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# Trade policy and *international linkages:* a Latin American *perspective*

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This article looks at the trade policy guidelines that the region should follow in order to achieve dynamic international economic linkages, in the light of the international context, the main normative conclusions that could be drawn from the theoretical debates on this subject, and some lessons that may be learnt from the study of successful cases. It is posited that in the countries of the region, trade policy can be an instrument for macroeconomic management, fiscal management and, at the microeconomic level, resource allocation; its use as a second-best instrument is justified when there are constraints on the use of the best possible solutions (in exchange rate policy, for example). It is also held that there must be close coordination of the policies applied in the fields of trade, industry and technology in order to ensure high levels of investment in the tradeable sectors of the economy, a form of competitiveness based on constant increases in productivity, and an improvement in the region's specialization profile. Finally, emphasis is placed on the need to strengthen the institutions of Latin American States in order to ensure that their interventions in the economy have a suitable level of effectiveness.

# I

## Introduction

The consolidation of a long-term growth process in Latin America is closely linked with the achievement of dynamic linkages with the international economy. It is therefore important to define a trade policy capable of meeting the challenges faced by the region. At the same time, the specialized literature emphasizes that knowledge and scientific and technical progress are factors which determine the development of new comparative advantages. This means that the limits between policies in the fields of trade, industry and technology are increasingly vague. In other words, talking about trade policy in the limited sense (tariffs, non-tariff barriers, export drawback arrangements, etc.) can only give us an incomplete idea of the restructuring strategy applied by a country.

The aim of this article, then, is to make an analysis—in the light of the various contributions offered by the theoretical literature and by international experience—of the role of trade policy in those fields

where public intervention can help to improve Latin America's international economic linkages. To this end, we begin by looking at the international context and the prospects opened up by the recently completed Uruguay Round of GATT (section II).<sup>1</sup> An evaluation is made of the role of trade policy as a means of macroeconomic management (section III) and as an element affecting horizontal and specific microeconomic policies (section IV). The article then goes on to deal with the restrictions arising from the limited capacity of public institutions to effectively apply active policies (section V). Finally, in the light of the broad theoretical lines sketched in the article and the internal and external constraints due to the actual economic conditions prevailing in the countries of the region, an attempt is made to formulate some recommendations with regard to the trade policies that should be applied in coming years (section VI).

# II

## The international context and the prospects opened up by GATT

In the 1980s, the processes of globalization and regionalization became more deeply rooted in the international economy.

Globalization of the economy, in the sense of the growing interdependence of the various nations, was reflected in that fact that the growth rate of international trade, and especially of foreign direct investment (FDI) and financial flows, considerably exceeded the growth of the world's gross product.<sup>2</sup>

The big increase in world trade began after the war, when a process of trade liberalization through successive tariff reductions agreed upon at the various GATT negotiation rounds was begun. The growth of FDI, for its part, was stimulated by the efforts to avert potential protectionist measures and the need to build stronger bases for competition (both in the area of marketing and in terms of the incorporation of technological progress). Finally, the increase in financial globalization was spurred by the growing trade imbalances, technological advances in the areas of information and communications, and the worldwide trend towards the deregulation of financial operations.

In this context, which has also been marked by the increasing pace of technological innovation, it is generally agreed that an export-oriented strategy will

<sup>1</sup> The Appendix to this article describes the new instruments recently incorporated by the Uruguay Round in order to increase the level of discipline in the implementation of trade policies.

<sup>2</sup> Thus, between 1983 and 1989 direct investments grew three times faster than the increase in world exports and four times faster than the growth of world GDP (Guerra Borges, 1993).

favour the absorption and adaptation of technology and, hence, economic development, more than policies aimed exclusively at the domestic market.

Thus, this growing economic interdependence underlines the advisability of improving economic linkages with the international market, while at the same time redefining the degrees of freedom available to national policies.

It is necessary at this point to highlight two characteristics of this globalization process: the asymmetrical way it affects the peripheral countries, and the contradictions it involves.

Its asymmetrical nature is reflected in the fact that two-thirds of world trade is currently accounted for by the United States, the EEC and Japan. In the second half of the 1980s, these countries together received over 80% of total world FDI, whereas the developing countries received only 17%, and two-thirds of that share went to only 10 countries.

The contradictions of the globalization process, for their part, are reflected in the considerable increase in new types of protectionist pressures exerted by the industrialized countries.<sup>3</sup> Thus, since the 1970s there has been a big increase in non-tariff barriers (voluntary export restriction agreements, countervailing duties, antidumping clauses, etc.)<sup>4</sup> whose spread—especially to mature sectors such as iron and steel, textiles and agricultural products—has hit trade with peripheral countries particularly hard (Laird and Nogués, 1989).<sup>5</sup>

The reasons for these new outbreaks of protectionism include the following:

i) The big increase in exports from Japan and the newly-industrialized Asian countries to the industrialized nations, which began to register low growth rates as from the 1970s. The consequent higher levels of unemployment and idle capacity mean that it is all the more difficult to adjust to the penetration by imports (there are fewer new jobs to offset the jobs lost in declining sectors) and there is a lower degree of social tolerance.

<sup>3</sup> In striking contrast to this, since the 1980s the developing countries have been displaying a marked tendency to open up their economies.

