happened extensively during the debt crisis in the 1980s (Sachs, 1998, p. 53).

Because of absence of a multilaterally agreed legal system for debt workouts, the practice tends to be disorderly and ad hoc, and tends to favour creditors. Very often the IMF is involved in coordinating and resolving debt servicing difficulties, be it due to solvency or liquidity problems, based on an adjustment program agreed with the debtor country. The Fund generally seeks a voluntary agreement with creditors, but its position is asymmetrical – while it has a significant leverage vis-à-vis sovereign debtors it cannot impose appropriate terms and conditions on creditors. Even in bond contracts with collective action clauses (CACs), bondholders can hold out and opt for litigation in search of a better deal. Such ad hoc restructuring has rarely secured sustainability where there were problems of solvency. In cases where debt servicing difficulties were due to liquidity shortages, it provided relief through maturity rollover at penalty rates, but this often came very late in the crisis and failed to prevent the damage.[29]

Multilateral arrangements for orderly workouts for sovereign debt should be efficient in that they should seek to contain the damage inflicted by debt servicing difficulties on the debtor and allow rapid recovery and growth, as in national bankruptcy procedures in many advanced economies, such as Chapter 11 of the United States Bankruptcy Code. They should also be fair in the distribution of the burden, making creditors bear the full consequences of the risks they have taken – risks which have already been compensated by handsome premiums. To the extent possible, debt restructuring including rollovers and write-offs should be based on negotiations between the debtor and creditors, and facilitated by the introduction of automatic rollover and CACs in debt contracts. However, impartial arbitration is needed to settle disputes in the case of failure to reach agreement over the terms of restructuring.

29. For a discussion of Fund-led debt restructuring in emerging market crises see Akyüz (2002).

Existing procedures for official debt workouts also need a fundamental change. Decisions on restructuring such debt are currently left to a club of creditors – the Paris Club – and are tied to IMF structural adjustment programs and sustainability assessments. Sustainability is often judged on the basis of how much debt and debt servicing a country can tolerate without adequate attention to its implications for development and poverty. Furthermore, political considerations often dominate debt-relief outcomes. It might be highly desirable to delink official debt restructuring from the IMF, and leave debt sustainability analysis to an independent body of experts, appointed with the consent of the debtors. The Fund, the Bank and United Nations agencies could provide inputs to this process in their respective areas of work. Debtor countries should also be allowed to submit their own analyses of sustainability. Consideration should also be given to establishing impartial arbitration for official debt disputes along the lines of Chapter 9 of the United States Bankruptcy Code which deals with public debtors and applies the same principles as Chapter 11.[30]

4 SUMMARY OF POLICY CONCLUSIONS AND PROPOSALS

4.1 Immediate policy response

a) DEEs should not incur heavy burden in order to respond to fallouts from a crisis they cannot be held responsible for.

b) DEEs facing payments constraints should not be denied the right to use legitimate trade measures in order to mitigate the impact of the crisis on jobs, incomes and poverty. Such actions should not be put in the same pot as import restrictions and subsidies introduced in advanced economies not facing similar constraints.

c) DEEs should be encouraged to use temporary capital account restrictions and debt standstills in order to stem large and sustained outflows of capital. These should be supported by the IMF, where necessary, through lending into arrears.

d) Any additional financing the DEEs may need in order to respond positively to shocks from the crisis should be unconditional, non-debt creating and/or at low-cost. This can best be achieved by SDR allocations rather than grants or IMF lending funded by bilateral borrowing from its shareholders:

- A one-off permanent SDR allocation to low-income countries based on their need, with the interest costs of withdrawals being financed internally by the IMF.

30. For the rationale of an international chapter 9 insolvency see, Raffer (1993).

- A large reversible SDR allocation to other DEEs.

e) There should be a moratorium on debt servicing by low-income countries to official creditors, including the Bretton Woods Institutions, at no additional costs.

4.2 Crisis prevention: multilateral policy surveillance

a) There is a need to significantly improve the effectiveness, evenhandedness and the quality of IMF surveillance over macroeconomic, financial and exchange rate policies. This is needed to secure greater multilateral discipline over policies in systemically important countries and bring greater coherence between trade and finance in this respect. Improvements are also needed to provide early warning for risks of macroeconomic and financial instability.

b) Meeting these objectives depends very much on addressing the governance-related shortcomings of the Fund. Current arrangements suffer from a conflict of interest whereby Executive Directors pass judgement on surveillance of policies of the countries they represent. A solution could be formal separation of surveillance from lending decisions, entrusting it to an independent body.

