

# CEPAL

## Review

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#### Notes and explanation of symbols

The following symbols are used in tables in the *Review*:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A blank space in a table means that the item in question is not applicable.

A minus sign (-) indicates a deficit or decrease, unless otherwise specified.

A point (.) is used to indicate decimals.

A slash (/) indicates a crop year or fiscal year, e.g., 1970/1971.

Use of a hyphen (-) between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.

Reference to "tons" mean metric tons, and to "dollars", United States dollars, unless otherwise stated.

Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates.

Individual figures and percentages in tables do not necessarily add up to corresponding totals, because of rounding.

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## Review

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## Selection of dynamic comparative advantages

*Eduardo García D'Acuña*

The future development of Latin America and the Caribbean will feature the progressive and more effective insertion of its products in the international economy. This process appears to be determined by two important factors.

First is the need to generate a large export surplus that will allow for real payment of the external debt, even in the most favourable case of a definitive agreement being reached between debtor countries, the banking system and central countries which would change current liabilities into longer-term commitments at lower interest rates than those currently in effect.

Second is the need for more rational use of resources, in particular through the promotion and diversification of exports and greater efficiency and effectiveness in imports substitution.

This requires a marked change in the macro-economic and sectoral policy framework of each country. It also requires decisive action by the region in international forums in order to reduce the protectionist measures of industrialized countries that hinder full access to their domestic markets. In the first case, it is necessary to have various resource-allocation criteria that provide a basis for adoption of sound macroeconomic and sectoral policies. Let us first examine these criteria.

The first criterion in the economic literature relates to the principle of comparative or market advantages, according to which domestic production of any item that is relatively cheaper domestically *vis-à-vis* its counterpart in the international market should be promoted, whereas production of any goods that are *relatively* more expensive should be discouraged. If the current exchange rate has a value that balances the balance of payments, cost and price comparisons can be made in the same currency and in absolute terms, and obtain the same results. From this criterion there stems a whole series of economic policy prescriptions that can be summarized as follows: a) setting a low and standard tariff that does not distort costs or market prices; b) applying a low and standard export subsidy rate, equivalent to the tariff;

c) uniform tax treatment for production sectors that supply the domestic or external market; d) setting an effective exchange rate whose level will ensure adequate profitability of the export sector and of the sector competing with imports; e) rejection in general, of any sectoral policies that generate specific advantages for any sector or activity; and f) stability in these rules of the game in order to stimulate new investments that will guarantee the effective reallocation of resources over time.

This set of economic policies is commonly associated with market-economy practice when there are many private agents who are very sensitive to market signals and who would respond positively to the indicated policy framework. However, it may also be associated with a socialist market economy, in which independent and co-operative State enterprises, operating on a decentralized basis, adapt their protectionist and trade actions to a similar policy framework set up by the central planning agency. In this connection we can cite the experience of socialist countries such as Hungary and Yugoslavia.

The criterion of comparative advantages—and the attendant policies—is correct, given a set of assumptions that endorse its social desirability, but it has undergone a series of qualifications and corrections in order to take into account: a) distributive, social and employment factors; b) dynamic elements linked to the incorporation of technological advances; c) elements associated with the environment and natural-resource depletion; and d) some considerations regarding the structure of world trade and the role in it of transnational corporations and the trade and financial policies of central countries.

We shall examine each of these factors in order to see how to modify the simple principle of market and static comparative advantages.

*Distributive, social and employment factors* can seriously alter the pattern of comparative market advantages. We shall examine the case of country *A* which, faced with the need to pay its external debt, needs to generate an export sur-

plus, and therefore resorts to devaluating its currency, while keeping nominal wages constant. The inflationary pressures associated with the devaluation produce a drop in real wages that allows the exports and imports-substitution sectors to raise their profitability sharply by improving the competitiveness of their enterprises. Has a real comparative advantage been generated? Indeed not, because a simple reversal of the wages policy would eliminate the competitive edge gained. The situation of country *B* is different, for its enterprises introduce and apply more efficient production techniques that increase output per worker. In this case, if real wages are maintained, the enterprises will enjoy greater profitability which will enable them to compete successfully in international markets. And to do so on a permanent basis, without detriment to the standard of living of any member of society. The factors associated with expenditure and social welfare have similar implications. The same country could make its enterprises more competitive by reducing taxes on company profits, resulting in a cutback in government social spending on health, education, housing, etc. Such a cutback, once again, will give a competitive edge to exporters and to imports-substitution companies, but at a social cost that is disregarded in private cost-benefit analysis.

