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Trade liberalization
in Latin America

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A major shift has been observed in the development strategies of most of the Latin American countries in recent years. One sign of this change has been that the countries have increased the neutrality of their trade policy incentives in an effort to give greater priority to the market as a resource-allocation mechanism; it is also hoped that this will result in a more export-oriented production apparatus. The authors review these changes and, in assessing the results to date and the consistency of these policy packages, contend that their impact in terms of economic growth and changing production patterns has thus far been unpromising. Indeed, generally speaking, the countries' performances as regards capital formation and overall productivity have not been satisfactory. A number of recommendations are also made regarding other measures that could complement existing policies aimed at opening up the region's economies in a way conducive both to changes in production patterns and to development.

I

Towards a new development strategy?

In recent years, many Latin American countries have embarked upon trade liberalization drives. This article reviews the radical changes in trade policy which this has entailed, together with these processes' current and foreseeable results, and offers some preliminary recommendations regarding possible complementary measures.

The first sustained experience with trade liberalization was in Chile, which launched a process in the 1970s that, by the end of that decade, had made its economy one of the most open in the entire world.

By the mid-1980s, after more than half a century of protectionism, a tendency towards radical change in the countries' development strategies and policies was becoming evident. As early as 1983 Costa Rica set out on a gradual transition from the import-substitution model it had been implementing at the national and Central American levels to a model oriented towards forging a more dynamic position in the international economy, with emphasis on extra-regional markets. Then, in 1985, Bolivia and Mexico started up relatively fast-paced liberalization programmes of their own.

In the early 1990s, several other countries joined in this movement, including Argentina, Brazil, Peru and Venezuela. Even Colombia, which had undertaken a gradual programme in 1990 to open up its economy over a four-year time span, decided to step up the pace of its liberalization effort midway through 1991 so that it could be completed in 1992. Thus, although they were moving forward at different speeds, it was clear that the countries of the region had reached a major turning point.

Explicitly or implicitly, each country had to decide how to go about the business of liberalization, what to liberalize and what not to, how much, in what sequence, and what other policies it should adopt to ensure that its liberalization process would contribute to its development (see section II). In this article we will attempt to come up with some preliminary answers for those questions based on recent events in Latin America.

Later on in this essay (see section III), we will review a portion of the voluminous literature on Asia's export-oriented economies (the Republic of Korea, the Chinese province of Taiwan and, more recently, Indonesia, Malaysia and Thailand) so that Latin America's more recent experiences can be compared with other experiences of a longer standing and very different character. The greatest differences between the liberalization efforts of the Latin American countries and the way in which the Asian countries have opened up their economies are that most Latin American liberalization programmes have been carried out rapidly and the State has played a passive role in those programmes, whereas the opening of the Asian economies has been a long, State-led process involving the construction of a production apparatus oriented towards international markets.[1] When imports were liberalized in Asia, the economy's structural transformation had already been accomplished and exports had been on the rise for a long time. These conditions were buttressed, in most cases, by macroeconomic equilibria and much higher investment rates. In contrast, the drastic import liberalization programmes carried out in Latin America were launched during the initial stage of the countries' internationalization strategies and often coincided with stabilization processes and low rates of capital formation.

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[1] In this article we will make use of the distinction drawn by Damill and Keifman (1992) between "opening" and "liberalization". The former concept applies to a policy package designed to orient an economy towards international markets as part of an export-led process. The latter refers only to the dismantling of protective barriers and other government controls as part of an import-led process.

Some of the key elements of these reform programmes will be examined later on in this analysis (see section IV) in the light of the conditions required in order to open up an economy in a way that will stimulate its long-term development. Clearly, in the world of today, international competitiveness and a more dynamic position in international markets must be achieved in order to permit sustained development. Therefore, restrictions on imports must be reduced. Regardless of whatever benefits it may have provided on the domestic front, the old sort of protectionist policy is undoubtedly an obstacle to development.

The basic problem with the protectionist policies of the past was that, in the final analysis, policy-makers did not know what they were promoting or why (Ffrench-Davis, 1986). As noted by Fritsch and Franco (1993, p. 32), in addition to the fact that it is very costly, comprehensive protection may ultimately end up not protecting anything in particular. The protectionist policies of the past, both in Latin America and in other regions, were often exploited by private concerns seeking to turn an easy profit. In many cases no social benefits were evident, and the resulting industrial structures tended not to be competitive on the international market and to continue being dependent on government protection indefinitely. It should also be recognized, however, that these schemes permitted the establishment of industrial sectors that have served as the basis for a subsequent form of development which is more strongly oriented towards international competitiveness than before.

In order for trade reforms to be successful, the value added by the creation of new activities must exceed the value subtracted by the destruction of existing activities. This means, in other words, that the increase in exports must be greater than the decrease in import substitution;[2] that export activity must have positive spillover effects on the rest of the economy, which will depend upon those exports' degree of diversification and the amount of value added they contain; and that international competitiveness must be attained through a continuing increase in productivity rather than by means of low wage levels and rising subsidies or tax exemptions.

This is why it is essential to open up an economy in a way that will not entail the indiscriminate destruction of existing installed capacity and that will permit an effective retooling of production activities. This process also needs to be coupled with a sustained, credible change in relative prices favourable to the production of export products and with the improvement or creation of the markets and institutions essential to a steady increase in productivity through vocational training, improvements in infrastructure, incentives for technological innovation, the development of long-term or productive investment-oriented capital markets, and an increased ability to negotiate access to external markets.

This focus has not, generally speaking, been the primary one chosen by Latin American countries launching trade liberalization initiatives, since most of them have embarked upon this course of action without the benefit of a strategy for achieving a more open economy. This approach suffers from serious shortcomings in three crucial areas. First, unilateral bids to open up an economy would make sense in an open, dynamic, competitive world economy, but are less advisable in an international economy where protectionism is still a very real factor, trade is growing slowly, and a strong trend towards the formation of regional trade blocs is to be observed. Second, this process is based on static comparative advantages and short-term gains in resource allocation, but it becomes vulnerable if it is concentrated in areas of activity whose markets are more sluggish and less active in terms of technological innovation. Third, in financial markets and on the capital account of the balance of payments, the recent move towards market deregulation has hampered the reallocation of resources which was supposed to be brought about by the liberalization of trade because, under the conditions prevailing in the 1990s, it has been conducive to sharp increases in exchange rates and high interest rates. These factors discourage the productive investment needed to bring about structural change and cause resources to be concentrated in purely financial investments.

[2] This does not mean that the option of import substitution should be discarded. The larger the domestic market in question, the greater the potential scope of import substitution. This is attested to by the fact that the exports of countries such as the United States and Japan represent no more than 10% and 15%, respectively, of their GDP. What is truly new about the development strategy that is now taking shape is the idea that firms producing goods and services, whether for the domestic or international market, must become increasingly competitive during the learning period. This is done, in part, through exposure to outside competition and the achievement of export, investment and technological development targets.

II

Trade liberalization programmes in Latin America

Many countries in the region have undertaken trade liberalization reforms in recent years (see table 1). Eight of the nine countries shown in table 1 –all except Costa Rica– introduced reforms that could be described as drastic and sudden. Moreover, in seven of these eight countries –in this case the exception is Chile– the liberalization of imports was carried out within a period of just two or three years (1989-1990 to 1992-1993). Argentina implemented the bulk of its liberalization programme in April 1991. In Chile, the process took five and one-half years (from late 1973 to mid-1979).

