

219

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Latin American Trade Policies: Issues and Options

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1. Introduction

After a decade of turmoil, the trade policies of most Latin American countries are converging towards three basic traits: (a) the use of few, if any, non-tariff barriers; (b) the adherence to subregional projects of economic integration designed to face international competition, and not to avoid it, as it was usual during the time of import substitution strategies; and (c) the inclination to accept a free trade area with the US, despite the historical record of frictions and complaints.

The degree of interdependence among such trends is high. Stable and transparent national policies are essential to any integration process, the negotiation of a free trade agreement with the US would be easier if Latin American integration were more advanced than it is now, and the accomplishment of both tasks would strengthen the credibility of national policies.

This paper aims to discuss the conditions for long run stability of these policies. This implies two types of endeavors. First, it is necessary to analyze the consistency of current trade policies in regard to other national policies. Second, the constraints that international commitments impose on governmental behavior should also be considered.

¹ This paper was prepared for the IDB/ECLAC project Support to the Process of Hemispheric Trade Liberalization. I would like to thank, without implicating, Ronald Sprout, Inés Bustillo, Isaac Cohen, Daniel Lederman and Daniel Robinson for helpful criticism and advice. I am grateful also to Rex García, who introduced me to Harvard Graphics.

This approach is useful not only to assess perspectives but also to clarify certain peculiarities of Latin American commercial strategies in the past. In fact, the intention to open these economies is not new. During the last thirty years, almost every country in the region has tried to implement trade reforms that afterwards were abandoned. Argentina (1977/81), Brazil (1967/73), Colombia (1978/82) and Uruguay (1974/82) are some outstanding examples. Even Chile, the most radical and enduring experiment ever dared in the continent, passed through a partial reversal in 1983/85.

No ideological tags can be attached to Latin American trade reforms. They have been implemented by either right wing military dictatorships or by social democratic governments. In Brazil, for instance, the economy was under the command of the same Minister, Mr. Antonio Delfim Netto, on two occasions: 1968/73 and 1980/84. In the first period, tariffs were lowered and the administrative controls on imports relaxed. In the second, tariffs were prohibitive and import controls so tight that no commodity made in the country faced foreign competition in the local market. Afterwards, Mr. Delfim Netto won a seat in Congress and became a devoted supporter of free trade!

Another interesting aspect is that rent seeking is not the only relevant factor to explain protectionism in Latin America. As it is well known, balance of payments' disequilibria always have been among the major triggers to establish trade barriers in the region. Evidently, once import management is in place, vested interests start to fight for its perpetuation and rent seeking becomes dominant.

It is worth remembering that the great intellectual appeal of import substituting industrialization resulted from the belief that it would solve simultaneously two long run problems: the structural

roots of inflation and the bottlenecks that were hampering the process of economic development. Some competitive industries were created by that strategy, and this can be credited as a partial achievement of the latter objective. But, in regard to the former, there is not a single piece of evidence that could be interpreted as a sign of its success.

Nowadays, when liberalism is fashionable in the region, the same basic question remains to be answered: How can trade policy be used as an instrument to promote economic efficiency under an environment of growth, social equity, and macroeconomic stability? The following sections will treat this question through the discussion of three main topics: (a) exchange rate instability (section 2); (b) nature of the linkages among trade, industrial and fiscal policies (section 3); and (c) the interplay between domestic policies and international interests (section 4). The conclusions are summarized in section 5.

