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Best practices, policy *convergence and* the WTO trade-related *investment measures*

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International experience shows that cost-free replication and adoption of industrial best practices on a universal basis is a misconception. Rather, it is a matter of a progressive and reciprocal adaptation between external and local practices in which learning costs and times are an essential factor. The potential for convergence of policies, practices and institutions triggered by globalization appears to be greater at the macroeconomic than at the microeconomic level. This article first examines such issues in a general way and then focuses on the dilemmas facing the countries of the Association of South East Asian Nations (ASEAN) and other developing countries of Asia in their efforts to comply with the World Trade Organization's Trade-Related Investment Measures (TRIMS) by the year 2000. The experience of these countries is of special relevance to other developing regions, Latin America and the Caribbean in particular, in view of the difficulties arising in the race against time to reconcile those commitments with national development objectives.

I

Introduction

Globalization has put the issue of the international convergence of production practices, policies and institutions on the world's economic agenda. The spread of universal best practices, such as those agreed by a large number of WTO member countries, appears to have become inexorable and, at the same time, to be easing the way towards a level playing field in the international economy. The deadlines involved for the adaptation of national policies to uniform and universal standards impart an added sense of urgency and priority, underscored by the impact they will have on economic and social development in the developing countries and the economies in transition (the former centrally-planned economies).

The force and speed of the move towards policy convergence is undeniable. Of the 109 developing countries and economies in transition that have launched major market-oriented reform programmes, 75 have done so since 1989. At the same time, 104 of the 131 member countries of the WTO are developing countries, while another 28, including China, Russia and Taiwan, are actively negotiating their entry (Sercovich and others, forthcoming, chapter 2).

These figures reflect a general trend towards the withdrawal of the State as a direct economic agent and an evolution instead towards more open economies and more deregulated and competitive markets. This should not lead us, however, to minimize the importance of international policy convergence or to jump to hasty conclusions about the loss of degrees of freedom at the national level (Sercovich and others, forthcoming; De María y Campos and Sercovich, forthcoming).

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According to the World Trade Organization's TRIMS agreement,¹ by the year 2000 the developing countries (and by 2002, the least developed countries) will have to abolish all restrictions on foreign direct investment that affect imports, exports or foreign exchange balances, including local content rules.

Typically, such regulations are part and parcel of industrial development programmes with horizons that go far beyond the year 2000 (as notably in the case of some South East Asian countries). We may consequently wonder what the situation will be like once the brief period of two years separating us from that date has elapsed.

These circumstances are likely to bring about requests for waivers and exemptions from the enforcement of TRIMS deadlines by a number of WTO members and, even more so, by countries which are still negotiating their entry. Such requests were already being prepared before the growth crisis that began in Thailand in mid-1997 and then spread to the whole of South East Asia and beyond, and will probably be further encouraged by it.² Both groups of WTO members will seek to secure authorization to

¹ For the text of this Agreement, see the Final Act of the WTO (Marrakesh, 1994), annex 1A.

² The crisis of the second half of 1997 has unleashed two forces acting in opposite directions. On the one hand, the slowing-down of investment plans due to the accumulation of stocks and excess production capacity will cause delays in attaining the objectives of national development plans and, hence, strong pressures to seek to extend the WTO deadlines, while on the other, the crisis is also helping to lower ambitious modernization and technological development goals. All in all, it is unlikely that the net result will favour the equally ambitious objectives pursued by WTO 2000 in terms of convergence. There is a wide variety of situations in this respect. On the one hand, the East Asian countries will be faced for the first time with the problem of unemployment (in the absence of effective social security arrangements). It is estimated that the dramatic fall in growth rates will lead to two million unemployed in Thailand, 1.5 million in South Korea and 200,000 in Malaysia. The latter country has already begun to reverse its policy of generalized progress towards capital- and technology-intensive manufacturing activities and is now welcoming foreign-owned manufacturing operations that make intensive use of labour, in so far as they are aimed at supplying foreign markets (see the official announcement by Malaysian Prime Minister Dr. Mahathir in *The Star*, 1997). Although energetic measures are being taken all

comply with the policy changes involved only when the activities they are promoting for their future development become sustainably competitive, and not before. Thus, a resurgence of debates on the legitimacy of the forms and periods of application of the infant industry argument can be expected (since the validity of the argument itself would be beyond question).

If the uneven manner in which policy convergence is taking place becomes still more pronounced, particularly from the interregional and intersectoral perspectives, so that the "particular difficulties" allowed for in the WTO agreement are extensively resorted to, the necessary universality in the application of the TRIMS, together with the desired levelling of the playing field, may be jeopardized.³

This raises the more general question of whether universal, preemptory compliance with a uniform set of rules is the best route to a level playing field. More precisely, it questions the possibility of defining universal international best practice rules that can be

applied by all countries, regardless of their stage of development and national conditions, in a uniform manner, without net costs and within the space of a few years. The ultimate question is: can a balance be struck between the rewards for those who comply punctually and meticulously with the agreed rules and the penalties for those who do not?

The following sections do not purport to completely clarify these questions, but merely to deal with some dimensions of the problem from an interregional and sectoral perspective, with the aim of providing some elements for a more exhaustive study.

In the following section, the general question of convergence is addressed, after which we review the question of the "replicability" of best production practices and policies in the light of disparities in initial conditions and strategic challenges, finally going on to assess the various uncertainties and disparities raised by the countdown to the year 2000 in the specific field of TRIMS, from an interregional and sectoral perspective.

II

Verification of hypotheses on convergence of levels of productivity and income

The formulation of hypotheses and predictions on the inter-country convergence of levels of productivity and income is based on the theory of economic growth, whose basic conceptual foundations were laid by the classical economists and their direct successors.⁴ Among these foundations are the role of decreasing returns in the accumulation of physical and human capital, the relation between per capita

income and population growth, the effects of technological progress on the specialization of labour, and the influence of monopoly power on technological progress.

The neoclassical growth models predict a conditional form of convergence whereby, the lower the initial level of the real per capita GDP of a country compared with its steady-state level, the higher its

over the subregion to impose fiscal austerity and contain aggregate demand, in the case of Malaysia this is being done in preparation for an agreement with the International Monetary Fund (IMF), including the recent submission to the WTO of a programme for the liberalization of the financial sector. Thailand, for its part, is postponing its programme of tariff reductions in the chemical sector, while Indonesia's latest agreement with the IMF eliminates the tax exemptions for the Timor project. In the Southern Cone of South America, Chile has announced a reduction in the average tariff level from 11% to 8% as from 1998, at the same time that MERCOSUR has decided to raise the group's common external tariff by 3% for three years, from 12% to 15%. Although *The Economist* (1997, "The Americas" section) has taken an unusually tolerant and understanding attitude to this increase, the European Union has already expressed its

concern in this respect (see the statements by A. M. Campogrande, Principal Foreign Relations Administrator of the European Union, in *Estrategia*, 5 December 1997).

³ "On request, the Council for Trade in Goods, may extend the transition period for the elimination of the TRIMS ... for a ... Member...which demonstrates particular difficulties in implementing the provisions of this Agreement. In considering such request, the Council ... shall take into account the individual development, financial and trade needs of the Member in question" (Para. 3, Art. 5 on Notification and Transitional Arrangements of the TRIMS Agreement).

⁴ These include, in addition to Adam Smith, David Ricardo and Thomas Malthus, economists of the present century such as Frank Knight and Joseph Schumpeter.

growth rate will be because of a higher relative return on investment, provided we leave out of the reckoning all differences between countries as regards rates of saving, initial levels of human capital, population growth, government policies and technological change.