TABLE 1

Latin America (nine countries): overview of trade liberalization process

Country	Start of liberalization programme	Maximum tariff		Number of tariff lines		Average tariff		Non-tariff barries	Variation in real exchange rate [a]
		Initial	End 1992	Initial	End 1992	Initial	End 1992		
Argentina [b]	1989	65	30		8	39 [c]	15 [c]	In 1988 the value of industrial output subject to restrictions was reduced from 62% to 18%. In 1989-1991 non-tariff barriers, additional temporary duties and specific duties were eliminated.	-40
Bolivia	1985	150	10		2	12 [d]	7 [d]	All but a few bans and import permit requirements were discontinued.	134
Brazil	1990	105	35	29	7	32 [e]	21 [e]	In 1990 the list of prohibited import products and advance permit requirements were eliminated. National content requirements applying to intermediate and capital goods will be maintained, however	31
Colombia [b]	1990	100	20	14	4	44 [d]	12 [d]	Virtually all advance permit restrictions were eliminated in late 1990.	1
Costa Rica	1986	100	27			27 [e]	20 [e]	Import permits and other restrictions are to be phased out over the period 1990-1994.	4
Chile [f]	1973	220	10	57	1	94 [e]	10 [e]	Quantitative restrictions on imports were eliminated in the 1970s.	-10
	1985	35	11	1	1	35 [e]	11 [e]	Price bands were reintroduced and an anti-dumping system was established.	0
Mexico	1985	100	20	10	3	24 [c]	12 [c]	The coverage of import permit requirements was cut from 92% in June 1985 to 18% by December 1990, and the system of official import prices was discontinued.	-9
Peru [b]	1990	108	25	56	2	66 [e]	18 [e]	In September 1990 import permits, controls and authorization requirements, quotas and bans were all eliminated.	-21
Venezuela	1989	135	20	41	4	35 [d]	10 [d]	The number of items subject to restrictions has decreased from 2 200 in 1988 to 200 at present. Specific duties, which in some cases had raised the tariff ceiling to 940% prior to the liberalization programme's implementation, were eliminated.	7

Source: ECLAC, on the basis of figures provided by the countries.
[a] From the initiation of the liberalization programme until 1992; the exchange rate applying to exports has been used.
[b] Tariffs include surcharges. [c] Weighted by domestic production. [d] Weighted by imports. [e] Simple average of tariff positions.
[f] Chile's first trade liberalization programme was completed in 1979, and a uniform 10% tariff was in effect until 1982. The first row of figures therefore refers to that period (1973-1982). The second row gives information on the reduction of import duties, which, after having been raised to 35% in 1984, were brought down to 20% (1985), 15% (1988) and then to 11% (1991).

In all cases, albeit to varying extents, quantitative restrictions have been dismantled and tariffs have been lowered significantly. Generally speaking, the amount of tariff protection provided differs considerably from its pre-reform levels, and the spread of rates of effective protection has diminished substantially. No country has yet adopted a tariff rate of zero, however, and only Chile has a uniform tariff (currently 11%). Bolivia is close behind it with a tariff system having just two brackets and a 10% maximum. All the other countries have a number of different tariff rates with ceilings ranging from 20% to 40% and average rates of between 10% and 20%. These regional trends in trade policy have been complemented by a trend towards the conclusion of bilateral or multilateral free trade agreements covering a wide spectrum of tariff items whose provisions are not confined to the reduction of tariffs on individual products (Lahera, 1992).[3]

In a number of countries, trade liberalization measures have been accompanied by the liberalization of the balance-of-payments capital account. Under the conditions prevailing since the start of the 1990s, when international capital markets began to take a positive view of the Latin American countries once again, the liberalization of the capital account has prompted considerable increases in currency values (Calvo, Leiderman and Reinhart, 1993; ECLAC, 1992a) just when trade reforms urgently required a decline in those values. Some countries (Chile and Colombia) have been more successful than others in countering upward pressure on their currencies, but in order to do so they have had to resort to exchange controls and other heterodox forms of "financial engineering".[4]

In the following section we will examine the reforms recently implemented in three countries of the region within the frame of reference set out above. These three countries have been chosen because their reforms have been in place long enough for the effects to be reflected in economic performance (Chile, Mexico and Bolivia), thereby providing a basis for an evaluation of their impacts on growth and investment.

1. The frame of reference for an analysis of international economic positioning strategies

Trade reforms are usually undertaken as part of a broad-ranging process of change in which international competitiveness and exports play a leading role. The main instrument of reform has been a somewhat indiscriminate and rapid liberalization of imports. The aim is to expose producers of importables, which have often been receiving a high level of protection until then, to outside competition. It is hoped that this will result in higher productivity, less inefficiency, the absorption of new technologies and increased specialization. Producers that do not adapt to outside competition will be pushed out of the market, and the resources freed up by their displacement will be swiftly absorbed by other activities, primarily in the production of exportables.

Exports are encouraged, indirectly, by the reduced cost and wider range of importable inputs which thus become available and by the decline in the local currency's value which the liberalization of imports will tend to prompt in the exchange market.

The reaction of import-substituting activities will depend on how much relative prices change, how swift the change is and how well the relevant producers are able to adjust. It is best if producers can be given the time they need to restructure, but no more than is strictly necessary, so that they will actually be prodded to change. For example, if a tariff is redundant, all the slack can be eliminated very quickly, but the reduction of effective protection should be paced to allow producers to introduce innovations, increase their level of specialization and reallocate their resources. The pace of the adjustment will depend on the credibility of the timetable for change and on how much access producers have to the resources they will need in order to restructure. This will determine whether exposure to competition will be a creative or destructive process.

The reaction of export sectors will depend on how much use they make of importables and on how such goods were dealt with in the pre-reform trade system. Often, imports of inputs and capital goods by

[3] Up until June 1990, the mainstream opinion was that integration accords should be of a partial, very limited scope, along the lines of the Latin American Integration Association (ALADI) agreement in force at the time. The majority view was that trade blocs were inefficient and hindered world trade. President Bush's Enterprise for the Americas changed all that, however, and concerns about trade diversion now appear to have been entirely forgotten.

[4] Regarding the case of Chile, see Agosin, Fuentes and Letelier (1993); on recent measures to avert an appreciation of the currency in Colombia, see Cárdenas and Barrera, 1993.

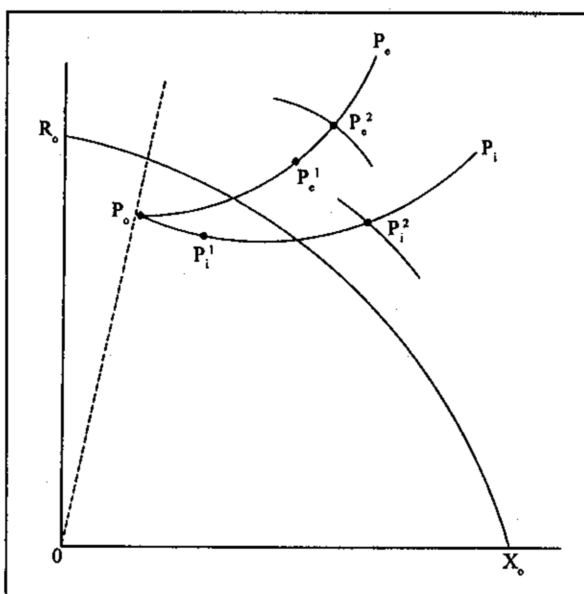
exporters have benefited from some type of exemption from customs duties, but in some cases exports have been discouraged by inoperative or arbitrary import systems.

The movement of the real exchange rate will be a decisive factor in determining the response of production (both of exportables and importables). In order for a reform effort to be successful, the net effect of the changes it makes in incentives must be to boost the production of goods that can be traded on the international market. The ability to restructure will also depend on the overall dynamism of investment and technological innovation, the supply of trained manpower, the operability of the domestic capital market, the existing infrastructure and the extent of access to external markets.

The combination of changes in relative prices, in their credibility and graduality and in the macro- and meso-economic context for the implementation of reforms will determine whether their effects on resource allocation will be predominantly positive or negative. There are two possibilities: the restructuring process can start out with an expansion of the production frontier –as has occurred in the newly industrializing economies (NIEs) of Asia– or it can begin with a drop in economic activity and form part of an adjustment process that takes place behind the production frontier (see figure 1).

FIGURE 1

Asia and Latin America: schematic outline of two trade reform options



In figure 1, the X axis represents the value added during the production of exportables and the R axis (the sum of importables and non-tradables) represents the rest of GDP. R_oX_o is the initial frontier and P_o is the starting point for production, behind the frontier, which entails a low export coefficient and some degree of inefficiency in resource allocation. Within the framework of a dynamic expansion of the production frontier, the reforms should bring effective production closer to that frontier and should shift the production mix towards a larger percentage of exportables.

In an export-led internationalization strategy in which the liberalization of imports plays no more than a secondary supporting role –as in the case of the dynamic economies of Asia– the adjustment process will tend to follow a path such as that described by the curve P_oP_e . This curve denotes a more than proportional increase in X together with a moderate growth rate for R within the context of an expanding production frontier and a gradual increase in the efficiency of existing business enterprises. Thus, the economy is positioned on or near a steadily expanding production frontier.

The curve P_oP_i denotes a different strategy, similar to that used in Latin America; this approach is led by the liberalization of imports and involves the bankruptcy of a significant portion of import-substituting concerns together with a gradual rise in exports. These "dis-substitution" pressures predominate during the early stages of the process, and the economy will therefore be positioned behind the production frontier, which will, moreover, remain stationary during the initial years of the reform.