<sup>4</sup> According to some estimates, in 1980 or thereabouts 48% of world trade was managed (subject to some form of non-tariff barrier), compared with 40% in 1974 (Grimwade, 1989).

<sup>5</sup> In the 1980s, for example, 44% of the antidumping actions and 61% of the countervailing duties applied by the United States, the European Economic Community, Australia and Canada were aimed at restricting exports from developing countries (Fundación U.I.A., Consejo Académico, 1994).

ii) The shortcomings of the international monetary system, which make it more difficult to correct—as for example by exchange rate adjustments—the big trade imbalances registered between countries.

iii) The absence of a clear leading power in international trade policy. The authority and leadership in trade matters exercised by the United States after the war were gradually eroded by that country's increasingly protectionist stance as from the mid-1970s.<sup>6</sup>

According to Grimwade (1989), a further explanation for the increase in protectionism lies in the shortcomings in the GATT rules and mechanisms.<sup>7</sup> Because of the decisions adopted in 1979 at the Tokyo Round, GATT has been ineffective in checking the proliferation of non-tariff barriers. In our view, however, GATT's lack of disciplinary capacity during this period was not the cause of the increase in protectionist pressures, but rather its reflection.

The laborious negotiations at the Uruguay Round represented an effort to negotiate global rules to deal with these protectionist pressures. Their results display the same asymmetrical features referred to earlier. There is stiffer discipline for the peripheral countries (through the limits placed on certain subsidies used by them), but at the same time the industrialized countries have tried not to lose their freedom to protect certain non-competitive sectors of their economies and to preserve their existing comparative advantages in the technologically most advanced sectors (see Appendix).

GATT's effectiveness in the future will depend on whether the root causes which gave rise to the growing protectionist pressures in the North can be reversed. For this reason, even the most enthusiastic supporters of such measures admit that their success is still far from being definitive or that it may only prove to be partial.

<sup>6</sup> Motta Veiga (1988) notes that, in seeking to regain its lost trade leadership, the United States is carrying out two strategies: one defensive and the other offensive. The first of these is applied in the sectors in course of restructuring, through trade protection instruments. The second, which it is applying in the industrial and services sectors linked with new technologies—in which it defends the principle of free trade—seeks to maintain its existing comparative advantages and is being implemented through multilateral negotiations within GATT (on free trade in services, intellectual property rights, etc.) and also through bilateral negotiations, by means of pressures and reciprocity clauses.

<sup>7</sup> Especially the safeguard clauses of article 19, adopted at the Tokyo Round, which have allowed that article to be circumvented by many countries through the establishment of non-tariff barriers.

Some authors hold that the agreements reached at the Uruguay Round are a necessary but not in themselves sufficient condition for the attainment by the world economic system of the "in-depth integration" called for by the globalization process.<sup>8</sup> Indeed, they go so far as to maintain that, to begin with, such integration can only take place at the level of regional trade agreements, which are therefore bound to increase at least during the 1990s (Lawrence, 1993).<sup>9</sup>

The regionalization of markets –the other major trend in the international economy– is a further factor which could hinder the success of GATT and favour a further increase in the existing asymmetrical aspects. For the countries forming part of the main trade blocs which already exist or are in course of formation (the European Union, NAFTA, the Asia-Pacific area), economic integration ensures greater competitiveness, a broader scale of production, and greater market access. The countries which do not form part of these groupings, however, may be even more vulnerable to possible trade conflicts or to

diversion of trade and FDI to countries which form part of such blocs.

In other words, market access will be more secure for countries which have a chance of joining regional blocs. Even the less efficient firms of such countries may be able to spoil the export markets of more efficient producers through the greater economies of scale made possible by the expansion of the market (Hughes Hallets and Primo Braga, 1994).

The asymmetrical features of the globalization process, against the background of the climate of uncertainty prevailing with regard to GATT's future effectiveness and the strong progress being made in the regionalization processes, highlight the importance of promoting closer regional links among the Southern Cone countries of Latin America.<sup>10</sup> In addition to the potential economic benefits that may be derived from broader markets, the consolidation of these regional spaces can help to increase the bargaining power of the area both with other countries and trade blocs and within GATT itself.

### III

## Macroeconomic policy, investment in tradeable sectors and trade policy

The first condition which must be satisfied in order to achieve suitable international economic linkages is to reach appropriate levels of investment in the sectors in which the economy is to specialize internationally. This opens up fields of action for macroeconomic policy which range from investment incentives in general to specific incentives for investment in tradeable or non-tradeable sectors.

In order to achieve a favourable climate for investment it is above all necessary to ensure a stable global setting which makes it possible to plan in the longer term, and to make sure that the system of

relative prices offers the information and incentives needed to take fullest advantage of comparative advantages.<sup>11</sup> Equally important are public policies which affect the parameters of the saving and investment functions and efficient organization of the financial system which makes it possible to channel savings to productive projects.<sup>12</sup> In its macroeconomic dimension, trade policy can play at least two important roles: as an instrument for the generation

<sup>8</sup> According to Lawrence (1993), in-depth integration means going beyond the elimination of frontier barriers and moving towards the harmonization of all policies which can discriminate, albeit invisibly, against other countries.