The neoclassical theory of growth lost its significance as a field of research as from the early 1970s because it was not empirically relevant. Since then, macroeconomic research has concentrated on short-term fluctuations. The growth theory was revived towards the mid-1980s, however, when a period of great intellectual activity in this field began.⁵

What are the conclusions reached by the available empirical studies on the hypothesis of the convergence of levels of productivity and income? Comparison of the evolution of real per capita GDP in 129 countries during the period from 1960 to 1990 indicates that the degree of dispersal has increased: the per capita GDP of the most advanced country in the sample (the United States) increased from 39 times that of the most backward country (Ethiopia) in 1960 to 65 times its level in 1990. At the historical growth rate of Japan between 1890 and 1990

(2.75%), Ethiopia could come close to the 1990 level of the United States by 2149, but at the more modest historical growth rate of the latter country (1.75%) it would only do so by the year 2236 (Barro and Sala-i-Martin, 1995, p. 3).

The average annual real per capita GDP growth rate between 1960 and 1990 for a sample of 114 countries was 1.8%, with South Korea (6.7%) at one extreme and Iraq (-2.1%) at the other. A further 16 countries in the sample, mostly from Africa south of the Sahara, also registered negative growth rates. In other words, a representative country of that region would take 30 years to grow by a factor of 1.3, while South Korea would grow by a factor of 7.4 in the same period (Barro and Sala-i-Martin, 1995, pp. 3-4).

In short, the hypothesis that the more backward the initial position of a country in terms of real per capita GDP, the higher will be its growth rate, has not been confirmed, except in the conditional sense defined above. Even in such a hypothetical scenario of a world which is totally homogeneous except in levels of growth, however, the rate of convergence would be so slow that the elimination of the gap between the current real per capita GDP and its long-term level would take at least 70 years.

In the particular case of Latin America, the available estimates indicate that the gap between total factor productivity in that region, on the one hand, and in the advanced recently-industrialized economies of East Asia, on the other, has widened markedly since the end of the Second World War, especially since the mid-1960s (Ramos, 1997). Nor is there any confirmation of convergence between the levels of labour productivity in the manufacturing sectors of Latin America and the United States over the period from 1970 to 1994, except in the 1973-1982 period (Benavente, Crespi, Katz and Stumpo, 1996).

If we look into the dimensions of such divergence beyond the hypotheses of growth theory, a distinction may be seen between economic convergence (i.e., convergence of productivity levels and standards of living) and institutional convergence. The latter refers to the multiple forms of relations between the market, public policy and public and private associations and organizations, which vary widely in the factor and product markets. In this sense, the convergence would appear to take the form of a growing affinity of forms of institutions and responses to political, social and economic imbalances of an external or domestic nature.

⁵ The emergence of this new growth theory marks an epoch-making break with the tradition (and irrelevance) of the neoclassical assumptions. Instead of perfect markets it posits that markets are imperfect, the idea of an abundance of public goods takes the place of the possibility of complete private appropriation, increasing returns replace the idea of decreasing returns, and endogenous technological change replaces exogenous technological change. In these conditions, and particularly in the presence of monopolistic appropriation of the fruits of investment in scientific and technological research, the growth rate does not necessarily have to fall in the presence of high levels of capital accumulation per employed person, while the influence of government policies on the growth rate through their impact on the degree of openness of the economy, the rate of saving, the educational level, the spread of technology, etc., does assume importance. Thus, although the new growth theory still fails to provide answers in many cases, it is reconciled with reality and once again feeds empirical research and receives feedback from it. In particular, it makes it possible to reconsider the predictions regarding conditional convergence. In an "agnostic" interpretation of the contribution of the new growth theories, Nelson (1997) notes that much of the formal modelling of these theories is carried out at the expense of their actual pertinence and consists of the belated adoption of existing empirical observations. Thus, for example, it assumes perfect predictability (or a correctly specified distribution of the probability of occurrence of future events), it ignores differences between the models of business management and institutional organization, and it leaves out the question of technological learning. An important methodological reason for this is that the respective models try not to depart too much from the basic ideas of general equilibrium theory.

The viability of types of economic performance which are comparable over the long term may be compatible with very different institutional configurations (see the distinction between macro and micro convergence later in this article), so that the purview of heterogeneity in institutional matters is considerably broader than it is in the strict sense of the stylized variables of growth theory.

If, as we have seen, the hypothesis of economic convergence is difficult to confirm, then it is much harder to confirm that of institutional convergence,

which is seriously weakened by the persistence of specific national conditions (Boyer, 1996).

In the final analysis, the debate on convergence boils down to the rivalry between different civilizations and their influence on the configuration of the world order in terms of the acceptable degree of diversity. The relation between universality and specificity has been the subject of a very long-standing controversy which has now been renewed by the changes that have taken place since the end of the Cold War (see Huntington, 1997, especially chapter 12).⁶

III

“Replicability” of best practices in the light of disparities in initial conditions and strategic challenges

In contrast with the hypothetical convergence towards best international production and policy practices, the developing world has faced a growing differentiation in recent decades. This has had two main effects: on the one hand, a gradation between economic and social winners and losers and, on the other, sharply differing policy dilemmas and challenges that considerably reduce the scope for transferring and reproducing successful experiences. The diversity of initial conditions displayed by the developing countries and the economies in transition mean that the challenges faced have a high degree of specificity.

In order to give some idea of the nature of the problem, box 1 shows the diversity of strategic challenges faced by four categories of countries: i) newly open economies (NOEs: i.e., countries which have moved from inward-looking to substantially open economies integrated into the world market); ii) successful industrializing countries (SICs: i.e., those of East and South East Asia); iii) economies in transition (which comprise the former centrally planned economies); and iv) least developed countries (LDCs: comprising several dozen of the world's poorest economies). Apart from sharp intra-group contrasts of a historical, geographical, economic, social and institutional nature (for example, the Central European economies in transition which are joining the European Union are making faster progress towards

convergence than their Central Asian counterparts), the differences in policy challenges between these four groups of countries have acquired historical proportions, associated with stages of development almost as distinct as those that exist between them, on the one hand, and the advanced industrial countries (AICs) on the other.⁷

⁶ Huntington (1997, pp. 309-311) holds that those who do not acknowledge the fundamental divisions (between civilizations) are doomed to be frustrated by them. He goes on to explain that the diversities of cultures and civilizations challenge the Western—and above all United States—belief in the universal validity of Western culture. At the descriptive level, this belief holds that the peoples of all societies wish to adopt Western values, institutions and practices, while at the normative level it holds that all the peoples of the world wish to embrace Western values, institutions and culture because they enshrine the loftiest, most enlightened, most liberal, rational, modern and civilized thinking of mankind. This belief suffers from three problems, asserts Huntington: it is incorrect, immoral and dangerous, so that the most prudent course for the West is not (like Brutus) to try to freeze power shifts but to learn to swim with the current, combat misery, refrain from adventures, and protect its own culture. The ideas of individual liberties, political democracy, the rule of law, human rights and cultural freedom were born in the West, and Western civilization is valuable not because it is universal but because it is unique. Lian and Oneal (1997) have not found any systematic association whatever between the different cultures (ethnic, religious or linguistic) and economic performance.

⁷ For more details, see Sercovich and others (forthcoming), chapter 2.

Box 1

SPECIFICITY OF STRATEGIC CHALLENGES IN TERMS OF COMPETITIVENESS, BY COUNTRY CATEGORY

| Country category | Key policy challenges |
|--|---|
| Newly open economies | To couple opening of the economy with consolidation of the manufacturing sector's competitive sustainability |
| Successfully industrializing countries | To make the transition towards improved manufacturing competitiveness founded on endogenous innovation and technical change |
| Economies in transition | To effect a fundamental redefinition of the role of the State, upgrade human capital, establish a market system, restructure industry, modernize management systems and close or eliminate important structural adjustment gaps |
| Least developed countries | To ensure the viability and sustainability of reform processes by enhancing domestic supply response via structural change, resource accumulation and an incentive regime to match the stage of evolution of the economic and social structure and institutional restrictions |

Source: Sercovich and others (forthcoming).