4.3 Crisis prevention: International reserves system

a) The current multiple-currency reserves system centred on the dollar is highly unstable. It is very costly for DEEs which are compelled to hold large amounts of reserves as self insurance at the expense of growth and development. It should be replaced by a system not based on national currencies.

b) An SDR-based reserve system appears to be the most viable option. This calls for fundamental changes in current arrangements regarding the allocation and use of SDRs.

c) A way forward is to make the IMF an SDR-based institution by allowing it to allocate SDRs to itself to replace quotas, GAB and NAB and to become the only source of funding. This would also improve the governance of the IMF by removing its dependence on major countries for funding. SDR allocations could be linked to growth in world trade in a countercyclical manner. Under such an arrangement non-conditional access limits should be redefined and widened significantly.

d) This could be supplemented with an arrangement to allow existing reserve currency holdings to be replaced with SDRs without causing disruptions in currency markets. This can be done through a substitution account at the IMF, extensively discussed in two previous episodes of significant dollar weaknesses in the early 1970s and 1980s.

e) However, care should be taken in following this course, particularly to ensure that the exchange rate risk does not fall on the IMF including its poor members; and that the SDR does not become a new instrument of speculation.

4.4 Crisis prevention: regulation of international financial markets

a) The principle that could guide the approach of DEEs to regulation of financial institutions, markets and instruments could be to retain sufficient domestic policy autonomy while seeking to reduce their vulnerability to instability and crises through regulation and supervision of transnational players with border-crossing activities.

b) A supreme international body with fully-fledged regulatory and supervisory powers is neither realistic nor desirable. This is also true for replicating WTO in the area of finance, with binding multilateral agreements on rules and standards to be applied by national governments and sanctions for non-compliance.

c) Such an arrangement could entail serious loss of autonomy and lead to one-size-fits-all. Moreover, there is the risk that the process designed to broaden the scope of global governance over finance may end up extending the global reach of financial markets, forcing DEEs into granting greater market access in financial services than would be appropriate.

d) In assessing various proposals for regulatory reform of global financial institutions and markets, DEEs should pay attention to what these proposals could offer in reducing their vulnerability by:

- Reducing pro-cyclicality in international bank lending to DEEs;
- Reducing the bias against DEEs and pro-cyclicality in ratings by international rating agencies;
- Improving the quality of assets in which DEEs invest their reserves and private savings; and
- Improving the information on international portfolio investors in DEEs.

e) DEEs should also resist giving the IMF a greater role in financial surveillance and monitoring before undertaking a thorough examination of the reasons why its ROSC and FSAP activities have been highly ineffective and removing them through appropriate reforms.

4.5 Crisis intervention and resolution

a) In providing international liquidity the Fund should not impose structural conditions; nor should it insist on macroeconomic policy adjustments when payments imbalances are due to temporary external shocks beyond the control of the borrowing country.

b) IMF bailouts of international lenders and investors in countries facing rapid exit of capital undermine market discipline, encourage imprudent lending, shift the burden onto debtors and threaten the Fund's financial integrity. The IMF should not finance large and sustained capital outflows, but encourage involving private creditors and investors in the resolution of balance-of-payments and debt crises in emerging economies.

c) The rights of countries experiencing large and sustained capital outflows to exercise temporary debt standstills and exchange controls should be recognized; and they should be granted statutory protection in the form of stay on litigation.

d) To the extent possible restructuring of sovereign debt should be based on negotiations with private creditors and facilitated by inclusion of rollover and collective action clauses in debt contracts. But an international system of impartial arbitration is needed to settle sovereign debt disputes.

e) Sustainability analyses in official debt restructuring exercises should be taken from the IMF and given to an independent body of experts. Consideration should be given to introducing arbitration for the restructuring of official debt of DEEs.