<sup>9</sup> Hughes Hallets and Primo Braga (1994) hold that it is easier to meet policy coordination aims at the regional than at the multi-lateral level, because in the latter case it is hard to demonstrate a credible level of commitment by all the participants.

<sup>10</sup> Wonacott and Wonacott (1981) give a theoretical demonstration of the superiority of regional integration over trade openness in cases where countries face protectionist barriers in world markets.

<sup>11</sup> Macroeconomic stability is also a necessary prior condition for ensuring the effectiveness of microeconomic policies (Rodrik, 1993).

<sup>12</sup> These aspects –especially the existence of arrangements for short- and long-term financing at suitable rates– are essential factors for building up a truly competitive production system. Since this is a very well-known issue, we will not go into it in greater detail here.

and distribution of fiscal resources, and as one of the decisive elements in the real effective exchange rate.

The first of these roles is important because consolidation on the fiscal front is an essential condition for macroeconomic stability. On the basis of the neoclassical theory of domestic distortions it may be concluded that, in the absence of "non-distortionary" taxes (the mythical fixed-total tax) and the presence of serious costs and limitations on the capacity for fiscal revenue collection, trade policy may present itself as a second-best fiscal instrument (Corden, 1974).<sup>13</sup> The extent to which it is advisable to use trade policy as a revenue-raising instrument, however, must be weighed against the possible costs in terms of distortion deriving from this management of tariff policy. Moreover, the increase in revenue may be neutralized if, in order to avoid an anti-export bias, fiscal export incentives are increased at the same time.

The second role is of fundamental importance because, in addition to ensuring a sound macroeconomic setting which will promote investment in general, it is essential to make sure that an adequate proportion of this investment goes to the tradeable goods sector. The key price determining the incentives to invest in the tradeable or non-tradeable sectors is the real effective exchange rate (for exports or imports). There is a problem here, however: in contrast with what the theory of comparative

advantages implicitly assumes, the real exchange rate does not adjust automatically to its equilibrium level (or at least to that level which ensures trade balance equilibrium in conditions of full employment).

Both the theoretical literature and the experience of the Asian countries highlight the importance of a high, stable real exchange rate (with the same theoretical justification as macroeconomic stability in general). In a process of increasing trade openness such as that being experienced by many countries of the region, the real exchange rate which is capable of bringing the trade balance into equilibrium may be higher, because of the need to promote the reallocation of resources to the tradeables sector (ECLAC, 1990; Fritsch and Franco, 1992).<sup>14</sup> Successful cases of export-oriented openness (such as that of South Korea) are examples of the application of policies which simultaneously combined trade openness with devaluation in terms of the real exchange rate (Amsden, 1986).

When a country loses the capacity to fix the real exchange rate in the midst of a stabilization process,<sup>15</sup> external adjustment processes can become extremely costly, since the level of activity then becomes the main adjustment variable. In this context, trade policy—acting as a purely macroeconomic instrument—can be used to make up for possible deviations in the real exchange rate.<sup>16</sup>

## IV

### Microeconomic policies and trade policy

As the process of macroeconomic stabilization is consolidated, the need begins to arise to carry out a number of additional policies of a markedly different nature from those aimed at securing adjustment. These policies can have various names: microeconomic or mesoeconomic policies, policies aimed at securing systemic competitiveness, etc. For simplicity's sake, in this article we will give the name of microeconomic policies to all those which, by their nature or objectives, are aimed fundamentally at improving the productivity and pattern of international specialization of the economy.

<sup>13</sup> If, for example, we analyse the frequent changes in Argentina's tariff structure since the late 1980s, we see that in many cases the decisions to raise the level of protection were motivated by fiscal considerations.

#### 1. Horizontal policies

##### a) *Doing away with anti-export bias*

The existence of tradeable goods sectors with adequate levels of productivity does not necessarily

<sup>14</sup> This is because the improvements in efficiency deriving from this are not usually—at least in the short term—big enough to offset the initial negative effect on the trade balance.

<sup>15</sup> Because of the use of an exchange rate anchor in a context of downward rigidity of nominal prices (absence of deflation), because of a dollarized form of price formation, or because of the impact of capital inflows from abroad.

<sup>16</sup> The same function is served by all measures (in the area of trade policies or not) which seek to reduce the costs of the export sector.

mean that their output is directed to the international market, for apart from the absolute profitability of export operations (which is determined basically by the comparative efficiency of the sectors and the exchange rate) it is also necessary to take into account their relative profitability compared with that of sales on the domestic market. Trade policy plays a decisive role in this respect.

As noted in the previous section, in certain contexts trade policy can be used to compensate for deviations in the real exchange rate. In order to fulfil this purpose without causing fresh distortions, however, the barriers to imports and the incentives for exports must move simultaneously and proportionately to each other. Otherwise, tariff barriers which are not offset by export incentives lead to a general disincentive to trade known as an anti-export or anti-trade bias.<sup>17</sup>

The main argument in favour of applying policies with an anti-export bias (the argument of the optimum tariff whereby a large country can use its monopolistic or monopsonic power to improve its terms of trade) is hardly applicable to the countries of the region, except in a few isolated cases concerning certain scarce natural resources.

The experience of Southeast Asia (especially South Korea and Taiwan), however, shows that it is not necessary to apply a system of total trade openness in order to avoid anti-export bias. The same result can be obtained through administrative mechanisms (arrangements for export drawbacks, temporary importation, export processing zones, etc.), which, if used efficiently, provide virtually free-trade conditions for producers of exportable goods (Wade, 1990).