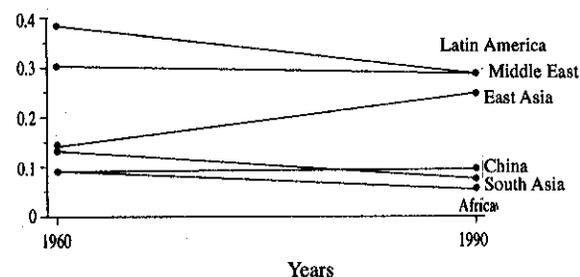
At one extreme of the spectrum, for instance, there are the countries which have substantially overcome most of the obstacles to convergence in income and productivity with the developed world within a matter of a few decades, while at the other extreme there are those which have yet to emerge from relative or absolute backwardness. The former are now aiming to generate domestic sources of innovation and technical change, while consolidating their progress towards higher unit value-added activities. The latter are still trying to find socially viable ways of achieving institutional and social progress and sustainable ways to accumulate resources in an open economy, institute markets and develop the skills and capabilities required for structural change. The NOEs and economies in transition, for their part, are pursuing totally different routes that demand profound changes in their economic regimes, strategic orientations and linkages with the world market.

Figure 1 provides a graphical illustration of the foregoing. If we compare the evolution of the per capita incomes of the developing countries, as a percentage of the per capita income of the developed countries during the period from 1960 to 1990, in terms of purchasing power parities, we may conclude that the East Asian countries have been the only ones which have managed to narrow the gap, which remained unchanged in China and grew still wider in Africa, Latin America and the Caribbean, South Asia and the Middle Eastern countries.

FIGURE 1

Convergence?, 1960-1990

Per capita income, as a percentage of that of the industrialized countries



Source: Summers and Heston (1994), Penn World Tables Mark 5.6.

Such a wide range of challenges highlights the difficulty in devising universal, ubiquitous policy packages.⁸ To expect countries passing through periods which are historically so diverse in terms of the features and rates of their institutional, social, economic, technological and educational evolution to converge in their policies within a few years would be an illusion.

⁸ See Sercovich and others (forthcoming), especially part III.

Box 2

LEAN PRODUCTION, SKILL DEVELOPMENT AND CORPORATE GOVERNANCE:
THE LIMITS TO CROSS-BORDER REPLICABILITY OF "BEST PRACTICES"
AMONG MEMBERS OF THE "CONVERGENCE CLUB"

| "Best practice" and country of origin | Key attributes in the country of origin | Restrictions on its replicability |
|---|--|---|
| 1. Lean production ^a (Japan) | <ul style="list-style-type: none"> - Decentralization of responsibility, elimination of "dead time" and induction of constant work effort among the labour force - Team work, polyvalent skills - Motivation through "stress" and "reciprocal obligation" | <p>In Germany: Skills are occupational, standardized and portable rather than being general and focussed on firm-specific organizational and labour environments, as they are in Japan. The portability of skills facilitates labour mobility among independent enterprises; non-portability favours labour markets <i>internal</i> to the firm or conglomerate. In Germany, priority is given to workers' commitment to their own performance and labour ethos rather than to their loyalty and devotion to their employer. Performance prevails over seniority and team work rests on individual skills rather than on team capabilities as such</p> |
| 2. Technical training (Germany) | <ul style="list-style-type: none"> - Efficient mechanisms for collective bargaining between employers and employees; low pressure for unit labour cost increases; aversion of trade unions to inflation and protectionism - Training is an explicit component of collective bargaining - Trade unions respond to technical change by demanding upgrading of skills and an increase in the proportion of skilled workers in the labour force | <p>In France: The tradition of employer control and the propensity for conflictive labour relations have blocked the assimilation of the German model of a tripartite government/enterprise/trade union dialogue which is vital for reaching consensus on effective and sustainable technical training programmes</p> |
| 3. Corporate governance (United States and Japan) | <ul style="list-style-type: none"> - Minimization of transaction costs (Japan), versus - Minimization of agency costs (United States) | <p>In the United States and Japan: Each of these countries has advanced in a particular dimension of the dichotomy between transaction costs and agency costs, so that they have corporate governance systems which are not mutually replicable. Similar contrasts between the United Kingdom and Germany have blocked progress towards common European legislation in this field</p> |

Source: Based on Berger and Dore (eds.), 1996.

^a Applies to manual work in assembly operations.

If the assumption that there can be similar paths, analogous policies and similar strategic guidelines for carrying out such diverse processes of change is open to doubt, these doubts become still greater when we see that, even among the countries which are members of the "convergence club" (i.e., the most highly developed countries), replication of best practices is hindered by the substantive disparities that exist among them. Box 2 gives some examples of this.

It is generally acknowledged that the principles of lean production, which originated in Japan, have produced a quantum leap as compared with traditional Fordism, so that they can be considered as exemplifying an international best practice worth emulating. Indeed, this has been the direction followed by enterprises around the world, particularly in the developed countries, including Germany. As shown in box 2 with respect to the case of Ger-

many, however, different institutions, practices and forms of social conduct have significantly narrowed the scope for the general application of the principles of lean production outside Japan.

France and the United Kingdom are known to have encountered difficulties in trying to emulate the efficient German practices in the field of training and skill formation. Indeed, France has failed not only in its attempts to replicate German practices in education and training but also in research and development, labour relations and industrial restructuring. Latin America and the Caribbean has also experienced serious problems in trying to follow the example of the German dual technical training system owing, among other things, to poor standards of basic education. The lack of a tradition of public-private cooperation in this field has also been an important factor.

Let us now look at what may be considered best practice among the advanced countries in the field of corporate governance. Management practices based on large industrial conglomerates in countries such as Germany, Italy, Japan, South Korea and Switzerland – typified by the Japanese *keiretsu* and the South Korean *chaebol* – are more efficient in terms of lower transaction costs due to the use of implicit contracts and permanent, stable and foreseeable relationships among enterprises. On the other hand, the Anglo-American system facilitates lower agency costs associated with the separation between ownership and control. What represents an advantage in one system translates into a disadvantage in the other and vice versa. An analogous contrast exists within the European Union (with Germany and the United Kingdom at the antipodes, and France and Italy somewhere in between), which has led to a paralysis in the timetable for advancing towards a common business legislation. This suggests that there may be not just a single best practice but a multiplicity of best practices in any given field, associated with country-specific historical, institutional and social organization legacies.

If the workability of convergence beyond the limits of national autonomy is still in doubt in the monetary and fiscal spheres (as illustrated by the problems of launching the European common cur-

rency), the impact of globalization on the domestic microeconomic scenarios raises even stronger doubts, in view of the considerable differences in national institutions, policies and practices.⁹ Divergences in the microeconomic domain are greater and more resistant than those at the macroeconomic level, since they involve more deeply-rooted national institutions, practices and traditions. This challenges the hypothesis that globalization reduces national states to a condition of irrelevance, passivity and impotence.

Evidence that microeconomic policies and institutions can be successfully replicated across borders is not very convincing: indeed, the number of cases of failure may well exceed those of success. Best practices espoused in the management literature mostly refer to issues of operational efficiency. Yet, the essence of entrepreneurial strategies and related public policy guidelines concerns choices among alternatives specific to the economic and social milieu. The possibility of replication of techniques geared to improve operational efficiency, such as total quality control or “time-based” competition, must pass the acid test of the adaptation of such techniques to a specific entrepreneurial environment (Porter, 1997).