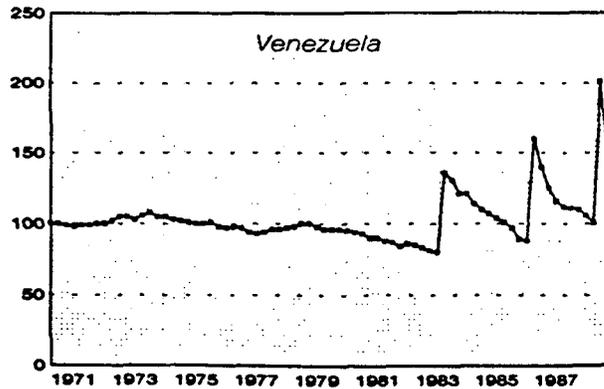
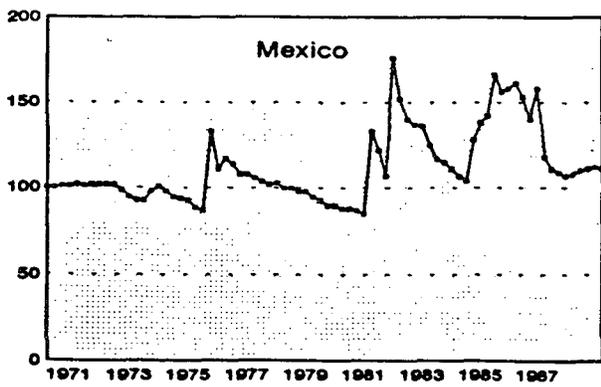
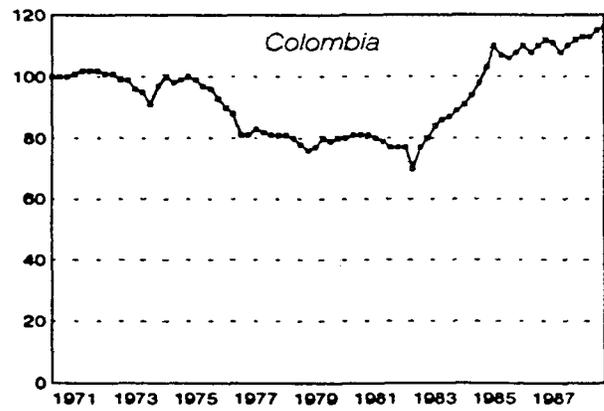
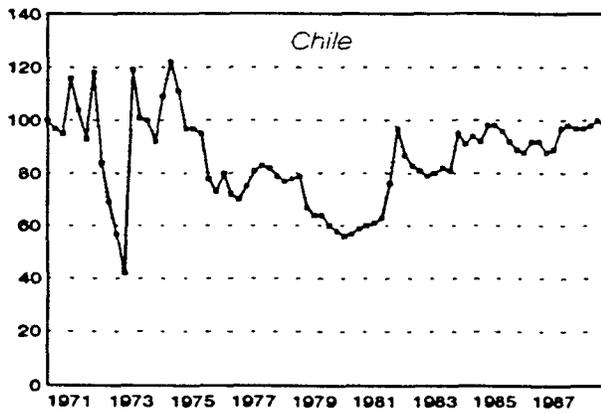
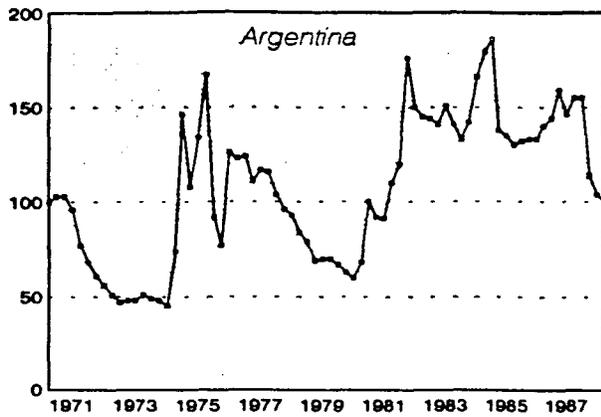
2. Exchange rate instability

The graphs in the next two pages describe the behavior of real exchange rates in six Latin American countries (Argentina, Brazil, Chile, Colombia, Mexico, and Venezuela) during the last two decades, and in four industrial economies (Canada, Germany, Japan, and United States) during the eighties.² They reveal three

²We are not using the same definition of real exchange rate for both sets of countries, but this does not alter our conclusions. For Latin America, the real exchange rate index e is measured as follows: $e = NR * PW/PD$; where NR is the nominal exchange rate (national currency units per dollar); PW is the US wholesale price index; and PD is the consumer price index of the domestic country. For the developed countries, we are using the IMF definition, based on relative consumer prices, that is: $e = PD/PG$; where PG is a weighted geometric average of consumer price indexes for 16 other industrial countries. The most relevant distinction between the two formulae is that, in the former, an increase in the index reflects depreciation, and, in the latter, appreciation.