An anti-export bias is not only induced by trade policies, however. It also occurs when certain market flaws have a bigger impact on external trade operations than on domestic sales. Three of these flaws are worthy of special mention: insufficient information on foreign markets, inability of the capital market to provide finance for exports, and the economies of scale required for the international marketing of

new products. In view of the world situation described in section II of this article, public policies designed to overcome such flaws are increasingly important when it is desired to move into new niches in foreign markets and improve a country's international specialization profile.

The successful experience of Southeast Asia shows that big efforts have been made in each of these areas. In the opinion of several authors, the system of export financing applied by South Korea was the instrument which contributed most to the success of that country's export strategy (Rhee, 1989). This system was channelled through the banks, by rediscounting and automatic financing mechanisms set up by the Bank of Korea. Likewise, both Korea and Taiwan have tackled the problem of the economies of scale involved in international marketing. South Korea was successful in stimulating the development of big private marketing firms, from which it demanded specific minimum levels of capital, export volume and number of offices abroad. Taiwan, for its part, whose export potential is based on small and medium-sized enterprises, applied an active international marketing policy through trade offices set up in the main world trading centres.

At all events, the policy recommendations designed to deal with these market flaws are very well known and, in the final analysis, all countries apply them to some extent. The differences lie rather in the intensity with which they put them into effect. International experience shows us that it is precisely the countries which have gone furthest in the development and application of these policies which have achieved the most substantial improvements in their international trade linkages.

#### b) *Negotiating access to foreign markets*

According to the traditional neo-classical approach, trade openness is the best option, even when other countries apply distortionary trade policies (tariffs, export subsidies, etc.). In that case, it is held, the right approach is to use the international forums in order to negotiate the wider spread of such openness at the multilateral level (Krueger, 1990).

The rejection of some simplifying assumptions (perfect competition in international markets, constant yields, etc.) has caused some theoretical approaches (including the new international trade theory) to depart radically from neo-classical

<sup>17</sup> In such a case, firms in tradeable goods sectors estimate that it is better to sell on the protected domestic market than to face the lower prices prevailing on the international market. In turn, trade protection makes imported goods more expensive and thus distorts demand in favour of locally-made goods. There is thus a simultaneous reduction in the incentives to export and to import, which leads to a decline in levels of trade.



theory.<sup>18</sup> Basically, they question whether it is really best, in situations of strong foreign interventionism, to apply a policy of indiscriminate free trade. In such circumstances, it is suggested that trade policy – or the threat to use trade policy – should be employed as a means of furthering negotiations aimed at facilitating access to markets which are protected or subsidized by other nations (Tyson, 1990; Dornbusch, 1990).<sup>19</sup> In this context, as already noted in section II, regional integration processes such as MERCOSUR offer potential advantages in terms of strengthening the bargaining power of their member countries to deal with the biases and imbalances that exist in international trade relations.

c) *Policies in support of productivity and trade policy*

In order to consolidate a dynamic export sector it is necessary not only to ensure suitable levels of investment in tradeable goods sectors but also to make ongoing efforts to improve their productivity. It is true that competitiveness can be increased at certain times through macroeconomic variables (such as the exchange rate) or by the reduction of certain costs (such as direct or indirect wage costs, taxes, etc.) which affect the export sector, but in order to ensure a sustained process of export growth which is compatible with improvements in the population's standard of living – that is to say, in order to achieve high levels of true competitiveness – it is necessary to promote higher productivity (Fajnzylber, 1988).

The main role in this field is played by policies on industry and technology which are aimed, among other things, at ensuring that there is a “critical mass” of skilled labour, developing a suitable physical infrastructure and network of suppliers, and promoting technological research and development.

A similar role is played by policies aimed at making up for market information shortcomings, such as policies in the fields of industrial extension services, provision of advice to small and medium-sized firms, improvements in coordination among the agents of production, etc. Some authors stress that it is important that, before incorporating new capital

goods, firms should make suitable changes in their production organization techniques to fit in with the new technological paradigms, through the introduction of total quality control, “just in time” production, etc. (Kaplinsky, 1988). This is why it is so important that the State, through specialized bodies, should help the private sector (and especially small and medium-sized firms) in this restructuring process.

Trade policy instruments can play an indirect but important role in this. Firstly, policies aimed at lowering the cost of buying capital goods (through tariff reduction or elimination)<sup>20</sup> undoubtedly favour the modernization of industrial facilities. When fixing the tariffs on capital goods, however, it is necessary to take into account not only their incidence on industrial costs but also the opportunity costs of the fiscal resources thus committed and the possible effects on local capital goods producers, since the latter sector can be an important vehicle of technological progress.

Secondly, mention should be made of the special arrangements sometimes used to promote specialization in production, such as the Industrial Specialization Scheme in Argentina, since in many cases these can give rise to a pro-export bias. Within the context of a static analysis, such a bias is just as negative as the corresponding anti-export situation, but in the early stages of a restructuring process high incentives for specialization can be an effective means of overcoming the inertia caused by the high costs of industrial conversion.