Technological learning, production of public goods, the formation of skills and capabilities and the promotion of the use of increasing returns to scale are spheres of national policy that even the governments of the most advanced countries are reluctant to leave in the hands of the market, whether visible or invisible.

Rather than universally superior practices, there are usually ranges of best practices which are normally hybridised during the process of adoption and adaptation to specific national conditions.

⁹ Thus, for example, it is still to be shown whether it is possible to link German orthodoxy at the macroeconomic level with Anglo-American *laissez-faire* at the microeconomic level. With regard to the developing countries and the economies in transition, Rodrik (1996) has noted that the consensus on what constitutes suitable structural reforms is based on theoretical and empirical foundations which are much more fragile than those of the consensus on the need for macroeconomic stability.

IV

WTO 2000: a comparative subregional and sectoral perspective

1. The challenge

The diverse rates and approaches countries are taking in the countdown towards 1 January 2000, when the period of transition to comply with TRIMS expires, offer insights into disparities in microeconomic policy. There seems to be no consensus as to what the precise meaning of such a transitional period is, but there appear to be two main approaches.

Some countries are using the transition period as a time of progressive convergence towards the situation which is scheduled to prevail as from 1 January 2000, in order to arrive at that date with their houses in order. Other countries, however, see it as a race against time: something like a last chance to employ policy instruments and practices which, as of 2000 (or 2002 for the least developed countries), will be prohibited because they will be considered as bad practices and duly punished. What these countries are trying to do is to place themselves in the best possible position in terms of technological learning and manufacturing competitiveness, while seeking to postpone the deadlines for compliance by resorting to exception mechanisms.¹⁰

The recent escalation of the number of disputes before the WTO appears to be related to some extent with this diversity of approaches. Between January 1995 and September 1996, 54 disputes concerning 34 regulations were brought before the WTO, compared with 196 disputes during the 47 years of GATT's existence. This increase is symptomatic of a high rate of activity connected with accommodation to the new international economic order, as well as a heightened awareness of the need for reciprocal monitoring. Table 1 gives an idea of the geographical distribution of the cases brought before the WTO by developed countries regarding developing countries' practices during the period in question.

¹⁰ This distinction is not so clear when the measures are part of policy packages agreed upon in the context of economic integration treaties.

TABLE I
Cases brought before the WTO by developed countries between 1 January 1995 and 18 October 1996

| | Number of cases | Percentage |
|----------------------------|-----------------|------------|
| Asian developing countries | 11 | 65 |
| Other developing countries | 6 | 35 |
| Total | 17 | 100 |

Source: Asian Development Bank (1997).

According to the Asian Development Bank, of 25 disputes submitted to the WTO dispute settlement machinery involving Asian developing countries (either as plaintiffs or as respondents), six relate to the automobile industry, while the remaining 19 are spread throughout ten other sectors. As one of the sectors most exposed to such trade disputes, this industry probably best illustrates the diversity of rates and styles of accommodation to the new international economic order.

This brief sketch of the situation cannot leave out China, whose influence permeates the whole of the Asia-Pacific region and beyond. China is unlikely to agree to comply, except at best partially, with the WTO disciplines before 2010 at the earliest, even though it is the world's fifth largest trading power and the recipient of 35% to 40% of total foreign direct investment flows going to developing countries and economies in transition (the ambiguous position of Hong Kong, which is a WTO member but is now part of China, cannot be expected to simplify or shorten these times). This of itself raises vital questions as to how level the playing field will be as of 1 January 2000.

2. ASEAN policies for the automobile industry

The world automobile industry is expected to reach a capacity to produce more than 210,000 vehicles per day by the year 2000 (compared with 178,000 today), and more than 40% of world excess capacity will be located in Asia (Deloitte & Touche Consulting Group, 1997).

As may be seen from table 2, within ASEAN Thailand is the main assembler, accounting for some 40% of current supply, followed in descending order by Indonesia, Malaysia, the Philippines and Vietnam.

Thailand is taking advantage of its privileged position *vis-à-vis* its ASEAN partners in terms of its domestic market size, good infrastructure, accumulated experience and development of the auto parts industry. It plans to become the Detroit of ASEAN and is therefore pursuing a much more open policy than its subregional partners.¹¹

Almost all of the large world automobile enterprises (and a good many of their respective suppliers, particularly those of Japanese origin) have set up shop in Thailand already or are about to do so. The case of General Motors (GM) merits special mention, as it has negotiated a US\$ 750 million investment in Rayong to produce 100,000 units annually as of 1999, 70% of which will be destined for export markets starting from the second year of operation. GM expects that some 30 of its component suppliers, particularly the European suppliers of Opel in Germany, will follow it to Thailand or other neighbouring countries, since intra-ASEAN trade will be almost fully liberalized as of 2003.¹²

GM has benefitted from incentives for investment in rural areas, duty-free machinery and equipment imports for two years and tax exemptions on export income for eight years, followed by a 50% tax reduction during the following five years. It will also enjoy an income tax reduction for ten years amounting to as much as 25% of its investments in infrastructure and 200% of its expenses for transportation, electricity and water. Import duties on some raw materials will also be reduced. Furthermore, the Thai Government has agreed to finance a US\$ 15 million investment to set up an education and training centre. The most salient and unusual feature of the deal negotiated between the Thai Government and GM, however, is the cancellation of the local content rules for automobiles. Besides having traditionally been more open to foreign direct investment than its neighbours,

¹¹ It is estimated that Thailand has some 600 auto parts firms, 200 of which would be internationally competitive. Many of them are Japanese enterprises which relocated to avoid the high wage costs of Japan and the appreciation of the yen.

¹² Almost two-thirds of the units produced by Toyota in ASEAN countries have a local content of at least 40%. This figure will include products to be traded under the common preferential regime (AICO) which is to come into force in 2003 (*JEI Report*, 1997).

TABLE 2
ASEAN: Distribution of automobile supply
in 1995 and projection for the year 2000

| Country | 1995 | 2000 (projection) |
|--------------|------------------|-------------------|
| Thailand | 571 000 | 850 000 |
| Indonesia | 380 000 | 600 000 |
| Malaysia | 296 000 | 320 000 |
| Philippines | 129 000 | 275 000 |
| Vietnam | 15 000 | 60 000 |
| Total | 1 391 000 | 2 105 000 |

Source: UNIDO.

starting in 1998 (provided there are no unexpected delays) Thailand will be the only ASEAN country preparing to fulfill its TRIMS commitments under WTO 2000 in terms of both dates and content.¹³

By contrast, both Indonesia and Malaysia are pursuing their respective national car projects (dubbed "Timor" and "Saga", respectively). These include highly selective promotional regimes that comprise fiscal and tariff exemptions as well as subsidized financing,¹⁴ thus keeping prices considerably below those of the competition. Key features of these regimes are rules providing for gradually higher local content.

Malaysia, the relatively more advanced of the two, has been proceeding with an unusual blend of strong State support and entrepreneurial drive, particularly in terms of technology mastery.¹⁵ In 1996, Proton acquired an 80% share of Lotus, U.K., in order to have access to design technology and thus reduce its dependence on Mitsubishi, which has an 8% stake in Proton. Several Lotus engineers are now working for Proton's R&D division on the development of an integrated engine and gearbox system. Proton, which is now negotiating the purchase of Royal Begemann, a Belgian gearbox producer, for US\$ 126 million, is one of the key elements in Prime Minister Mahathir's plan to turn Malaysia into an industrialized country by the year 2020. It exports

¹³ GM took good advantage of intra-ASEAN rivalry, in this case between Philippines and Thailand, to attract investments. President Ramos had negotiated personally with GM's head the most enticing incentive package ever offered by the Philippines, including a free site for five years, compensation for investments in infrastructure, a training school worth US\$ 20 million and other typical sweeteners. The Philippine offer was useful to GM in its negotiations to induce the Thai Government to lift local content rules 18 months ahead of schedule.