Real Exchange Rate Indexes

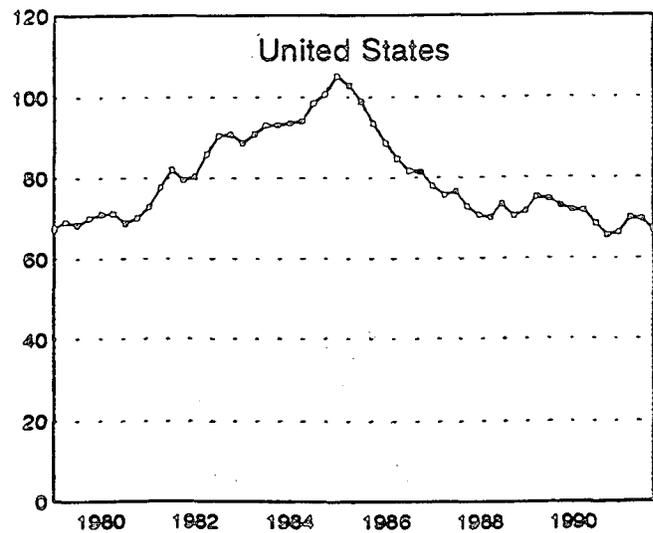
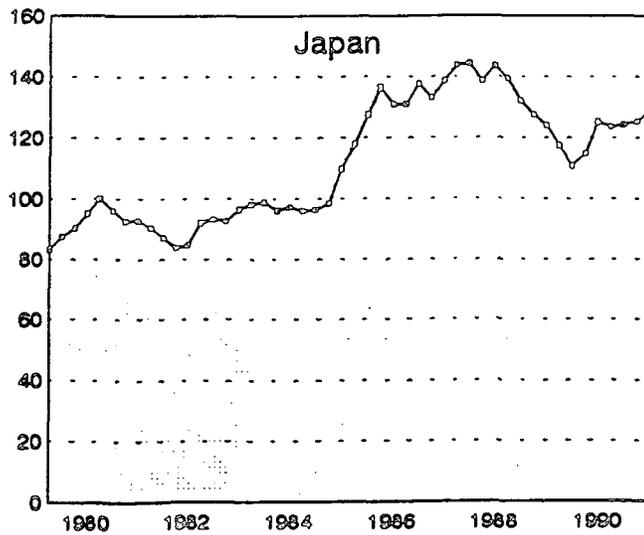
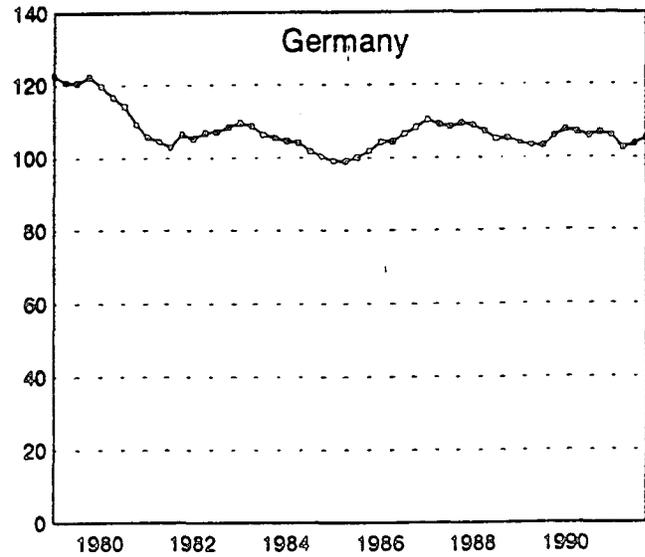
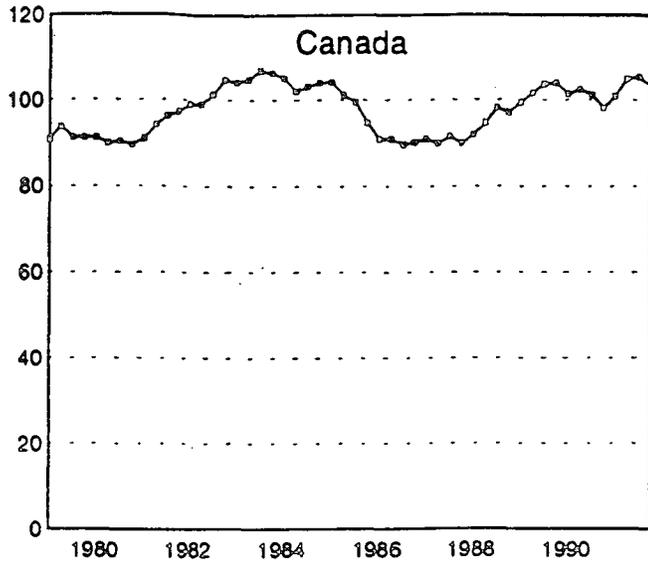
Quarterly Averages