It is possible that, with this second strategy, the firms that survive will tend to be, on average, stronger and more dynamic than in the first case. During the early years of the adjustment, however, the production resources available and in use will be fewer, owing to the higher rate of bankruptcies and of downscaling; the underutilization of resources will thus be greater, and the stimulus for total investment will be weaker. Therefore, a higher degree of microeconomic efficiency will tend to be combined with a lower degree of macroeconomic efficiency. The hysteresis of the process dictates its end result, since what happens during the transition will have a decisive effect on the level of well-being and on the production structure that emerges upon the completion of the adjustment process.

Of course, there is room for a large number of variations on these two options in the process of changing production patterns. Even within each product category, different intertemporal trends will probably be observed. There will also be crossovers between categories: import-substituting enterprises may be converted either entirely or partially into importers, or, in response to the reforms, may become exporters (Katz, 1993). For the purposes of this discussion, however, we have focused on two sharply differentiated cases in an effort to characterize two opposing styles of internationalization. Figure 1 illustrates these two alternative strategies, whose paths and final end points are represented by the points of production $P_i^{\,2}$ *and* $P_e^{\,2}$. Both exhibit sharp increases in X but very different results for R. The point $P_e^{\,2}$ is associated with economies such as those of Japan, the Republic of Korea and the Chinese province of Taiwan, whose GDP has shown strong growth for an extended period of time and which maintain an X-led position in the external economy. In the 1960s and 1970s, Brazil's growth curve was characterized by a more even rate of expansion in X and R (in the vicinity of the prolongation of OP_o). Chile's situation, on the other hand, is depicted more accurately by $P_e^{\,2}$, with a steep increase in X but the stagnation of R as compared to P_o: between 1981 and 1989, X rose substantially (a 51% increase in exports of goods and services per capita) whereas R climbed slowly in absolute terms and actually decreased in per capita terms (the production of importables rose while the production of non-tradables declined). Towards the end of the process, however, rapid growth is seen in R as well (as occurred between the late 1980s and 1993).

2. Chile

Chile's trade liberalization scheme is the oldest and the longest continuously-applied programme in the region. In late 1973, before the introduction of reforms, Chilean foreign trade was subject to a great deal of government control: nominal tariffs averaged 94% and ranged from 0% to 750%; 50% of all imports had to be authorized by the Central Bank; countless non-tariff barriers were in place, including the requirement of large advance deposits for 60% of all imports, and a complicated multi-rate exchange system was in use involving eight different official exchange rates, with a 1000% difference between the lowest and the highest (Ffrench-Davis, Leiva and Madrid, 1991; Meller, 1992).

(i) *The sweeping reforms of the 1970s.* As part of a far-reaching scheme for handing over the vast majority of economic decisions to market forces, in 1973 trade policy reforms were launched which covered everything from the elimination of all non-tariff trade barriers and the reduction of tariff levels to the establishment of a single exchange rate. Although it was not one of the programme's initial goals, by June 1979 a low, uniform tariff (10%) had also been established.

During the first two years of the trade liberalization programme, real devaluations of the government-controlled exchange rate offset the reduction in the average nominal level of protection (see table 2).

TABLE 2

Chile: average tariff and real exchange rate, 1973-1992

Year	Average tariff [a] (percentages)	Real exchange rate [b] (1980 = 100)	
		All countries	Excluding Latin America
1973	94.0 [c]	-	110.0 [c]
1974	75.6	-	115.2
1975	49.3	-	156.2
1976	35.6	-	126.6
1977	24.3	-	105.6
1978	14.8	-	117.2
1979	12.1	-	114.6
1980	10.1	-	100.0
1981	10.1	-	85.0
1982	10.1	-	98.7
1983	17.9	-	118.5
1984	24.4	-	122.0
1985	25.8	-	152.2
1986	20.1	171.8	171.8
1987	20.0	179.2	179.0
1988	15.1	191.0	186.1
1989	15.1	186.6	174.9
1990	15.1	193.6	170.4
1991	13.1	182.8	164.2
1992	11.1	168.2	152.0

Source: Ffrench-Davis, Leiva and Madrid (1991) and Central Bank of Chile.

[a] Simple average, excluding preferential arrangements such as those negotiated with the Latin American Integration Association (ALADI) and Mexico.

[b] The external price index used for the heading "All countries" was constructed on the basis of the following countries: Argentina, Brazil, Canada, Germany, Italy, Japan, Peru, Republic of Korea, Spain, United Kingdom and United States. The heading "Excluding Latin America" omits Argentina, Brazil and Peru. For the years up to 1985, the information was taken from Ffrench-Davis, Leiva and Madrid (1991); from 1986 on, it was obtained from the Central Bank of Chile. For methodological reasons, under the "All countries" heading information is presented only from 1986 on.

[c] December 1973.

This gave a strong boost to exports other than copper and afforded some protection for the more efficient import-substituting activities. In 1976, however, the overall direction of the fluctuations in the real exchange rate began to indicate the presence of a lag. One of the reasons for this was that the main focus of exchange policy gradually shifted away from support for the opening up of the economy and towards inflation control. This trend reached its height in 1979 when the nominal exchange rate was fixed in an effort to find a rapid way of bringing domestic inflation closer to the international rate.

The move to open up the capital account, in combination with the international capital markets' high level of liquidity, constituted another reason for the appreciation of the currency. Beginning in 1977, quantitative limits on borrowing by Chilean banks for the purpose of making local-currency loans were gradually relaxed (and, in fact, eliminated altogether by mid-1979). Restrictions regarding minimum borrowing terms were also reduced until these, too, were eliminated entirely in 1982. The heavy inflow of foreign capital to Chile, where local-currency interest rates were considerably higher than the rates being quoted on international markets, buoyed up the real appreciation of the peso (Ffrench-Davis, Leiva and Madrid, 1991).

Interestingly enough, in 1979, when the trade liberalization drive was brought to completion and a uniform 10% tariff was established, the real exchange rate was at almost the same level as it had been at the start of the liberalization process in 1974. Although there was a great deal of slack in the average nominal tariff (94%) existing at the start of the liberalization process and the amount by which domestic prices exceeded international prices was certainly smaller, the fact remains that such a sharp reduction in tariffs was unprecedented in Latin America. Basic trade policy theory would have indicated a need for a compensatory devaluation, but policy-makers actually did just the opposite. In the three years following the completion of the import liberalization programme, the rise in the currency's value accelerated, and this had a severe dampening effect on the production of tradable goods (Ffrench-Davis, 1986).

(ii) *Rectification of the reforms in the 1980s.* The domestic and balance-of-payments crises that hit the country in 1982 as a result of a combination of errors in economic management and three severe external shocks (the suspension of external credit, an increase in interest rates and a drop in copper prices) caused aggregate demand to fall by 27% and GDP to shrink by over 15% between 1981 and 1983. In an effort to cope with the crisis, a number of separate devaluations were instituted beginning in 1982 and, later on, a crawling peg was reintroduced. Between 1981 and 1988, the real price of the United States dollar rose by 119%. At the same time, the tariff rate was raised in stages up to a level of 35% in September 1984 (with annual averages of 24% in 1984 and 26% in 1985). Starting in March 1985, as the severe shortage of foreign exchange eased, the tariff was gradually lowered again, reaching 11% by mid-1991.

Following the crisis, trade policy became more flexible in various ways. One aspect of this change was that the Government began to make active use of anti-dumping measures to protect the economy from unfair trade practices. To this end, the tariff was raised again to a maximum of 35% (the level to which Chile had committed itself under the terms of GATT in 1979) on imports that Chile could prove were being dumped. In addition, a certain price range, which could be altered if necessary to keep it in line with international price trends, was set for three agricultural products (wheat, sugar and oilseeds); this also constituted a departure from the uniform tariff level. With regard to exports, the system of drawbacks was refined and a simplified system was adopted for minor exports; under this system, such exports are eligible for a refund of up to 10% of the value of the export so long as total exports of the corresponding tariff item do not exceed a certain annual maximum (currently set at US$20 million).