¹⁴ See footnote 2 above.

¹⁵ For a detailed analysis of another similar interesting case, see Sercovich, 1980.

18-20% of its annual production to some 30 countries, including Australia, Chile, England, France, Indonesia and Singapore, with margins close to zero.

Malaysia's budget for 1997 includes incentives to limit imports of intermediate goods, parts and components, through the gradual elimination or reduction of tariff and sales-tax exemptions. Faced by the forthcoming constraints associated with its WTO commitments, the Malaysian Government is pursuing accelerated measures to deepen the industrial structure and foster greater use of domestic inputs, particularly intermediate and capital goods, through the development of industrial clusters, with activities ranging from final products to manufacturing and service support activities, in order to strengthen intrasectoral linkages, increase domestic value-added and reduce dependence on imports. Imports represent some 85% of the value of manufacturing exports, and capital goods imports still account for nearly half of the value of investment. All capital goods imports must be accompanied by export offset programmes, including the transfer of technology (*The Jakarta Post*, 1996a).¹⁶

The Indonesian Government has reiterated its strong commitment to the development of an independent automobile industry, favouring local ownership, development and use of domestic technology and enforcement of local content rules. So far only the "Timor" project, carried out by a local enterprise in association with the South Korean firm KIA, has qualified for special treatment. The Timor car is a four-door, 1600cc sedan whose domestic production is scheduled for 1998 after an initial year in which all completely built-up units (CBU) will be imported tariff-free for local sale. The cars will be exempt from domestic sales and luxury product taxes, so that they can be sold at around half the price of the competi-

tion. The project also enjoys subsidized financing and benefits from government procurement guidelines (*Business Times Malaysia*, 1996a, p. 2, and 1996b, p. 1).

The European Union, the United States and Japan have accused Indonesia of violating the non-discrimination and most-favoured-nation principles, as well as the TRIMS agreement, whereby its existing policy in the automobile sector should have been notified in 1995 and no new non-complying regulations should have been introduced since 1 January 1995. Since agreement among the parties was not reached in bilateral negotiations, the WTO has instituted a panel to settle the controversy along the procedural guidelines currently in force.¹⁷ It is considered that by the time the panel reaches a decision, Indonesia is likely to be beyond the point of no return in the execution of the project (although this has now become more doubtful because of the exchange and financial crisis that broke out in July 1997). A sharp disparity between generic and selective policies is apparent in ASEAN in general and Indonesia in particular. While being criticized by the largest trading powers for its policy in the automobile sector, Indonesia is also being commended by the World Bank as South East Asia's most liberalized economy since the deregulation package adopted in June 1996.¹⁸ Yet, this deregulation has not affected such non-tariff barriers as those relating to local content, investment licenses, government procurement and export restrictions on certain products. The current average rate of effective protection for 269 categories of manufactured goods is estimated at 52%. This level is due to go down over the next years as a result of scheduled reductions in nominal tariffs to between 0% and 5% in 1998 for one category of products and 20% in 2000 for another category (*Business Taiwan*, 1996).

For comparative purposes, table 3 gives information on local content regulations in the ASEAN countries and some other countries. It also shows the respective rules to be complied with by the enterprises and the effective local content levels achieved or programmed.

¹⁶ Government policy was clearly stated by Prime Minister Mahathir at the launching of the Seventh Plan, which runs until 2000: "Some people believe that the way to minimize the balance of payments deficit is to reduce the rate of growth of the economy. The simple answer is that it is necessary to reduce imports and increase exports. The local content of exports is still low and must be raised ... The worst thing to do is to slow down growth by increasing interest rates ... Domestic industry ought to produce everything that goes into the fabrication of the components of the final product. This way, increases in exports will not result in similar increases in imports. There will still be imports, but these will consist of low-value raw materials for the most part ... The Government will actively support R&D to increase the local content and enable domestic enterprises to manufacture goods bearing their own brands".

¹⁷ The stages in the dispute settlement process are: consultations (60 days), establishment of the independent panel, issue of its report and decision (between 6½ months and one year), approval of the panel's report (60 days), compliance with the decision or lodging of an appeal (three months), and final fulfillment (within a reasonable time agreed between the parties). More details of the complaints entered may be found on the WTO's page on the Internet (<http://www.wto.org>).

¹⁸ Statement by Dennis de Tray, Director of the World Bank's Jakarta Office, in *The Jakarta Post*, 1996b.

TABLE 3

**ASEAN and other Asian countries:
Local content rules and cases in the automobile industry ^a**

| Country | Automobiles | Commercial vehicles | Per capita MVA in 1993 (US\$) ^b |
|----------------|--|--|---|
| Indonesia | (up to) 65% | (up to) 30% ^c 40% (Bakrie pickup in 3 years) 60% | 167 |
| Philippines | 40% | 45% | 198 |
| Malaysia | (up to) 60% ^d 46%: Kijang Astra (60% in 1998) 75% (Saga Proton) 58% (Honda City) | 45% 70% (ILOKOM pickups and light trucks in 3 years) 17% (Prado Toyota Land Cruiser) 51% (Hicom/DRB/Isuzu trucks in 3 years) | 724 (1991) |
| Thailand | 54% ^e 60% (Honda City) 70% (Toyota Soluna) 65% (GM Opel, 1999) | 72% 80% (Ford/Mazda pickup) | 607 |
| Vietnam | 30% in 10 years ^f | | 39 |
| Taiwan | 50% ^g | | 3 202 |
| India | 80% (Fiat) 70% (Peugeot 309) 90% (Maruti 800) | | 59 |
| China | 80% ^h 90% (Santana LX, 2.7%, 1985) 80% (Santana 2000, 60%, 1995) 90% (Jetta) 65% (Audi) 85% (Citroën 1988) | | 190 |
| Russia | 65% (KIA in 5 years) | 65% (KIA in 5 years) | 628 |
| Hungary | 10% (GM engines) | | 716 |
| Botswana | 20% (Hyundai from 1998) | | 101 |
| Argentina | The regime has been essentially liberalized ⁱ | | 1 498 |
| Brazil | 85% actual average, liberalization continues | | 596 (1991) |
| Mexico | 36% (since 1985) | | 464 |
| Turkey | | 50% (KIA pickup) | 630 |
| Italy | 75% (Mitsubishi Pajero, 1999) | | 3 503 |
| United States | 75% (Toyota Camry) | | 4 298 |
| United Kingdom | 90% (Nissan Primera) | | 2 954 |

Source: UNIDO.

^a In all ASEAN countries except Thailand, a progressive increase in local content is scheduled over the next few years. Thailand has decided to abolish local content rules in 1998.

^b MVA = Manufacturing value added.

^c Depending on installed capacity.

^d 30% for automobiles of over 2851 cc, 45% for those between 1851 and 2850 cc and 60% for those up to 1850 cc. The government of Malaysia has warned that it will exclude from the calculation of local content those parts and components with a high content of imported subcomponents.

^e In this case the local content is not measured according to the value of the parts but with a weighting system which assigns "points" to each part of the vehicle so that they add up to 100.

^f The actual local content is less than 10%.