Source: International Monetary Fund

Real Exchange Rate Indexes

Quarterly Averages



Source: International Monetary Fund

interesting facts. First, exchange rate instability affects both groups of countries, although it is more intense in Latin America. Second, evidence from Canada and Germany shows that it is feasible to keep stability under a volatile environment. Third, evidence from Brazil, Colombia, and Venezuela in the seventies shows that stability can also be obtained through managed regimes.

Despite these similarities, the origins of exchange rate instability in each group of countries are quite distinct, as Sebastian Edwards (1991) has argued. The main reason is that Latin American currencies are not convertible, and exchange controls often imply a significant amount of black market transactions and strong restrictions on capital mobility. Moreover, exchange rate arrangements are diversified (fixed, crawling peg, multiple rates, floating, dirty floating, etc.) and short-lived in the region. Thus, most of the literature on exchange rate instability in developed economies has limited applicability for Latin America.

The debate on exchange rate problems has a long history in Latin America, but, curiously, its main subject is overvaluation, not instability. This sometimes can be misleading. For instance, Julio Nogués and Sunil Gulati (1991), when discussing the behavior of the real exchange rate (RER) during trade liberalization episodes, stress that the best deflator for the nominal rate is the ratio of wholesale price index of the foreign country to the consumer price index (CPI) of the domestic country.

"The CPI is used in the denominator because it includes more non-tradeable goods than the wholesale price index and the crucial variable that we seek to capture with RER is precisely the change in relative prices between tradeables and non-tradeables." (p.31)

The assertion is undoubtedly correct, but, when applying this RER definition to a group of Latin American economies, they use

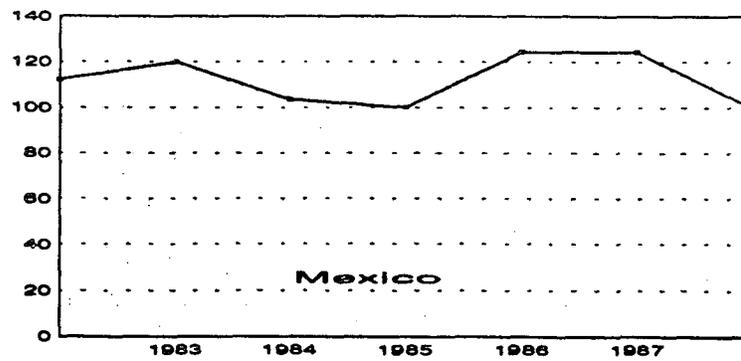
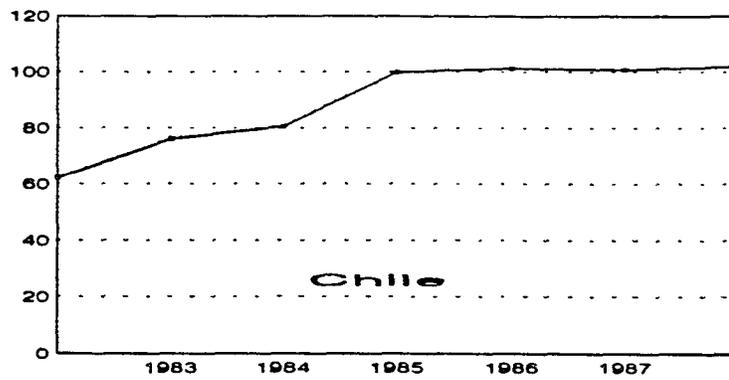
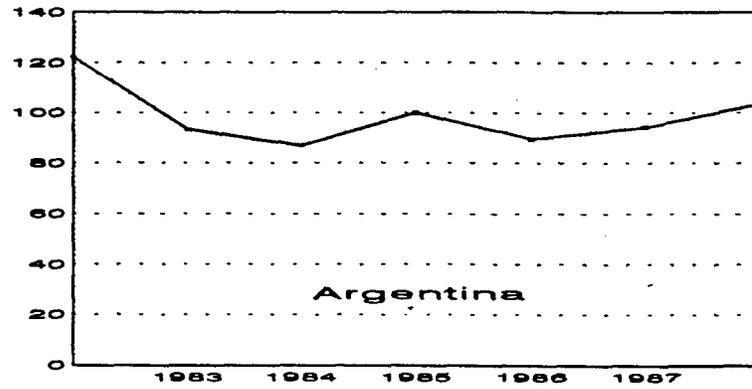
annual averages for all variables, instead of quarterly averages. The results of this procedure can be assessed by the three graphs on the next page, showing the evolution of RER in Argentina, Chile, and Mexico, from 1982 to 1988, according to Nogués and Gulati's calculations. Since the signs of instability practically disappear, the whole effort in selecting an accurate indicator for RER becomes useless.