(iii) *Contrasts between the two reform programmes.* In summary, Chile has carried out two different trade reform programmes: a radical reform in 1974-1979 and a moderate reform package in 1985-1991. While it is true that the basic characteristics of the country's trade policy –in terms of the discontinuation of non-tariff trade barriers and the institution of a uniform tariff– have not changed since 1979, it should be remembered that the tariff had once again become relatively high by 1984 and was, in addition, accompanied by anti-dumping measures and the price bands mentioned above. In fact, the tariff level averaged 20% in 1984-1989, which was double the average rate for 1979-1982. The greatest difference, however, was that during the first liberalization drive the exchange rate had decreased in the beginning but thereafter rose steadily. During the 1980s, on the other hand, the reduction of the tariff from its maximum level of 35% in September 1984 to 11% by

June 1991 (its present level) was accompanied by a sharp real depreciation (associated with the debt crisis). This sent out positive signals to exporters while at the same time far outweighing the tariff reduction's slight negative effect on the production of goods that competed with imports. As a result, during the second liberalization programme the production of exportables grew more steadily. Unlike the first liberalization effort, however, it was also coupled with a strong upturn in the production of import substitutes, especially between 1984 and the end of that decade.

This more pragmatic approach has left its mark on exchange policy and the balance-of-payments capital account as well. Since 1987, Chile has had to cope with another influx of external capital; however, whereas a prolonged rise in the currency's value was permitted during the first liberalization programme, in keeping with the country's increasingly liberal policy regarding private capital flows, in mid-1990 an effort was mounted to curb the peso's appreciation in order to safeguard the growth prospects of producers of internationally tradable goods. To this end, policy emphasis has shifted away from unlimited entry for capital inflows and an effort has been made to hinder international arbitrage of interest rates. The Central Bank now uses a crawling peg whose point of reference is no longer the dollar but rather a basket of currencies. This basket is used to determine the central rate for the United States dollar, which is allowed to fluctuate within a 20% band and is thus subject to a dirty float. As regards capital flows, short-term external credits are subject to a reserve requirement (currently set at 30%). These policies have curbed the real upward trend in the currency which began early in 1988 and strengthened between January 1991 and late 1992 (Agosin, Fuentes and Letelier, 1993).

If we are to draw any conclusions from Chile's experience (Ffrench-Davis, Leiva and Madrid, 1991), one of them must certainly be that the second reform programme yielded better results that the first. The first was begun during a deep depression (1974-1975) and ended in another (1981-1982). Both crises were associated with severe external disturbances whose internal effects were exacerbated by the dogmatism with which the liberalization of the economy's external sector was implemented and by the confusion that surrounded the programme's goals and the policy tools required to achieve them.

During the first trade liberalization programme, sharp tariff reductions and the dismantling of quantitative controls appear to have had a greater impact on export growth than the much more modest tariff reduction of the second programme; in the first case, the trade reform initiative's point of departure was one in which the domestic prices of current (consumer and intermediate) importable products[5] were not pegged to international prices; consequently, there was an enormous amount of room in which to reduce costs through the substitution of nationally-produced inputs for imported ones and an abundance of opportunities for bringing about changes in relative levels of profitability. The fact remains, however, that because of the recessionary situation in which these reforms were instituted, their suddenness, and the nature of the trends exhibited by the exchange rate and interest rates, the export sector's strong performance was achieved at an extremely high cost and its dynamism was not transmitted to the rest of the economy; indeed, per capita GDP (as measured by comparing its 1974 and 1981 highs) grew by less than 1% per year, investment was far below its historical levels and the economy fell victim to a rapid process of de-industrialization (see table 3).

In 1984 the Chilean economy began to recover and then went on to achieve sustained growth based on an expansion of exportable supply in non-traditional sectors. The primary reason for the strong performance turned in by non-traditional exports was not the reduction of the country's tariffs, however, since tariffs were lowered by a quite moderate amount and a system of drawbacks was in place for exporters.

During the second liberalization drive, the depreciation of the currency was the main reason for Chile's export success (Agosin, Fuentes and Letelier, 1993), as the real exchange rate more than doubled between 1981 and 1988. The role played by foreign direct investment (FDI) in that export performance was also a fundamental factor. This suggests that the country's markedly pro-FDI policies and the fact that those policies have remained stable since 1974 have done more than tariff reduction has to stimulate export growth.

Two aspects that must be taken into consideration when evaluating Chile's two trade reform programmes are their impacts on capital formation and the growth of the manufacturing sector. Although gross fixed capital formation and capital efficiency had increased since the end of the recession of the early 1980s, the coefficient for fixed investment was

[5] Most capital goods imports were eligible for a wide range of exemptions.

TABLE 3

Chile: selected growth indicators, 1961-1992[a]
(Percentages)

	1961-1971	1971-1974	1974-1981	1981-1989	1989-1992
GDP growth rate	4.7	0.3	2.6	2.3	6.0
Growth rates for real exports:[b]					
Total exports	3.4	9.1	7.1	8.5	10.9
Non-copper exports	4.7	8.5	12.8	11.5	13.4
	1961-1970	1971-1973	1974-1981	1982-1989	1990-1992
Gross fixed investment / GDP	20.2	15.9	15.7	15.2	19.1
Manufactures / GDP	25.4	27.2	22.0	20.5	20.6
Exports[c] / GDP	12.0	9.9	20.2	27.0	32.4

Source: Calculations by the authors based on figures from the Central Bank of Chile and from Ffrench-Davis and Muñoz, 1990, tables 1, 3 and 6.

[a] At 1977 prices.
[b] Exports of goods.
[c] Exports of goods and services.

still below 20% of GDP at the start of the 1990s, a mark attained as far back as the 1960s. The economy's inability to surpass that level of investment prevented it from achieving significant growth in the period between 1974 and the end of the 1980s; indeed, the average cumulative growth rate for that period was only 2.3% per year.

During the first liberalization programme, the economy was subject to a rapid de-industrialization process, as evidenced by a five-point drop in the manufacturing sector's share of GDP. Many potentially strong manufacturing enterprises went bankrupt as a consequence of the particular combination of trade and exchange policies in use during that period.

The success of the second liberalization effort notwithstanding, the de-industrialization process set in motion by the first programme has not been reversed, and exports are still concentrated in natural resource-intensive product lines. It is also true, however, that the relative share of products with more value added has been expanding, investment has continued to rise, and the creation of new production capacity (although only since the start of the 1990s) has begun to increase at a sustainable pace which is also faster than the rate recorded for the 1960s.

3. Mexico

Like Chile, Mexico, too, launched a programme in mid-1985 that called for a drastic form of import liberalization and a gradual disassembly of the country's traditional instruments of industrial policy. It is important to note that, in contrast to the Chilean experiment of the 1970s, Mexico's liberalization effort was preceded and followed by a steep real depreciation of the currency (in 1982-1983 and in 1986-1987) which gave the manufacturing sector a large foreign-exchange "cushion" for its adjustment (Ten Kate, 1992). These large devaluations were necessary in order to cope with the balance-of-payments and fiscal crises sparked by the suspension of external credit (in 1982) and the drop in oil prices (in 1986-1987).[6]

Before embarking upon its trade liberalization programme, Mexico had used a wide variety of instruments to control imports, stimulate industrial production and steer the manufacturing sector towards external markets. In addition to a widely dispersed tariff structure having a ceiling rate of 100%, Mexican producers were protected by a system of advance permits applying to 92% of all imports and by the use of official prices for purposes of customs valuations which, in 19% of the cases, were higher than the imports' purchase prices. Exporters of non-traditional products were given large tax breaks to offset the anti-export bias of the country's trade policy. Furthermore, for quite some time Mexico had successfully been using industrial promotion programmes oriented towards import substitution in "strategic sectors" (in

[6] In Mexico, as in Chile, these devaluations helped the country to balance its fiscal accounts, since the earnings from its main export product are a major source of tax revenue and have converted the public sector into a net supplier of foreign exchange.

some cases in conjunction with export promotion measures). These programmes, which provided firms with protection in the domestic market and with tax incentives in exchange for the achievement of increasingly higher levels of local integration or export targets, had become the country's main industrial policy tool during the "difficult stage" of the import substitution process (Ros, 1992).

(i) *The reform programme launched in 1985.* The trade liberalization programme began in July 1985 with the elimination of quantitative controls on a large number of tariff positions. Its measures primarily affected intermediate and capital goods, but also applied to some consumer goods. Tariff rates were high in the beginning to offset the elimination of direct controls. Then, in July 1986, Mexico joined GATT, and its "entry fee" was a commitment to continue to substitute tariffs for direct controls and, later on, to reduce tariff rates. At the same time, a system of anti-dumping mechanisms was set up. In late 1987, together with the introduction of what was called the Economic Solidarity Pact, trade reforms were intensified: a large part of the advance permit requirements pertaining to consumer goods were discontinued; the remaining official prices were eliminated; and the tariff structure was simplified to the point where it involved only five rates, ranging from 0% to 20%, with a production-weighted average of 12% (and an import-weighted average of 6%). Subsequent adjustments made to narrow the spread of tariff rates even further had the effect of raising this average somewhat, but did not significantly change the liberal focus of Mexico's trade policy.