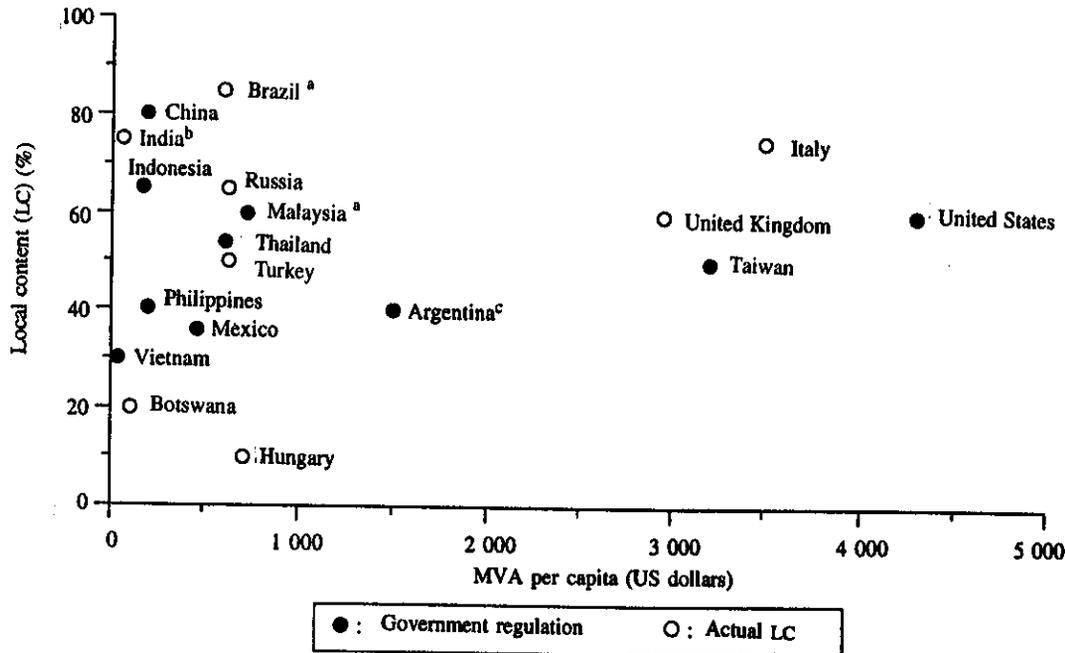
^g To be eliminated when Taiwan joins the WTO. However, tariffs as well as non-tariff restrictions in the automobile sector will continue for 8 more years (see text). Currently, only automobiles from the USA and Europe can be imported. The tariff is 30% for automobiles and 42% for trucks.

^h Since 1995 the automobile companies with installed capacity in China must ensure 40% local content immediately, 60% within the second year and 80% within the third year.

ⁱ The share of domestic value added in the value of industrial production fell from 51% in 1984/1985 to 35% in 1994/1995 (see text).

FIGURE 2

Automobile Industry: Local content (LC) versus manufacturing value added (MVA) per capita in 1993
(Percentages and values in US dollars)



Source: UNIDO.

^a 1991.

^b 1990.

^c 1992.

In short, the situation is as follows:

i) In all the ASEAN countries, except Thailand, there are policies aimed at a progressive increase in local content during the coming years (this is also the case in China and India).¹⁹

ii) Local content rules have little relation to the levels of per capita manufacturing value added (MVA) (see figure 2). This means that such rules are not a reflection of existing industrial capabilities—in respect of which they may be unnecessary, as is the case in many industrial countries—but rather of intended ones.²⁰

¹⁹ Local content policies in the ASEAN countries are not restricted to the automobile industry. Thus, for example, Samsung has bowed to the Malaysian Government's directives to raise the local content to 85% in the local production of consumer electronics goods.

²⁰ In the advanced industrial countries, local content rules are superfluous, except in the sense of the application of rules of origin in transactions with trading partners.

3. Local content rules and industrial strategy in ASEAN: Contrasts with MERCOSUR

Local content rules are normally an integral part of broader policies of "indigenization", import substitution, export expansion, assimilation and local development of technology, capability development and industrial deepening.²¹ Hence, such regulations are usually accompanied by a comprehensive set of complementary tariff and fiscal incentives, as well as special training, R&D, industrial location and other programmes. They are also used as bargaining points in foreign direct investment and trade negotiations.

Following the path first pursued by Japan and then by South Korea, the ASEAN countries apply policies aimed at promoting activities with increasing

²¹ The sharp contrast between this type of strategy and the maquila-type strategy is evident, for instance, with regard to the need to give priority, among other things, to the development of a well financed and equipped formal and technical education and training system able to form skilled workers. On the links between domestic learning, technical change and competitiveness, see Sercovich, 1988.

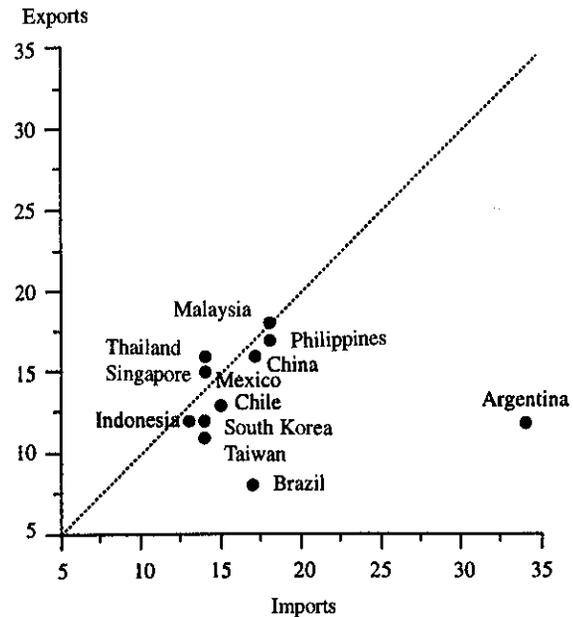
technological and skilled-labour content. The aim is to overcome the problem of rising unit labour costs and to attain the status of industrialized countries within a couple of decades. In Thailand, for instance, the Development Research Institute has reported that exports of medium- and high-technology products exceeded those of labour-intensive products in 1993 for the first time and have continued to grow at a much higher rate than the latter (*Business Times*, 1995, p. 5). Thailand's current Industrial Master Plan relies on the cluster approach as a means of deepening the industrial structure and completing the process of transition towards becoming an industrialized economy. The absence of cluster development is perceived as a market failure making necessary policy measures designed to increase local content and induce upstream development, including manufacturing and service support networks.

The ongoing increase in manufacturing value added (MVA) as a proportion of the value of production in the ASEAN countries is in marked contrast to the prevailing trend in the MERCOSUR countries, where the dismantling of measures aimed at increasing local content is well under way. In Argentina, for instance, the share of local MVA in the value of industrial production declined from 51% in 1984-1985 to 36% in 1994-1995. A similar trend, albeit more moderate, has begun to be observed in Brazil.²²

This contrast is also apparent at the aggregate level when comparing the growth of imports and exports (figure 3). During the present decade, Argentina and

FIGURE 3

**Latin America and South East Asia
(selected countries):
Growth of exports and imports, 1990-1996**
(Annual average growth rates in current US\$)



Source: UNIDO.

^a Exports by Brazil and Chile and imports by Indonesia and Taiwan refer to the period 1990-1995.