4.6 Further areas of reform of the IMF

a) Several of the above measures needed for reducing the likelihood of financial crises with global repercussions and ensuring better crisis intervention call for fundamental changes in the IMF. There are also additional reforms that need to be undertaken, particularly in its governance and mandate, in order to enhance its effectiveness and relevance.

b) There has been considerable debate on the shortcomings in the Fund's governance in several areas including the selection of its head, the distribution of voting rights, transparency and accountability, and no further remarks would be needed here. However, it should be emphasised that reforms at least in two areas discussed above may produce significantly greater improvement in the governance of the Fund than changes in areas emphasized in public debate:

- Ending the dependence of the IMF on its shareholders for funding through quotas and bilateral lending (GAB and NAB) by translating it into an SDR-based institution.
- The separation of surveillance from program lending and giving the task to authorities who are independent of their governments and who are not involved in lending decisions.

c) The Fund needs to focus on its main responsibility of safeguarding international monetary and financial stability. Consequently:

- It should stay out of development finance and policy and poverty alleviation. This is an unjustified diversion and an area that belongs to multilateral development banks. All facilities created for this purpose should be transferred to the World Bank as the Fund terminates its activities in development and long-term lending.
- It should also stay away from trade policies. Its attempts to promote unilateral trade liberalization in DEEs drawing on its resources undermine the bargaining power of these countries in multilateral trade negotiations. In this area its main task is to ensure a predictable global trading environment by helping secure stable payments positions and exchange rates.

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ZHOU, X. Reform the International Monetary system. **People Bank of China**, 23 Mar. 2009. Disponível em: <http://www.pbc.gov.cn/english>.

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Composed in Adobe Garamond 11/13.2 (text)
Frutiger 67 Bold Condensed (headings, graphs and tables)
Printed on offset 80g/m^2
Card stock 250g/m^2 (cover)
Brasília – DF – Brazil

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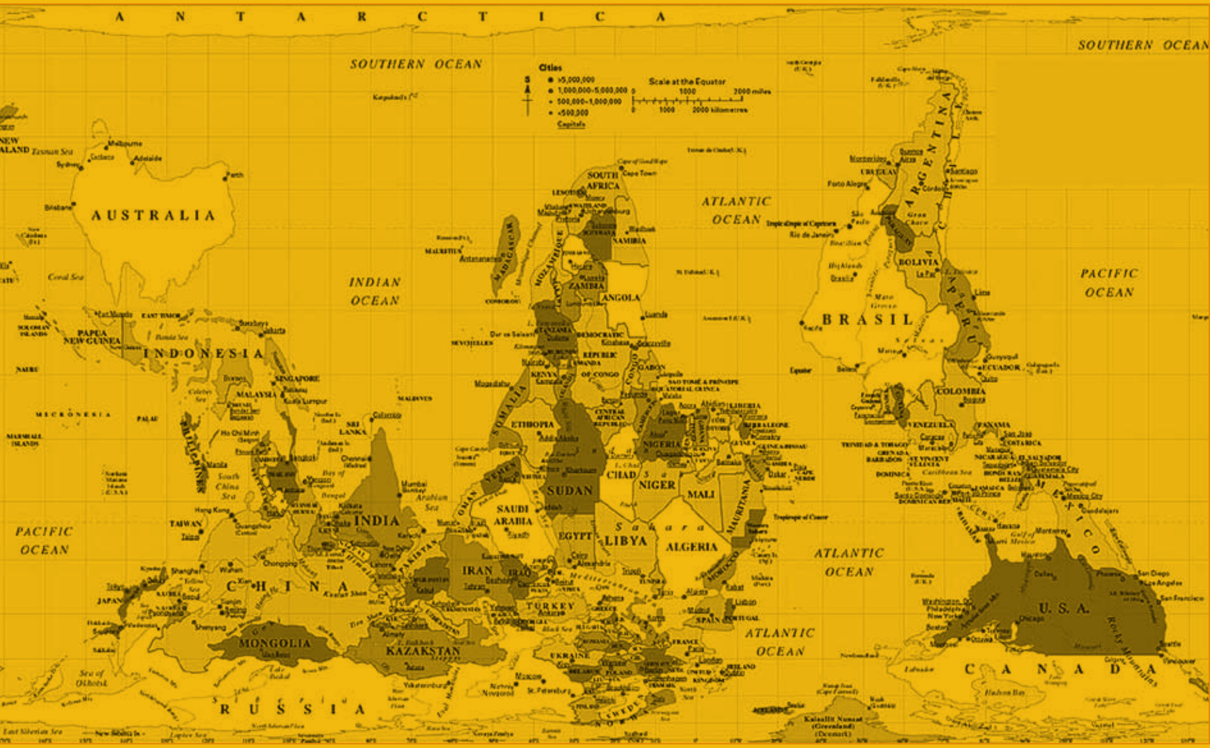

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ISSN 2177-0255