Thirdly, it may be noted that many countries have successfully used export behaviour as a means of evaluating the effectiveness of various types of incentives for investment and technological development. This approach – which gives such instruments a trade policy dimension – is based on the idea that in some production sectors effective access to international markets is fairly convincing proof that those sectors have developed the capacity to produce goods with acceptable levels of price and quality. Although these are not necessarily the best instruments from the point of view of economic theory, they can be second-best mechanisms when limited public monitoring capacity or the technological complexity of the goods in question make it too difficult to monitor the attainment of given price and quality goals. In any

<sup>18</sup> For a collection of articles on strategic trade policy, for example, see Krugman, 1987.

<sup>19</sup> This approach has had a lot of influence on current United States trade policy. We have already referred to the bilateral negotiations – through reciprocity clauses – which that country carries on in segments connected with new technologies.

<sup>20</sup> This policy may be seen as a microeconomic instrument aimed at raising the productivity of the economy or, in more general terms, as an indirect way of raising the real exchange rate.

case, the possibility of using trade policy in this way will be increasingly restricted by the new GATT rules (see Appendix).

Finally, the formation of regional trade blocs is another trade-related policy which can have a big impact on production efficiency. When local producers are exposed to greater competition but at the same time given preferential access to a broader market, this can give a big boost to the conversion process and to economies of scale and specialization. Trade among similar types of countries can also help to raise workers' skills (Amsden, 1986) and to promote innovation (Rodrik, 1993).

## 2. Specific policies and trade policy

So far, we have looked at macroeconomic or microeconomic policy instruments which affect competitiveness in general, without limiting ourselves (at least explicitly) to certain types of industries or activities. We shall now take up a different problem: that of deciding whether the economic authorities should remain neutral with regard to the types of sectors in which the nation is to specialize, or whether there are sound reasons for giving special incentives to certain sectors.

In the simplest version of neo-classical theory, all sectors are considered equal. On the basis of this assumption, the best policy is free trade, which makes it possible to take the fullest advantage of the possible benefits of international specialization. Selective policies, in contrast, are held to distort the pattern of comparative advantages and to reduce well-being.

More sophisticated analyses, however, have given rise to various theoretical arguments in favour of the formulation of selective policies, even in the case of trade policy.

In neo-classical theory, it is recognized that the existence of market flaws may give rise to arguments in favour of the formulation of trade policies of a selective nature.<sup>21</sup> Since many market flaws (externalities, indivisibilities, distortionary regulations or taxes, etc.) affect different production activities in

different ways, the pattern of international specialization resulting from the application of free trade policy may not be optimal. In most cases, the market distortions are of a domestic nature, and the best policies for correcting them do not involve the use of trade policy. In the absence of first-best instruments, however, such policy may have a role to play as a second-best solution.<sup>22</sup> While the first-best policies may be formally neutral (as for example in the case of measures to overcome flaws in capital markets), second-best trade policy probably has to take on a selective character (higher protection for sectors which, because of the predominance of small and medium-sized firms, higher technological risks, or other reasons, are more sensitive to lack of credit).

It may be inferred from the foregoing that if policies of trade openness are not accompanied by optimal policies designed to overcome the existing market flaws, they will probably not lead to an increase in well-being. At the same time, if the distribution of the optimal subsidies involves costs, selective trade protection may become the best policy alternative (Corden, 1974).

Another very well-known and well-worn argument is that of infant industries. The strictest neo-classical theory severely restricted the validity of this argument, linking it with the existence of certain market flaws basically associated with shortcomings in capital markets (Martirena-Mantel, 1988).<sup>23</sup> Here, once again, trade policy can only be used as a second-best instrument.

The formulation of assumptions which simplify traditional theory has given rise to other lines of theory which have taken up once again, in a strengthened form, the line of thinking implicit in the infant industry argument, to which we will briefly refer below.

<sup>21</sup> A great deal has been written on the theory of internal distortions analysed here. See, for example, the enlightening work by Corden (1974) and the analytical summary by Martirena-Mantel (1988).

<sup>22</sup> This use of trade policy as a second-best instrument plays a leading role in the theoretical justification of tariffs which are graduated, rather than having a uniform level, in the light of the degree of processing of goods. The argument would appear to be that the various distortions which affect the production of goods (transport costs of raw materials, distortionary taxes, etc.) increase their incidence with each stage in production. Thus, it is proposed that a graduated tariff structure may serve to restore a neutral scheme of incentives (Fundación U.L.A., Consejo Académico, 1994).

<sup>23</sup> At the empirical level, the various experiences in the promotion of infant industries display very disparate levels of effectiveness (Bell, Ross-Larson and Westphal, 1984).

The New International Trade Theory starts by rejecting the assumptions of perfect competition and constant returns to scale.<sup>24</sup> This means that there are clear differences between sectors of production in international trade, as some sectors give only normal yields, whereas others give monopoly rents. It is also posited that the main source of relative productivity in the sectors with monopoly rents is not the factor endowment of the country but the capacity of its inhabitants to install certain industries and reach the most desirable scales in their operation. The pattern of specialization thus includes a random or arbitrary element (Krugman, 1988). This may be linked to the existence of trade policies (tariff protection, export subsidies, etc.) which favour national monopoly firms (Brander, 1986).