Mexico's trade reform programme has encompassed exports as well, and many export permit requirements have been eliminated. Those quantitative export restrictions that are still in effect are made necessary by the existence of price controls (on some agricultural products) or by bilateral or international agreements (regarding coffee, sugar, steel and textiles, which together still represent 24% of the country's non-oil exports, including the value added by the maquila, or inbond assembly, industry). The traditional sorts of export subsidies have been eliminated, in part as a consequence of bilateral agreements with the United States. The only export incentives now in use are programmes allowing duty-free entry for "temporary" imports and exemptions from import permit requirements for inputs brought in by export firms.

The use of industrial promotion policies has also been reduced substantially. The programmes that remain, which continue to place quantitative restrictions on imports, primarily apply to the automobile, microcomputer and pharmaceuticals industries.

The thick exchange cushion created by the real devaluations of 1986 and 1987 enabled the Government to launch its Economic Solidarity Pact, which included a freeze on the exchange rate, more extensive trade liberalization measures and wage restraint. In effect, the exchange rate began to be used as a tool for controlling inflation. During 1988 the nominal exchange rate was frozen and since 1989, nominal devaluations have been less than the net rate of inflation (the domestic rate minus the external rate). Since 1987, the real effective exchange rate has reflected a steady appreciation of the currency (see table 4).

The Economic Solidarity Pact was highly successful in cutting inflation back sharply. Along with the privatization of the banking system and the decision to participate in the Brady Plan, it helped to change expectations regarding the future of the Mexican economy. This change, in turn, helped to bring in a large volume of foreign capital and repatriations of flight capital that had left the country at the time of the external debt crisis. This inflow of foreign capital has made it possible to sustain a real revaluation of the Mexican peso and has helped to quicken the pace of the revaluation process. Foreign capital inflows have also been stimulated by reforms in other areas of economic policy, such as domestic deregulation, the privatization of a large number of government-owned enterprises, opening up the economy to foreign investment, and authorization for foreign mutual funds to invest in the stock market. In order to moderate these capital inflows, in April 1991 some controls on the banks' acceptance of foreign-currency deposits were reinstituted: a certain percentage of such funds cannot be loaned out in pesos but must instead be held as liquid foreign-exchange assets, and foreign-currency deposits may not exceed 10% of total deposits.

(ii) *Gross domestic product and export performance.* Mexico's exports of manufactures have achieved high growth rates and the manufacturing sector's share of GDP has expanded slightly, but the Mexican economy's overall post-reform growth rates have been quite modest (see table 5). Between 1985 and 1992, per capita GDP did not increase at all and, although investment has made a substantial recovery, it is still below historical levels (investment coefficients have ranged from 16% to 22% of GDP, as compared to levels of between 22% and 25% in the 1970s).

TABLE 4

Mexico: trade policy indicators and real exchange rate, 1981-1992
(Percentages)

Year	Domestic production protected by import permits [a b]	Domestic production protected by official prices [a b]	Average tariff [a b]	Number of tariff lines	Maximum tariff	Real exchange rate [c] (1985=100)
1981	64.0	13.4	22.8	...	...	72
1983	...	...	...	...	...	115
1984	92.2	18.7	23.5	...	...	100
1985	47.1	25.4	28.5	10	100	100
1986	39.8	18.7	24.5	11	50	139
1987	25.4	0.6	11.8	11	40	145
1988	21.3	-	10.2	5	20	118
1989	19.8	-	12.5	3	20	110
1990	17.9	-	12.4	3	20	108
1991	...	-	12.0	3	20	98
1992	...	-	12.0	3	20	91

Source: Ten Kate (1992), Ros (1992) and ECLAC (1992a and 1992b).

[a] The figures shown for 1985 through 1990 refer to December of each year; the figures for 1981 correspond to April 1980 and those given for 1984 correspond to June 1985.
[b] Weighted by output.
[c] Exchange rate applying to exports (ECLAC, 1992a).

TABLE 5

Mexico: selected growth indicators, 1980-1992

Year	GDP growth rate (percentages)	Fixed investment / GDP (percentages)	Manufactures / GDP (percentages)	Non-petroleum exports		
				Billions of dollars		As a percentage of total exports [a]
				Goods	Maquila services	
1970-1979	6.5	23.4 [b]	22.8	...	...	85.9
1980	9.2	24.8	22.1	6.0	0.8	40.0
1985	2.6	17.9	21.4	6.9	1.3	35.6
1986	-3.8	16.4	21.0	9.7	1.3	63.6
1987	1.9	16.1	21.3	12.0	1.6	61.8
1988	1.2	16.8	21.7	14.1	2.3	71.3
1989	3.3	17.4	22.5	15.0	3.1	69.9
1990	4.4	18.8	22.8	16.9	3.6	67.4
1991	3.6	19.5	22.9	18.9	...	...
1992	2.5	21.7	22.7	19.5	...	...

Source: ECLAC (1992b and 1993) and Ros (1992).

[a] Share of total merchandise exports plus maquila services accounted for by non-oil merchandise exports plus maquila services.
[b] Simple average for the period 1970-1979 in constant 1980 dollars.

The Mexican economy has, however, undergone a major structural change in the form of a sustained increase in exports other than petroleum, which climbed from US$4.8 billion in 1982 to US$9.7 billion in 1986 and to US$18.9 billion in 1991. By the end of the 1980s, manufactures accounted for 85% of total non-petroleum exports.

Champions of the trade liberalization initiative contend that import liberalization is what has made the boom in non-oil exports possible by giving producers of exportable goods access to high-quality inputs at international prices and by making it less profitable to produce for the domestic market (thereby indirectly encouraging an export-oriented

reallocation of resources). However, the sharp increase in non-oil exports had begun in 1983, before the introduction of trade reforms, and it is therefore difficult to attribute the expansion entirely to those reforms. Ros (1992) has estimated that nearly one half of the increase in exports other than petroleum during the period 1982-1988 was accounted for by three sectors (the automobile, computer and *maquila* industries)[7] which did not benefit from the measures adopted in order to open up the economy, either because their imports of inputs were already duty-free (the *maquiladoras*) or because the imports that were competitive with their products or their imported inputs remained subject to restrictions under industrial development programmes (automobiles and personal computers).

One hypothesis which fits in better with actual trends in the Mexican economy is that the non-petroleum export boom had more to do with the steep real depreciation of the currency seen in 1982-1983 and 1986-1987 and with the depression that hit domestic markets, which obliged producers to look for markets outside the country, especially in the United States. Most of Mexico's new exports of manufactures are produced by industries that were founded during the era of import substitution with a relatively small new investment; there has not been any large-scale reallocation of resources to sectors in which Mexico may be supposed to have comparative advantages (labour-intensive activities oriented primarily towards external markets). Hence, Mexico's successful bid to expand its exports has largely been made possible by its earlier import substitution effort and the development programmes implemented in strategic sectors (Ros, 1992).

4. Bolivia

As part of its effort to stabilize and organize its economy in order to overcome hyperinflation and resume its growth, during the final quarter of 1985 Bolivia initiated an ambitious trade liberalization programme which it has been applying ever since (Morales, 1992). Before the start of its programme, Bolivia had a highly dispersed tariff structure with a maximum rate of 150%; it also had banned some imports and required import permits for others. Its first steps were to establish a single exchange rate, restore complete convertibility, dismantle its quantitative restrictions and reduce tariff levels. In addition, the capital account was opened up almost entirely. Since then, major devaluations have been instituted, as evidenced by the movement in the Bolivian currency's real effective exchange rate (see table 1).[8]

In July 1986 Bolivia greatly simplified its tariff structure by establishing a uniform 20% tariff rate. Early in 1988, the tariff on capital goods was lowered to 10%, with the 20% rate being retained for other products until the end of that year, when it was reduced to 17%. In 1990, tariffs were lowered to 5% on capital goods and 10% for other products and have remained at those levels since then. Thus, the Bolivian economy has become one of the most open economies in Latin America and, indeed, the world.