²² Argentina and Brazil have undertaken to cancel their respective motor industry regimes at the end of 1999. Brazilian motor industry policy gave rise to friction with the United States, Japan, South Korea and the European Union, however, when the government raised the import tariff on motor cars from 32% to 70% in mid-1995. A little later, this tariff was halved for established firms, provided they exported an equivalent number of units and that local content amounted to 60% (40% for the first three years in the case of new plants). Japan felt that it was discriminated against, because up to then it had stayed mainly in the import business. Subsequently, the Brazilian Government offered an import quota of 40,000 units per year at a tariff of 35% for firms which did not have manufacturing plants in Brazil. Although this still did not satisfy Japan, it was considered discriminatory by the United States, which submitted a complaint to the WTO on 10 January 1997, alleging the provision of discretionary benefits for enterprises of Japan, South Korea and the European Union and violation of articles I: 1 and III:4 of the 1994 GATT agreement, article 2 of the TRIMS agreement, and articles 3 and 27.4 of the WTO agreement on subsidies and countervailing measures. It also requested the cancellation of the benefits referred to in article XXIII:1(b) of GATT 1994. The

European Union, for its part, also submitted a complaint on 7 May 1997 regarding Acts Nos. 9440 and 9449 of 14 March 1997 and Decree No. 1987 of 20 August 1996, alleging the same violations referred to in the United States complaint. Japan withdrew an announced complaint when the Brazilian Government established a quota system to make up for the advantages provided by the motor industry regime for firms already established in Brazil, and the latter country avoided the institution of a panel, as occurred in the case of Indonesia, through skillful trade diplomacy. Brazil is currently the tenth largest car manufacturer in the world and could rise to fourth place by the year 2000. Twelve firms are setting up plants or implementing decisions to do so (Renault, Toyota, Honda, Mercedes-Benz, Volvo, Audi, Chrysler, Asia Motors, Kia, Daewoo, Hyundai and Peugeot). MERCOSUR is scheduled to initiate a common motor industry regime by the year 2000. The Motor Manufacturers' Association of Argentina (ADEFA) has requested that this regime should be postponed and that the existing rules should continue after 1 January 2000. This request is based on the claim that Brazilian firms are receiving bigger incentives and protection and that the playing field is therefore not level. The states in the north of Brazil exempt the plants established there from taxes until the year 2010, with an import tariff of 35%.

Brazil stand out clearly as applying relatively import-driven openness strategies as opposed to the relatively export-driven strategies of the ASEAN countries which, of late, have begun to experience trade problems. These problems, which would appear to be much less serious than those faced by the MERCOSUR countries, especially if only the balance of trade in manufactures is considered, are the overt impetus for a good deal of the renewed emphasis on import-substitution. This underlines the big contrasts that exist between the industrialization patterns of the two regions.²³

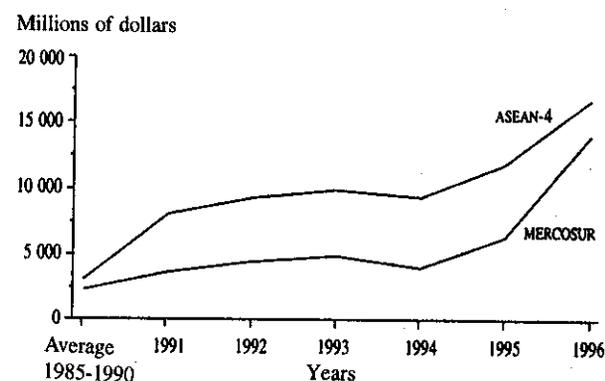
Having given priority to the development of exports of manufactures, the ASEAN countries are now attempting to meet their perceived need to deepen their industrial structure. This calls for policies which appear to be out of step with the WTO's timetable. Meanwhile, the MERCOSUR countries have been pursuing the opposite sequence. Indeed, in ASEAN voices are being heard that warn against the premature introduction of local content rules, for fear of dampening export development because of the limited degree of competitiveness attained so far by domestic intermediate and capital goods.²⁴

Over the last two decades, the ASEAN countries have been more faithful to orthodox policy lines than the MERCOSUR countries, and this has been even more so at the macro than at the micro level. In the 1990s, however, there has been a marked reversal in this respect. While the MERCOSUR countries have shown a strong leaning to more orthodox policies at both the macro and micro levels, the ASEAN nations' macro discipline has been somewhat eroded in financial matters, while there has been an appreciable, al-

²³ It is advisable, nevertheless, not to lose sight of the overall comparative economic picture. There is nothing intrinsically perverse in offsetting deficits in manufactured goods with surpluses in primary goods. On average, the relative endowment of natural resources compared with labour (especially skilled labour) of the MERCOSUR countries is much higher than that of the ASEAN countries, and their respective export profiles partly reflect this fact. (For a comparison between ASEAN and MERCOSUR, see Sercovich and Peña, 1996. See also Londero, Teitel and others, 1997).

²⁴ Among the ASEAN countries, Myanmar has the lowest average level of tariff protection (1.98%), while the Philippines have the highest (15.57%). The other countries are in the range of 5% - 10%. We can thus see that there has been appreciable convergence of average levels of tariff protection between ASEAN and MERCOSUR.

FIGURE 4
Foreign direct investment in four
ASEAN^a countries and in MERCOSUR



Source: UNCTAD (1997).

^a Indonesia, Malaysia, Philippines and Thailand.

though declining, degree of heterodoxy at the micro level.²⁵ These shifts seem to have been reflected to some degree in the behaviour of foreign direct investment (figure 4). Since 1995, the MERCOSUR countries have considerably narrowed the gap in the size of the investments attracted, which has gone down from around 50% between 1991 and 1994 to 18% in 1996.

4. The race against time

Sooner or later, the commitments that individual governments have made with the WTO will have to be reconciled with those they have made as members of free trade and economic integration treaties. For instance, while the TRIMS will come into force in the year 2000, the ASEAN Free Trade Area (AFTA) will start in 2003, the ASEAN Investment Area (AIA) in 2010, and the trade and investment liberalization programme of the Asia-Pacific Economic Cooperation forum (APEC) in 2020 for its developing members. Indications stemming from public debate and, more significantly perhaps, from private sector investment decisions and related agreements with host governments in the ASEAN countries suggest that the AFTA, AIA and APEC schedules are being kept more in mind than those of the WTO. In fact, as we shall see below, some explicit references are being made to the need

²⁵ For further details, see Sercovich and others (forthcoming), chapter 6.

to make these different schedules converge. If this is done, it is unlikely that this will lead to earlier compliance with those of the WTO.

Except in the case of Thailand, which has decided to abolish local content requirements in 1998, the governments of the other ASEAN countries are under various pressures to postpone their conformity to the WTO rules.²⁶ Firms that are carrying out pluri-annual investment programmes to attain progressively higher percentages of local content, as mandated by the regulations which will remain in force until the end of 1999, potentially face considerable losses if their markets are suddenly opened up to more efficient international competitors. Governments would find it hard to ignore the social consequences of this type of situation. It may therefore be expected that efforts will be made to exploit some grey areas in the TRIMS agreement, such as potential exceptions and differences of interpretation.²⁷

From the year 2000, very low tariffs will be practically the only substitute for local content rules. Hence, a race against time is on to attain domestic manufacturing capabilities efficient enough to compete in world markets, with very low margins of effective protection. This challenge has been further complicated by the crisis which broke out in the second half of 1997.

The Philippine private sector has already requested its government to revise its commitment with WTO to liberalize the automobile industry by 2000, on the grounds that auto part firms need more time to adjust to the new situation. The request calls for the retention of local content rules as well as the foreign exchange trade balance demands applied to domestic car production and assembly of completely knocked-down units. The private sector is also lobbying for postponement of the liberalization schedule until 2010: an idea which is gaining currency in other ASEAN countries (*Business World*, 1996, p. 12).

Significantly, the Investment Council (IC) of the Philippine government has endorsed the private sector's proposal to extend the application of the local content rules to CKD units beyond the year 2000, as

part of its efforts to help the domestic automobile industry attain international competitiveness. Moreover, the IC supports an increase in mandatory local content from the present level of 40% to 50% in 2000. Despite the fact that such a measure would have to be harmonized with the tariff reform programme underway, the IC regards it as a necessary step to develop the local auto parts industry.²⁸ Finally, the IC is also considering levying a 7% specific tax on CKD units, thus increasing the tariff applied to car parts and components from the current 3% to 10%. These proposals are contained in the document "Philippine Automobile Vision 2020", which sets out the strategy for the sector (*Business Daily*, 1997).