In countries with small markets (without firms which are big enough to alter the rules of international strategic competition), there is still room for the application of trade policies in sectors with normal yields which can use indirect economies of scale linked, for example, to transport and international marketing (Krugman, 1988). Likewise, regional integration processes (with the consequent increase in market size) also increase the possibility of making effective use of strategic policies that permit the achievement of economies of scale. It is also necessary to coordinate industrial and trade policies, since these can affect the form assumed by the intra-regional specialization pattern (Ocampo, 1993).

Although pro-interventionist deviations have been widely criticized by various authors (many of them belonging to the same school of thought), there is a tendency to accept the fact that strategic trade policies can affect the pattern of international trade, and as we have already seen, this has important implications for international negotiations.<sup>25</sup>

Other schools of thought have highlighted the role of technological change, notably the neo-Schumpeterian authors and those linked with the new theories on economic growth.<sup>26</sup> These lines of thought (especially the neo-Schumpeterian ones) identify a new source of heterogeneity between sectors, noting that technological development is neither exogenous nor homogeneous among them. Some sectors display greater capacity for technological innovation, which allows them to attain higher rates of productivity growth and enables them to win Schumpeterian rents in international trade. Others take on the role of strategic sectors because of the strong externalities they transmit to the rest of the production system through the spread of technological innovations.

In terms of policy connotations, these contributions can be interpreted in two different ways. Firstly, from the standpoint of neo-classical theory it may be concluded from the above arguments that the technologically more advanced sectors display more pronounced market flaws than the rest of the economy.<sup>27</sup>

The second possible reading highlights the fact that, as in other sectors with growing yields, the comparative advantages of the technologically advanced sectors do not derive solely from the factor endowment but from public and private efforts to develop capacity for technological innovation in specific areas. Public industrial and trade policies aimed at the spearhead sectors thus take on a strategic character, since they make it possible to secure the extraordinary benefits generated by those sectors.<sup>28</sup>

<sup>24</sup> See, *inter alia*, Brander and Spencer (1981), Helpman and Krugman (1985), Brander (1986) and Grossman (1986).

<sup>25</sup> The main lines of such criticisms are: the impossibility of knowing for sure which policies are best; the possibility of reprisals (either unilateral or resulting from the application of the GATT rules) which can lead to a worse situation than in the beginning, and governments' lack of freedom to withstand corporate lobbying (Grossman, 1986). It is also argued that strategic policies aimed at certain firms (in order to create "national champions") may help to aggravate market flaws in the area of competition (Richardson, 1993).

<sup>26</sup> For an instructive summary of the ideas of the first group of authors, see Dosi, Freeman, Nelson, Silverberg and Soete (1988). Among the best-known works of the second group are the pioneering studies by Romer (1986) and Lucas (1988).

<sup>27</sup> Examples of such flaws include those connected with the formation of human capital (which is used to different extents by the different sectors) and relations with the capital market (which is biased against projects involving technological risks and long lead times).

<sup>28</sup> Indeed, the authors of the New International Trade Theory themselves have been shifting their interest from static economies of scale to economies based on technological learning and innovation. See for example Grossman and Helpman, 1991.

## V

### Institutional limitations

Although the theoretical analyses discussed above justify the use of active trade and industrial policies, in practice there is no general agreement on their advisability. The various arguments levelled against them are based mainly on doubts about whether the public authorities are fitted to effectively design, apply and monitor policies which in theory appear to be optimal (especially when such policies are of a selective nature). Three types of problems are generally mentioned: the inability of the public sector to obtain all the necessary information, the inefficiency which is typical of public administrative mechanisms, and the generation of perverse forms of business behaviour in the private sector in an effort to seek non-productive rents.<sup>29</sup>

Although this is not the place to go into such problems in detail, there are some elements that must be taken into account when weighing the advisability of applying active trade policies.

Firstly, one should not take extreme positions such as assuming that the State can do everything or, alternatively, that bureaucratic shortcomings are worse than flaws in the market, so that no action should be taken at all. The administrative capacity and autonomy of the State are not exogenous data, but can be modified by public policies. Thus, various studies by international organizations are beginning to reflect the need to strengthen (in both administrative and budgetary terms) the public institutions re-

sponsible for policy in the areas of trade, industry and technology in order to turn them into satisfactory means of intervention, even though they may not be ideal solutions (OTA, 1990; Najmabadi, Banerji and Lall, 1992; ECLAC, 1990).

The fact that there are a number of cases of successful intervention suggests that it is possible to considerably reduce the negative effect of bureaucratic shortcomings. The strengthening of public institutions not only partly explains the marked differences between the results obtained in the past by the Asian countries, on the one hand, and the Latin American nations on the other, but would also appear to be a necessary condition and challenge for the future performance of the latter.

Secondly, the obstacles standing in the way of effective public intervention are not the same in all fields of action. It is generally accepted that horizontal microeconomic policies give rise to fewer difficulties than selective ones as regards the problems of obtaining the necessary information and avoiding the risk of the seduction of public agencies by private interests. Likewise, specific policies applied in sectors with a more competitive market structure (especially those where small and medium-sized firms predominate) would appear to be easier to keep under control than those applied in highly concentrated sectors with strong lobbying power.