It is evident from the foregoing that a very clear distinction must be made between real comparative advantages based on increased resource productivity and simple competitive advantages based on the deterioration in the living standards of some domestic sectors.

Lastly, a process of external economic openness based on comparative market advantages could cause a drop in overall employment, if the creation of new jobs in the exports sector does not compensate for job losses in the imports-substitution sectors which will have declined. In this case, openness would lead to a situation of structural unemployment and would necessarily involve expansion of imports substitution or domestic market activities until full employment of resources was achieved. In terms of the criterion of comparative advantages, an attempt will be made to evaluate the profitability of each activity, assigning labour its real opportunity cost which, if there is unemployment, will be lower than the market wage.

*The incorporation or non-incorporation of dynamic elements associated with technological factors* that would act over a given span of time provides another evaluation criterion. These technological factors relate to issues such as learning by doing or the argument of infant industry, the existence of potential economies of scale of which good use could be made in the future through the spread effect, and the creation and development of new technologies. None of these elements are usually taken into account in the statistical analysis of comparative advantages, as the market reveals them today. Given that each of these factors is found in a different form in the various agricultural, mining, industrial and service activities, their careful evaluation would make it possible to consider their benefits over their entire economic life, as well as their interactions within and between sectors. Evaluation methodologies should therefore consider applying traditional cost-benefit analysis not only to the individual project but also to a series of activities over the time span involved.

It is likewise possible to adduce arguments based on the effect on the environment of certain activities involving internationally traded goods, or on the use in such activities of renewable or non-renewable natural resources, in order to qualify the simple principle of static and market comparative advantages. The most obvious case is the export of an ore whose processing requires enormous quantities of groundwater and whose waste materials inflict considerable damage on fishing activities or on the well-being of neighbouring towns. Clearly, if the water has an alternative use in agricultural activities and in the support of associated ecosystems, a social cost should be assigned to its use. The waste materials also have a production and welfare cost that has to be evaluated. Therefore, these costs should be assigned to the export activity prior to any decision on its suitability from the international standpoint.

The use of renewable or non-renewable natural resources raises another problem of the correction of static market advantages. In recent years various countries have successfully developed exports based on natural gas by-products by imputing a very low cost to this non-renewable input, thus gaining a market advantage. If the product obtained is ultimately

destined for consumption and not for the creation of an alternative productive capacity, it would clearly involve the waste of a natural resource to the detriment of the welfare of future generations. This could be corrected by assigning a suitable discount rate to the future benefits of the project. In the case of renewable resources, for this same reason, rates allowing for the restoration of the resource to its original level should be incorporated as a cost factor.

Another consideration affecting comparative advantages is the gradual shift of polluting industrial activities or processes from industrialized countries to less developed ones as a result of restrictions and pollution-control charges imposed by the Governments of the industrialized countries. Thus, willingness to accept air, water and soil pollution from such processes appears as a "comparative advantage" of the less developed countries. Once again, it would be a false advantage unless the social costs and external diseconomies associated with these processes are taken into account.

Lastly, the evaluation criteria of comparative advantages should carefully study *the factors associated with the structure and dynamics of the world economy and with the performance of*

*transnational corporations* in their investment and technological development decisions. The current and future production pattern of the first world —the United States— as well as that of Japan, Western Europe and the newly industrialized countries of Southeast Asia is too important a factor to be ignored in an international insertion strategy for Latin America. The comparative advantage pattern of the United States, *vis-à-vis* these countries has ostensibly changed over the last 15 years. The United States has gained a competitive edge in goods with both a high natural-resource content, and a high technological content, and it has been the front runner in standardized industrial products. In turn, Western Europe, Japan and the other countries have undergone significant changes. Moreover, the major changes that are approaching with the advent of the European Common Market in 1992, the macroeconomic adjustment that the United States will undergo sooner or later, and the ever-increasing importance of Japan's role and that of the economies of South-East Asia will produce a change in the international framework which it will be imperative to take into account in any successful plan for the region's international insertion.