In order to stimulate non-traditional exports, a subsidy equivalent to 10% of the value of exported products was instituted. This instrument, which was known as the Tariff Drawback Certificate (CRA), was intended to mitigate the anti-export bias generated by the duties levied on imported inputs that were used in producing items for export. For fiscal reasons and by agreement with the International Monetary Fund (IMF) and the World Bank, the CRA was discontinued in early 1991.

As may be seen in table 6, ever since Bolivia put an end to hyperinflation in 1986, its economy's growth rates have been quite modest, especially in comparison to those recorded in the 1970s. In the six years following the steep decreases registered in 1985 and 1986, per capita GDP has risen by less than 1% annually. What little economic growth has been achieved has not even been enough to bring per capita GDP up to 80% of what it was before the crisis of the early 1980s. In addition, investment, when measured as a percentage of GDP, fell following the reforms. The decline in private gross fixed investment from 7% of GDP in 1982 to less than 4% in 1990 is particularly worrisome (Morales, 1992), although it was up somewhat again in 1991-1992. One positive development, in addition to the sharp reduction made in inflation, has been the diversification of exports, although they are still concentrated in the categories of mineral or agricultural products. Non-traditional exports rose steeply between 1988

[7] Only the value added by the *maquila* sector is computed as an export in Mexico's statistics. In keeping with Ros (1992), here the *maquila* sector is reclassified under merchandise exports.

[8] The system used by Bolivia for determining its currency's exchange rate can be characterized as a dirty float.

and 1990, but then slipped a bit in 1991 and 1992; meanwhile, it took total exports until 1990 to regain a level close to that of 1980, and then they, too, declined during the following biennium. Thus, the Bolivian experiment demonstrates that in a largely undiversified economy with low levels of productivity, reforms aimed at altering market signals in order to align domestic prices with international prices are clearly not enough to initiate or carry forward a timely process of structural change.

TABLE 6

Bolivia: selected growth indicators, 1970-1992
(Percentages)

Year	GDP growth rate	Gross fixed investment/GDP	Real export growth rates	Total exports (millions of dollars)	Non-traditional exports [a] (millions of dollars)
1970-1980	3.9		-10.5		
1980-1984	-1.9	12.1	-28.3	871 [b]	68
1985	-1.0	12.3	-7.6	673	35
1986	-2.5	13.3	4.5	638	108
1987	2.6	13.6	-0.2	569	106
1988	3.0	13.6	3.7	600	108
1989	2.8	12.7	18.5	822	204
1990	2.6	12.1	20.8	927	292
1991	4.1	12.9	2.3	849	252
1992	3.4	13.3	-11.1	710	205

Source: ECLAC (1992b) and ECLAC (1993).

[a] Total exports except zinc, tin, silver, tungsten, antimony, gold, lead, other minerals, natural gas and other hydrocarbons.
[b] Simple average.

III

The lessons to be learned from Asia's dynamic economies

Despite their great diversity, the manufactures-exporting economies of Asia have some characteristics in common with regard to their development strategies and policies (and their results) which make a comparison between them and Latin America particularly instructive. The analysis to be undertaken in this section will be based on the experiences of the Republic of Korea and the Chinese province of Taiwan, which have been engaged in an outward-looking industrialization process for several decades now. Since the late 1970s, other Asian economies (Indonesia, Malaysia and Thailand) have been implementing fairly similar policies and they, too, have had positive results in terms of promoting growth based on exports of manufactures (Agosin, 1992; Noland, 1990; Ariff and Hill, 1989). In all of these economies, the industrialization process started out with an import-substitution model and, without exception, subsequent policies aimed at giving the economy an outward-looking orientation have been superimposed upon the existing import-substitution system (Noland, 1990, chapters 2 and 3). These economies made the transition to an outward-oriented industrialization model without going through any contortions because it was based, in large part, on the industrial skills and capacities they had developed earlier.

In general, the strategy they used was to provide relatively equal incentives for exports and for production intended for the domestic market *within any given industry* but to offer quite dissimilar incentives

(and ones that changed over time) *to different industries*. In formal terms, the effective exchange rate, which incorporates the effects of all the various incentives (tariffs, subsidies, etc.), for exports was more or less equal to the effective exchange rate for import-substitution activities in industry i, but differed substantially between industry i and industry j:

$$TCE(X_i) \approx TCE(M_i);$$

$$TCE_i \neq TCE_j$$

Although the level of protection in the Republic of Korea and the Chinese province of Taiwan has decreased considerably in the past few decades and is now approaching levels characteristic of developed countries (Noland, 1990), these economies began their outward-oriented industrialization processes with high protective barriers which were not dismantled for the sake of reorienting the economy towards exports. [9] One facet of this process which an observer of the rapidly-growing economies of Asia cannot help but notice is the State's ability to provide incentives and then to take them away again, thereby preventing them from becoming vested interests of the businesses which have received them. In other words, the State has demonstrated a striking ability to apply *temporary promotion policies*. Furthermore, all such incentives have traditionally been granted only in exchange for the achievement of specific targets, usually in the area of exports.

Another highly significant aspect of these experiences is the authorities' success in forestalling a major revaluation or preventing the real exchange rate from exhibiting sharp fluctuations such as those usually seen in the Latin American countries. The presence of tariffs and other substantial trade barriers obviously indicates that the currencies of these Asian economies were overvalued, but the degree of overvaluation was moderate and was in most cases offset by various sorts of export subsidies. In order to control their exchange rate, most of these economies have exercised effective control over foreign capital flows and have achieved a satisfactory degree of macroeconomic stability.

The Asian countries' experiences suggest that trade liberalization is not a necessary element of export-based industrialization. In fact, most of these economies have been able to maintain relatively protectionist policies and to grow outward at the same time. Two factors play a fundamental part in accounting for this phenomenon, which appears to fly in the face of conventional trade policy recommendations. The first of these factors is that, in all the successful cases, the authorities have made heavy use of various sorts of export subsidies to offset the anti-export bias implicit in the protection of importable product lines; each and every one of the Asian economies examined here have mechanisms for refunding tariffs and indirect taxes to exporters and some have more than one such mechanism, with exporters being able to choose among them according to their particular circumstances. The second factor is that incentives have been provided in exchange for the achievement of specific performance targets and for limited periods of time.

Although all of Asia's fast-growing economies have certain characteristics in common, there are also some significant differences among them which are of interest to us here, since Latin America has important lessons to learn from each of these countries' experiences. Perhaps the most interesting aspect of the Republic of Korea's experience has been the different ways in which mature and infant industries have been treated (Westphal, 1992). The trade policy applied to mature industries was intended to be neutral, so drawback mechanisms were designed to refund customs duties and indirect taxes to both direct and indirect exporters (the latter being producers that sell inputs to exporters). During the 1960s, these businesses also enjoyed additional incentives, such as access to credit on easy terms, preferential access to import permits, and some reductions in direct taxes.[10]

The provision of incentives (which were tied to export targets) for government-promoted infant industries was much more aggressive. The main method used for this purpose was the award of temporary monopolies to selected firms in the branches of industry which the Government wished to promote in exchange for the achievement of specific export targets. This meant that, in practice, the promotion of import substitution was transformed into an export-promotion mechanism. These firms soon became

[9] For example, in 1976, more than a decade after its industrialization process was launched, the Republic of Korea had tariffs ranging from 0% to 150%, and for nearly 1,000 tariff items (approximately 40% of all items), the rates were between 30% and 60%. Quasi-tariff mechanisms and exemptions were also used heavily (Ffrench-Davis, 1986).

[10] Incentives other than drawback mechanisms started to disappear in the 1970s, but the levels of protection provided for these sectors on the domestic market were also lowered.

exporters, since they were able to subsidize their external sales with the substantial profits they realized in the domestic market. Perhaps the crucial factor in arriving at this result was that the system of incentives in use prompted these firms *to attain international competitiveness from the very outset.* This emphasis enabled them to rapidly take advantage of economies of scale and to learn through hands-on experience.

Another important element was the preferential access to *short- and long-term* credit on easy terms which was provided to firms in the selected sectors. Actually, by favouring certain sectors, the Government was favouring specific conglomerates whose creation it had instigated. This stimulus for the emergence of agents of production in State-promoted sectors, in conjunction with ample access to credit at subsidized interest rates for these activities, was the State's (successful) way of making up for the capital markets' shortcomings (Amsden, 1993). The industrial policy was a sequential one: in the 1960s priority was placed on investment in cement, fertilizers and oil refineries; in the late 1960s and early 1970s, the emphasis was on steel and petrochemicals; in the 1970s, importance was placed on shipyards, capital goods and consumer durables (including motor vehicles); and in the 1980s, the focus was on electronics, telecommunications and informatics.