## VI

### Conclusions and policy recommendations

In an international setting marked by increasing globalization and, at the same time, heightened trade friction, the countries of the region need to strengthen their place in the international economy by improving their export profile. Success in such an

endeavour is inevitably linked to industrial conversion processes which will increase production efficiency and make possible the incorporation of new comparative advantages. In this context, regional integration can act as a catalytic element which will facilitate and strengthen the conversion process.

This conversion will have to take place, in some countries, in the midst of exchange policy constraints which mean that there is no easy solution. In this

<sup>29</sup> With regard to these types of arguments, see Grossman (1986), Porter (1990) and the studies on corporate rent-seeking behaviour by such authors as Krueger (1974).

case, it will be necessary to emphasize the application of policies which foster the other basic means of increasing exports: improvements in the levels of productivity and comparative efficiency. Until such measures bear fruit, the use of trade policy as a second-best macroeconomic strategy –in order to offset possible deviations in the real exchange rate or as a supporting instrument on the fiscal front– should not be ruled out. It should be noted in this respect, however, that when trade policy is used for this purpose its purely macroeconomic dimension must be respected. This means that sectoral differences must not be established (since these must be based on other criteria), nor must the anti-export bias of the economy be increased.

Macroeconomic stability is a necessary condition for the development of new comparative advantages, but it cannot of itself guarantee such advantages.<sup>30</sup> As the successful countries of Asia have shown, a dynamic place in the world economy also requires more intensive application of horizontal microeconomic policies designed to increase productivity and consolidate market positions abroad.

In the field of productivity, it is necessary to define a rational strategy of optimal policies in the areas of trade, industry and technology aimed at dealing with the major market flaws which, in the countries of the periphery, hit the technologically most advanced sectors particularly hard. These policies should include industrial extension measures for small and medium-sized firms (especially in the field of modernization of the organization of labour), promotion of research and development activities, incentives for the training of human resources, etc.

One of the areas where most remains to be done is that of public policies to improve the supply of information on foreign markets and to promote marketing enterprises to increase in particular the viability of the exports of small and medium-sized firms. Another aspect of fundamental importance is the provision of export financing at reasonable interest rates.<sup>31</sup>

Another aspect of trade policy which is worth highlighting in this context is the progress made by

regional integration processes. These offer the possibility of increasing productivity (by taking advantage of economies of scale and specialization) and improving bargaining power in international forums. In order for regional integration processes to bear fruit to the full, however, there must be broad coordination of macroeconomic and microeconomic policies within them. The absence of such coordination and the persistence of certain imbalances at the microeconomic level may lead to the consolidation in the region of intersectoral specialization patterns (of the North-South type) which will prevent some countries from gaining full benefit from integration.

As regards the use of selective trade policies (such as protection for certain sectors which are in the course of retooling), the experience of the Asian countries shows that such measures must be of a temporary nature and must be subject –as GATT requires in these cases in the recently adopted Code on Safeguards– to the fulfilment of certain goals by the sectors given protection. Thus, the application of selective trade policies in sectors which are highly concentrated and have strong lobbying power requires, at the very least, that the State should have the necessary institutional capacity to ensure proper monitoring of the fulfilment of private sector commitments.

This means that there is a pressing need to carry out institutional reconstruction measures which will ensure that in the future countries will have public authorities capable of applying more effectively policy instruments which, although more complex, may be closer to the optimum. Meanwhile, it would seem advisable to limit selective policies, as far as possible, to sectors where small and medium-sized firms predominate and there may be greater capacity to impose discipline on the private sector.<sup>32</sup> It should also be noted that, as selective promotion instruments, tariff barriers or systems of tariff-based quotas awarded by competitive bidding are superior to straightforward quotas or other non-tariff barriers because they are more transparent (they clearly show what degree of protection is being given to a sector) and because they increase fiscal revenue instead of generating rents which are hardly ever passed on to consumers.

<sup>30</sup> Some authors are highly critical of what they describe as “the short-sighted attitude of macroeconomic adjustment schemes, which ignore the more distant horizons that should guide the strategic decisions of public and private agents” (Tavares, 1990).

<sup>31</sup> Subsidies for interest rates on export credits do not form part of the list of subsidies prohibited by GATT (Fundación U.I.A., Consejo Académico, 1994).

<sup>32</sup> When applying selective trade policies it is also necessary to bear in mind the need to avoid giving rise to an anti-export bias in the sector in question and an undesirable burden of effective negative protection on export sectors which use the goods thus protected.

These policy strategies must be seen within the context of the new patterns created by the Uruguay Round. As we noted in section II, the agreements reached at that Round will very likely give rise to various forms of friction because of the strong protectionist pressures in the countries of the North. Even in that case, however, the biased situation which we noted to be one of the features of the international setting may oblige the countries of the periphery to accept the effects of the new rules. Assuming that this takes place, two strategies may be proposed.

First, in the event that the GATT rules limit the use of certain instruments designed to eliminate anti-

export bias, it will be necessary to use other forms of export incentives which are not prohibited in order to reduce that bias, such as the provision of export credits on favourable terms.

Second, even though the GATT rules may impose certain restrictions, there are deadlines for complying with them, and it is extremely important to take advantage of this breathing space (see Appendix). Thus, since these deadlines exist, it will be necessary to make the fullest possible use, before they have to be eliminated, of whatever industrial and trade policies may be considered appropriate for consolidating the retooling process.