In contrast to the sparsity of clear signals in respect to WTO TRIMS deadlines, the Philippine government has declared that it favours liberalization of FDI incentives within South East Asia by 2010, in accordance with the AIA schedule, as a complementary measure to the AFTA, in order to increase intra-regional investments. Under AFTA, tariffs will go down to between 0% and 5% in 2003. In addition, the ASEAN Chamber of Commerce and Industry (ASEAN-CCI), whose current President is a Philippine businessman, is studying a regional local content rule of 50% for capital goods from outside ASEAN.

Outside ASEAN, an illustrative case is that of Taiwan, which, although ready to abolish local content rules in its bid to enter WTO, is negotiating compensatory measures aimed at lessening the impact of such a measure and stretching it over time.

The Government of Taiwan contends that if it were to accept the WTO disciplines *in toto*, the output of local automobile firms would fall 60% and their market share would drop to 30% from the current 67%, while auto parts production would fall by half, with only 35% of the domestic auto part producers surviving the abolition of the local content rules. It estimates that only three or four of the 11 automobile assembly firms in operation would survive as such in a liberalized market, while the remainder would become sellers of imported vehicles.²⁹ In its negotiations with the WTO, the Taiwan Government is trying

²⁶ In a sense, this is already the case, since this process of adaptation cannot take place instantaneously on 1 January 2000.

²⁷ The main unknown factor, of course, is China, which is negotiating substantial exceptions and grace periods. China had offered to abolish its non-tariff barriers in the automobile sector over 15 years (last March, it eased this stance somewhat, offering to shorten the period to 12 years).

²⁸ The private sector has also requested an increase in the mandatory foreign exchange offset margins from the current 50% of total sales to 65% in 2000, which would also be inconsistent with the commitments under the WTO.

²⁹ Statement by the Bureau of Industrial Development of the Ministry of Economic Affairs, published in *The Jakarta Post*, 1995, p. 9.

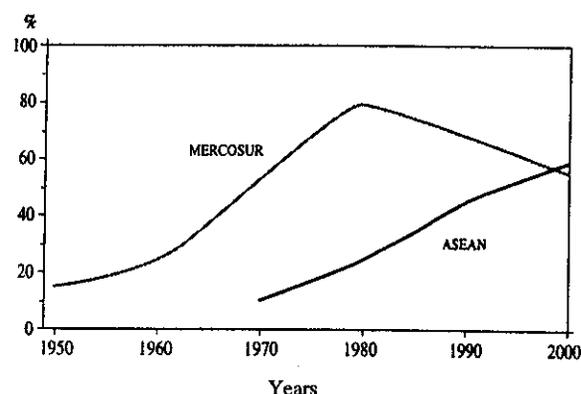
to safeguard the position of sectors that it considers vital for the domestic economy, such as automobiles and consumer electronics, which would continue to be highly protected. Basically, only those subsectors which have already gained a competitive edge, such as informatics and petrochemicals, would be substantially liberalized. The Taiwan Government has granted trade concessions in the shape of import quotas for automobiles to those countries which have agreed to support Taiwan's entry into the WTO under these conditions.

Thus, for instance, Taiwan has agreed a grace period of eight years after its entry into WTO with Japan, which includes the progressive lifting of the 20-year-long ban on imports of Japanese automobiles. A tariff-based quota system will be implemented, under which up to 7,700 small cars will be imported in 1997, with a 10% annual increase until 1999, when the increase in the quota will stop until Taiwan enters the WTO. Once this happens, the annual quota will be immediately raised to 10,000 units, increasing by 20% annually. The automobiles imported within the quota will be charged a 29% tariff during the first year after entry into the WTO, after which the tariff will gradually go down to 22.5% in the course of the eight-year grace period. Imports in excess of the quota will pay duty of 60%. After the grace period, quantitative restrictions will be removed and all imported automobiles will be subject to a uniform 22.5% tariff. The current local content requirement of 50% for locally assembled automobiles will be abolished immediately upon Taiwan's entry into WTO (*Business Taiwan*, 1997).

Taiwan is negotiating similar bilateral agreements with a number of other countries in return for their support of its entry into the WTO. To counteract the heavy expected impact that removal of local content requirements will have on auto parts firms, whose output may fall by 50%, active programmes are underway to encourage gains in efficiency through process automation, improved product quality, better management, updating of production technology, and strengthening of marketing networks. This is expected to help local firms to retain around 75% of the domestic market. Finally, it may be noted that, although it was the country of the region least affected by the 1997 financial and exchange-rate crisis, Taiwan has announced that it will postpone the liberalization of its capital market until after the year 2000 (*International Herald Tribune*, 19 January 1998, p. 11).

FIGURE 5

ASEAN and MERCOSUR: Stylized evolution of local content in the automotive industry, 1950-2000



Source: UNIDO.

Given their current policy approaches and place in the technological learning curve, the MERCOSUR countries will probably face less difficulties than those of ASEAN in complying with WTO 2000 (figure 5). It is difficult to see how most of the ASEAN countries, as well as several others in Asia, including China and India, can fully adopt the WTO TRIMS disciplines by 1 January 2000, because of the inertia of their current policies and investment processes and their relatively late entry into such sectors as automobiles and capital goods. This could make it necessary for them to apply for exception mechanisms under the "special difficulties" provision allowed for by WTO. An alternative might be to make their local content regulations consistent with those of the WTO through their application at the ASEAN level (a 50% local content rule has been proposed for capital goods, for example). On the other hand, none of the MERCOSUR countries has embarked on a "national car" policy, as have Indonesia and Malaysia.

The ASEAN countries are faced with a major challenge due to the potential competition of large countries such as China and India, which are seeking to develop their own automobile industry. Perhaps the best response would be to pursue intra-industry specialization at the regional level, but so far Thailand is the only ASEAN country that has favoured a regional approach in the automobile sector.

The ASEAN Enterprise-to-Enterprise Industrial Cooperation scheme (AICO) could perhaps serve as a regional means of encouraging an increase in local

content at the regional level with very low intra-regional tariffs. Because it will come into effect only in 2003, however, the scheme's impact is unlikely to be felt fully before 2005 or 2010. One of the difficul-

ties with AICO is that each member country applies different exception regimes (for instance, regarding local content), so that harmonization raises considerable problems.³⁰

V

Final remarks

There seems to be a lack of consensus in defining precisely the meaning of best practices, particularly with regard to microeconomic policies, which are largely guided by the institutional and historical heritage of each country and by the nature of the policy goals pursued, which, in turn, cannot be divorced from geopolitical considerations.

To varying degrees, for instance, the ASEAN countries are emulating the experiences of Japan and South Korea, with a view to joining the "convergence club" in a couple of decades. However, this is not precisely the type of emulation that

underlies the WTO disciplines, since it entails giving priority to policies aimed at substantially modifying the initial resource endowment over time, rather than taking it as a given element in terms of shaping the future.

Underlying these differences are two alternative paradigms with respect to the meaning of convergence and of a "level playing field". In one, levelling the playing field means policy convergence today. In the other, it means convergence in levels of development tomorrow. So the debate continues.

(Original: English)

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³⁰ AICO is a common preferential regime that will allow eligible enterprises (those which operate in a member country and have at least 30% local shareholding) to enjoy tariffs of 0-5% immediately after it comes into effect in 2003. The enterprises will also be given non-tariff incentives and regional local-content accreditation. AICO is an accelerated benefit of AFTA and will replace the ASEAN Industrial Joint-Venture (AIJV) and Brand-to-Brand Complementation (BBC) schemes.

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