The industrial and trade policies applied in the Taiwanese economy have in some ways been similar, particularly as regards the sequencing of State support for specific firms and sectors: special assistance was given to the textiles, glass, plastics, cement and consumer electronics industries in the 1950s; to synthetic textiles and steel in the 1960s; to motor vehicles in the 1970s; and to the information industry since the late 1970s (Wade, 1990a and 1990b, chapter 4). As in the Republic of Korea, State leadership in respect of the industrial strategy focused on high-overhead, capital-intensive activities or on activities in which the technology was monopolized by a small number of potential suppliers. These were industries which were expected to become internationally competitive.

Some of the promotion mechanisms were similar to those used in the Republic of Korea, including the protection of the domestic market, subsidized long-term credit, and tax exemptions. One somewhat different facet of the Taiwanese experiment, however, was the aggressive use of State enterprises and investment and the promotion of foreign investment (usually in partnership with national capital) in the sectors selected for promotion.

As time has passed, the State's leadership role in implementing this industrial strategy has been tempered and has taken on a less interventionist cast both in the Chinese province of Taiwan and in the Republic of Korea. It is hoped that, as a result of the trade reforms now being undertaken, both economies' tariff levels and spreads will closely approach those of industrialized countries (Noland, 1990, pp. 9-11). As the State withdraws from its leadership role in industry, protection is gradually taking on the same function in these economies that it performs in industrialized countries, i.e., that of defending the most backward sectors (especially agriculture).

IV

Criteria for an evaluation

An examination of Latin American liberalization efforts and of the longer-term Asian programmes yields conclusions that may have an important bearing on economic policy management in Latin America. These findings can help to adjust reforms now under way so that they will contribute more efficiently to the countries' efforts to speed up their growth and to change their production patterns. This does not mean that countries which have embarked upon comprehensive reforms should retrace their steps. The reversal of policies that are already in place can have such a high cost that it may be better to continue with existing policies even if they are suboptimal. What must be done even in such cases, however, is to assess both the steps already taken and their existing or probable outcomes in order to determine what else needs to be done to increase the probability that the countries of the region will reach the goals which their trade liberalization efforts are intended to achieve, i.e., the establishment of a position within the international economy that will be more effective in furthering their development.

1. The relationship between import liberalization and export promotion

Experience has demonstrated that it is more effective to liberalize imports once a sustained increase in exports and a dynamic transformation of the production apparatus have already been achieved. The cases of the East Asian countries bear witness to this fact (Sachs, 1987). This is the first of the options set forth in the analytical scheme presented earlier (see section II, subsection 1 and figure 1). Although this course of action is no longer a feasible option for many Latin American countries, the Asian countries' experiences demonstrate the need to take direct steps to boost exports rather than waiting for import liberalization alone to have the desired effect on export performance.

In the majority of the liberalization programmes being pursued in Latin America (especially in the cases of Argentina, Colombia, Peru and Venezuela), the option of promoting exports first and liberalizing imports later has already been explicitly ruled out; a liberalization programme has already been carried out, and it was done in a context where the creation of production capacity in these countries' economies was a far cry from being dynamic. A similar path was chosen by Chile, Bolivia and Mexico, which liberalized their imports without providing any significant measure of support for exports other than a depreciation of the currency (and even this trend tended to reverse itself in Chile during the period 1979-1982 and in Mexico starting in 1988). Moreover, all the countries that have undertaken sweeping reforms have proceeded to dismantle or cut back export promotion schemes that had been successful in the past. This suggests that the costs of these liberalization programmes in terms of growth will be high while the transition is being made to a new equilibrium. One constructive question that might be posed at this point is, given the constraints imposed by the path already chosen, how can the overall efficiency of the reforms be enhanced? The suggestions that follow are all directed towards achieving that objective.

2. Incentives: selectivity versus neutrality

Neither the mainstream of past experience or the cases discussed here support the hypothesis that, once a country has made its incentives neutral by dismantling all protection and discontinuing all subsidies, resources will be reallocated spontaneously and inexpensively to the sectors in which that country has comparative advantages. Chile's experience attests to the high costs of a radical liberalization drive which did away with all traces of selectivity. It is unlikely that these costs (in essence, the costs of the transition) will be cancelled out by the more rapid growth that may be achieved after the adjustment has been completed. As is suggested by the Asian countries' experiences, more selective, less drastic policies regarding the liberalization of imports, together with firmer support for non-traditional exports, might well have enabled the economy to turn in a stronger overall performance.

If the aim is to change production patterns efficiently in a way that will make the economy more open to external trade and carve out a qualitatively different position for it within international markets, then the entirely passive momentum generated by liberalization will not suffice; policies that create an active form of momentum will also be needed. Obviously, this does not mean that we should return to the high, indiscriminate protective barriers of the past. In fact, it can be argued that import substitution policies erred by being too indiscriminate rather than too selective. What is needed is a much greater degree of selectivity, not in the sense of giving support to specific activities (which may be difficult to identify), but rather of making sure that deviations from neutrality are few and well chosen.

The desired form of selectivity must also stay clear of the anti-export bias of the past; in other words, equivalent incentives should be given for exports and for production for the domestic market. Under present circumstances, and given the small size of most of the region's economies, an argument can be made for explicitly pro-export policies. Since the Latin American countries have opted for above-zero tariff levels and, in all cases except that of Chile, for some degree of differentiation, then roughly equivalent export subsidies are required.

There are no compelling theoretical or practical reasons for choosing absolute uniformity in the case of tariffs. If most industrial activities are subject to dynamic economies of scale of a more or less diffuse nature, then it can be argued (as it is by Rodrik, 1992) that it is best to benefit broad categories of manufacturing activities rather than getting embroiled in trying to "pick winners" by favouring specific industries. Moderation in terms of the number of tariff levels and brackets will help to curb abuses. Furthermore, any tariff in excess of the base level should be temporary in nature.

As noted earlier, export subsidies are necessary, especially if the aim is to promote an efficient form of industrialization in the presence of import duties. One element that is essential in order to avert an anti-export bias is the establishment of drawbacks on inputs used in the production of exportable goods. Indeed, cases can be found both in Latin America (e.g., Colombia, Costa Rica and Brazil) and in Asia where subsidies for non-traditional exports have been in place for extended periods of time and have yielded positive results. In order to minimize the possibility that such subsidies may be misused, consideration might be given to designing a system whereby subsidies would decrease as exports increase based on a pre-established, publicly-announced timetable that is not subject to renegotiation.

Selectivity involves a number of different aspects which extend beyond the bounds of trade policy and cannot be examined in detail here. These elements include means of giving exporters access to pre- and post-shipment commercial credit at international interest rates, measures to supplement the capital market and eliminate its bias against new projects, the improvement of the physical and social infrastructure needed to carry forward the development of the export sector, policies on foreign direct investment that will facilitate the acquisition of new technologies and access to international markets, and the adoption of a coherent policy regarding involvement in international trade negotiations for the purpose of gaining access to the international markets in which a given country hopes to position itself.

To return to the subject of incentives for a moment, one fact which policy-makers should bear in mind as they proceed to formulate trade policies for the 1990s is that the international situation has changed substantially since the burgeoning economies of East Asia embarked upon their export-based industrialization processes in the 1960s and 1970s. Today, it would be much more difficult to offer incentives of the magnitude that were granted at that time by the East Asian economies, both because of the more sluggish and more protectionist environment that now exists in the international economy (which now makes it more likely, for example, that importing countries would protect themselves against export subsidies by levying countervailing duties) and because international rules and standards in the area of trade policy are much stricter than they used to be. Moreover, if the Uruguay Round is brought to a successful conclusion, it is highly probable that the developing countries' manoeuvering room for the subsidization of exports will be even further reduced.

3. Gradual or swift liberalization?

The Latin American countries that have undertaken trade liberalization programmes in recent years have clearly opted for a rapid form of implementation. The comments made in this section are therefore directed primarily to countries that have not yet consolidated their reform process. It is still too early to evaluate the results of these recent, drastic reform efforts. Be that as it may, the experiences of the Asian economies as well as of Colombia between the mid-1960s and 1989 (Ocampo and Villar, 1992) and of Costa Rica between 1983 and 1990 (Herrera, 1992) appear to suggest the advisability of a gradual approach that permits the retrofitting of existing industries rather than destroying a large percentage of a country's installed capacity, as inevitably occurs during a rapidly-applied liberalization initiative.