(Original: Spanish)

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## APPENDIX

## New instruments adopted at the Uruguay Round of GATT

Among the main results of the Uruguay Round are the establishment of the World Trade Organization (WTO), with a General Council responsible for supervising the fulfilment of the various agreements reached and settling trade disputes among member countries, and the negotiation of sectoral agreements for agriculture and the textile sector, plus the inclusion of services and intellectual property in the multi-lateral negotiations.

What we wish to do here is to refer in particular to the new instruments designed to increase discipline in the field of trade. These include new rules on trade-related investments; subsidies and countervailing duties; safeguard clauses, and anti-dumping measures.

a) *Trade-related investment measures (TRIMS)*

The existence of investment measures which can affect trade led GATT to prohibit a number of practices in this respect. Particularly relevant in this connection is the prohibition of the adoption of rules on national content and measures tending to the levelling of trade (for example, measures linking the amount or value of the imports that a firm can make to the level of its exports). The developing countries were given a deadline of five years for the elimination of policies of this type.

b) *Subsidies and countervailing duties*

Stricter discipline was provided for with respect to subsidies, which were classified into three categories:

i) *Prohibited subsidies.* These are subsidies linked with the use of domestic inputs or the fulfilment of export goals. In order to avoid double taxation, however, it was agreed that exemptions from indirect taxes on inputs incorporated in export products and the use of drawback mechanisms could continue. In these cases, the amounts of the exemptions or drawbacks must not exceed the value of the taxes effectively payable.

ii) *Non-actionable subsidies (permissible subsidies).* These subsidies are at the other extreme. They include horizontal or non-specific subsidies: i.e., those which are not limited to particular types of industries or activities. Non-actionable subsidies, for example, are those designed to increase employment,

promote small and medium-sized firms, or provide funds for research and development. This category also extends to specific subsidies when they are applied in order to promote industrial research activities, provide support for under-privileged areas, or carry out environmental programmes. A member country can appeal for GATT's intervention, however, if it considers that a subsidy which is in principle not actionable is seriously harming one of its production sectors.

iii) *Actionable subsidies.* This category covers the cases of other types of subsidies which can adversely affect the interests of other countries and can be shown to have caused actual damage. In order for a subsidy to be actionable it is considered a necessary (although not of itself sufficient) condition that the total *ad valorem* subsidy should be equivalent to more than 5% of the value of the product in question. Members affected by actionable subsidies can submit the matter to the GATT dispute settlement body. If it is found that the subsidies did indeed have harmful effects, the country applying them must withdraw them or make good the harmful effects (GATT, 1993). For developing countries with a per capita income over US\$1 000, the prohibition of export subsidies will come into effect eight years after the coming into force of the agreement setting up the World Trade Organization (GATT, 1993).

The agreement also lays down more transparent procedures for the application of countervailing duties to imported products which are subsidized by third countries. The rules for opening an investigation are stricter, and it has now been made necessary to show a direct causal relation between such imports and the effective harm being suffered by the industry affected. Such investigations will be terminated when the amount of the subsidy is very small (less than 2% *ad valorem*) or the real or potential volume of the subsidized imports is not significant (less than 4% of the total imports of similar products by the importing country).

c) *Agreement on Safeguards*

This Agreement, which is included in the Final Act of the Uruguay Round, makes some very important changes in the rules on the defence of domestic industrial sectors which have lost competitiveness.



In order to limit unfair trade practices which could conceal arbitrary protectionist actions, clearer rules have been established regarding the application of the Code on Safeguards. Such safeguards can be used to protect local industry when an unforeseen increase in imports threatens to cause serious harm to local producers. In such cases, governments are authorized to temporarily suspend their commitments under GATT and to establish trade barriers for a maximum period of four years (which can be extended in certain circumstances to a maximum of eight years).<sup>33</sup>

When an increase in protection is strictly due to the lower efficiency of the local industry, the application of safeguard clauses is obviously a more appropriate instrument than anti-dumping measures or countervailing duties. The latter tend to penalize

foreign producers without demanding anything from the local producer, whereas the application of safeguard clauses—since it lays down a time limit for the protection—implies a demand that the affected sector should carry out an adjustment process. In this sense, this instrument can be even more beneficial for the country applying it (Guimarães and Naidin, 1994).

Furthermore, the new GATT rules prohibit the establishment of voluntary export restraint agreements or managed trade arrangements between countries. Measures of this type which were in force when the Agreement on Safeguards was signed must be gradually eliminated over a period of four years.

#### d) *The anti-dumping agreement*

This agreement aims to secure more transparent rules on the use of this mechanism. It seeks to define more clearly and in greater detail the method for determining whether there is dumping or not and calculating its true magnitude. The importing country must prove more strictly that there is a causal relation between the imports accused of representing dumping and the harm caused to national industry. New rules have also been established on the initiation and conduct of actions in this respect and on the facilities for the countries involved to defend their actions.

<sup>33</sup> In order to facilitate the adjustment of the affected sector, the Agreement on Safeguards provides that if the planned period is more than one year, the safeguard measures must be gradually relaxed at regular intervals during the period of application. If the measures are scheduled to last more than three years, the situation of the industry in question must be periodically reviewed so that the measures may be lifted or the rate of relaxation speeded up, if necessary.