In Colombia, the transition made in the mid-1960s from an import-substitution model to a mixed model that placed priority on both import substitution and export promotion has played a pivotal role in steering the manufacturing sector towards an increasingly external orientation while avoiding the trauma associated with drastic liberalization drives such as Chile's. In Costa Rica, tariff reduction was a gradual process and was coupled with export incentives and drawback mechanisms. The expansion of non-traditional exports –the most salient feature of Costa Rican development in the 1980s– was in large part generated by firms established during the application of the earlier import-substitution model. In addition, a deliberate effort was made to promote foreign investment in the production of exportable textiles and electronics.

The adoption of a gradual approach does not mean that all reforms need be gradual, however. The elimination of the slack in tariffs, the conversion of quantitative restrictions into tariffs ("tariffization") and the necessary exchange-rate adjustments can all be done at a single blow. Subsequent tariff reductions should, however, be phased in gradually so as to keep pace with producers' ability to adapt their production structures to increased competition.

4. The role of the exchange rate

The way in which the exchange rate is handled will undoubtedly play a decisive role in determining the outcome. Averting an exchange-rate lag would seem to be essential to the success of any trade reform whatsoever, regardless of whether it takes the form of a drastic liberalization drive or a gradual, controlled opening of the economy. Once again, the Chilean experiment of 1976-1981 (as well as the experiences of other Southern Cone countries during the 1970s) show just how harmful the combined impact of a real appreciation of the currency and a drastic import liberalization programme can be. In contrast, the new adjustment undertaken by Chile between 1983 and 1991 was more successful and sustainable than the programme it implemented in the 1970s because tariff reduction was coupled with a steep real devaluation.

Most of the more recent liberalization programmes in Latin America are being implemented in the presence of a sharp appreciation of the currency in real terms. In fact, some of the countries in which the import liberalization process has been the most comprehensive have also experienced severe exchange-rate lags. The question of how the exchange rate should be managed in order to bolster the process of changing the production apparatus is an aspect of economic policy that has not yet been satisfactorily addressed in Latin America.

The experiences of the Latin American countries demonstrate that exchange policy alone is not an adequate substitute for an effective anti-inflation policy. Except in the short term when it is used as a means of changing expectations, the exchange anchor for domestic prices has proven to be extremely flimsy, particularly in high-inflation countries. Stabilizing price levels is certainly an essential step in any policy attempt to bring about a permanent change in relative prices, but this cannot be achieved simply by fixing the nominal exchange rate. The exchange rate is an indispensable tool for changing production patterns while maintaining an external equilibrium. This is one of the messages of the East Asian success stories.

5. External financial liberalization

Another lesson to be learned from an examination of the differences between the Latin American and Asian experiences is that the liberalization of international capital flows can jeopardize the achievement of trade liberalization objectives.[11] Financial liberalization has two components –one internal and the other external– that usually go together. Internal financial liberalization involves, *inter alia*, allowing interest rates to be determined by market forces. External financial liberalization takes the form of a combination of various measures: permitting non-residents to deal in the domestic financial market or permitting residents to take out loans in international financial markets; permitting residents to buy foreign exchange in the domestic market and then to invest or spend it abroad; and permitting foreign-currency transactions to be conducted in domestic markets. While internal financial liberalization strengthens the link between inflation and interest rates, external financial liberalization weakens the link between domestic prices and the exchange rate (Akyüz, 1993). This makes it more difficult to implement a trade liberalization programme successfully, for two reasons. First, the combination of internal and external financial liberalization measures makes the exchange rate difficult to control. Second, it raises interest rates and makes them more volatile, thereby discouraging productive forms of investment.

The simultaneous liberalization of internal and external financial dealings poses serious problems for economic policy management. Internal liberalization measures usually lead to steep increases in interest rates (both nominal and real) and to wide swings in those rates over a protracted period of time; when a gap opens up between domestic and international interest rates and it does not appear that the gap is going to be closed by a depreciation of the currency, then destabilizing capital flows can reach considerable proportions.

Under conditions such as those prevailing during the second half of the 1970s or the early 1990s, external financial liberalization makes the management of the real exchange rate more difficult (Williamson, 1992). Short-term capital flows generated by the hope of turning a speculative profit from the differential between international and domestic interest rates may cause the real exchange rate to become highly unstable and may thus hinder the management of this variable, which is an economic policy tool of crucial importance in any attempt to change production patterns.

[11] Regarding the sequencing of trade and capital-account liberalization measures, see Edwards, 1989. On stability and capital movements, see Díaz-Alejandro (1985) and Williamson (1992).

Moreover, instability in exchange and interest rates tends to stimulate an attitude in which profit-seeking predominates over considerations of production and to send out mixed signals to resource allocators.

Some recent examples can be found in the region of fairly successful approaches to the management of speculative capital. One such example is that of Chile, which learned from its experiences in this connection. The steep appreciation of Chile's currency seen in the late 1970s was attributable to the fact that national banks had unrestricted access to external credit. More recently, the adoption of a more pragmatic attitude has made partial protection of the exchange rate possible and has helped make the benefits of trade liberalization more tangible. Colombia has also availed itself of a variety of measures to staunch the short-term capital flows that threatened to trigger a revaluation. Brazil and Mexico have also made some attempts to moderate short-term financial flows.

In a number of other Latin American countries, recent trade liberalization efforts have been accompanied by fairly ambitious financial liberalization initiatives coupled with heavy inflows of capital that have tended to outstrip the monetary authorities' ability to sterilize those flows. In these countries, the move to dismantle controls on capital and the authorities' inability to regulate capital movements are hindering efforts to open up production activities to foreign trade.

Hence, as regards the balance-of-payment capital account, the problem being faced by the countries of the region is how to link national capital markets up with external capital markets in a way that will minimize artificial inefficiencies (currency appreciations that tend to move the markets away from equilibrium) and the destabilizing effects of short-term capital flows, which usually appear when they are not needed and tend to dry up when they are essential to balance-of-payments equilibrium. It therefore appears necessary to distinguish between flows of foreign capital having long-term production objectives (e.g., foreign direct investment), which are beneficial, and other short-term flows of a purely speculative nature, which need to be discouraged.

V

Final considerations

In conclusion, past experience seems to demonstrate that, together with a rationalization of trade incentives, some degree of selectivity must be exercised with respect to a country's policy for the development of production. This is what has been done in the fastest-growing economies of East Asia. The problem lies in how to identify the most efficient mechanisms, which will include gradually decreasing incentives tied to specific export targets, and the necessary reforms in the public sector's institutional structure. The degree of selectivity must actually be greater than during the import substitution phase, and the criteria on which its administration is based need to be clearly defined. Protection for national production activities and export incentives are part of a policy package aimed at implementing a development strategy and changing production patterns. But experience teaches us that incentives must be moderate and have definite time limits; that departures from neutrality must be few and well chosen; and that the anti-export bias of protection must be counterbalanced with export incentives. It also seems to be more efficient to provide incentives for broad categories of activity –those which have the greatest chance of providing dynamic benefits that will not be internalized by the market– than to try to "pick winners". The promotion of non-traditional exports appears to be a particularly appropriate sphere for selective trade policies.

Other aspects of selectivity mentioned in this article which have not been accorded due attention in recent reform efforts (or, for that matter, in some longer-standing ones, such as Chile's) have to do with what the State does to correct market flaws that hamper investment oriented towards changing production patterns. Such State action includes policies for supplementing the capital market, attracting foreign investment to new sectors that can acquire comparative advantages and upgrading physical and social infrastructure, along with the application of an effective vocational training programme and the negotiation of access for specific products to specific markets.

In order to open up the production sector in a way that will further a country's development, corrections will have to be made in the extreme forms of liberalization advocated in recent years. More realistic adjustments will certainly have to be made in the policies being applied by many countries.

Trade policy modifications should be accompanied by a greater appreciation of the exchange rate's role in bringing about changes in production patterns. It appears to be impossible to steer the private sector's production activities firmly in the direction of internationally tradable goods unless a favourable exchange rate that remains stable over time (i.e., that withstands the influence of temporary economic conditions) is maintained. The economic authorities of the region need to devote greater attention to the economic policies required to achieve this objective, one of which will surely be the regulation of short-term international capital flows.

One essential condition for a successful liberalization effort is a supportive international environment. Unless protectionism is eradicated from the central countries, liberalization will be greatly weakened as a policy option –not, as in East Asia in the 1960s, for just a few countries but for the wide range of countries that are currently pursuing liberalization initiatives.

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