In a region submitted to wide exchange rate fluctuations for a long period of time, a trade liberalization experiment may face three major obstacles. First, if the government decides that imports will be regulated mainly through tariffs, the transparency of the economy's structure of effective protection will be rather poor, since, depending upon RER swings, local production will be either overprotected, or exposed to unfair competition from abroad. In this context, most investment decisions will be postponed.

Second, trade reforms are often accompanied by stabilization plans, but their degree of mutual consistency tends to be low. The most common blend is overvaluation with opening up, given the temptation of fighting inflation through cheap imports. As economic agents are familiar with exchange rate instability, they know that such a scenario is unsustainable, and the main result of this strategy is to spur speculative importations. Several trade reforms have been interrupted for this reason.

Third, a volatile exchange rate inhibits long-term contracts between local firms and independent foreign counterparts, due to the level of uncertainty involved in such type of operation. Together with intra-firm trade, these contracts form the core of intra-industry trade, which is a basic source of dynamism of contemporary world trade. An economy where such transactions are scant generates few organized supporters of trade liberalization.

Real Exchange Rate Indexes Annual Averages



Source: Nogues & Gulati (1991)

In Latin America, exchange rate instability has four overlapping origins: inflation, balance of payments disequilibria, inconsistent macroeconomic policies, and capital flows. The interactions among the first three factors will be discussed in the next section. Before dealing with them, it is convenient to examine the role played by capital flows.

As the debt crisis approaches the end, one evidence becomes clear: domestic macroeconomic adjustment is not a sufficient condition to ensure exchange rate stability. In fact, under the present international monetary system, no small open economy is able to keep a steady exchange rate, unless it enacts restrictions on capital flows, or joins an optimal currency area. The European Monetary System has provided convincing indications that the latter option is the most efficient (see Giavazzi and Giovannini, 1989), but, unfortunately it is not likely to be available soon for Latin American countries.

To transform Latin America into an optimal currency area, two requirements would be mandatory: the participation of the United States, and the stabilization of Argentina and Brazil. Although it may seem science fiction to imagine the American government immersed in an exercise of policy harmonization with Latin American countries, it should be noticed that the North American Free Trade Agreement (NAFTA) contains some seeds towards this direction, in the chapter on institutional arrangements and dispute settlement procedures. But, even under the most optimistic assumptions, this will be accomplished only in the long run.

The outlook for Argentine and Brazilian stabilization is also uncertain. Nevertheless, for Latin America, the potential benefits of an optimal currency area are high enough to maintain this project as a useful target to be pursued throughout this decade. Such a goal can be gradually reached by several alternative routes, each one implying a particular form of cooperation among

governments. As Peter Kenen (1989) has observed, the harmonization of macroeconomic policies may result from three sorts of activity: *consultation, coordination and collaboration.*

"[The first term is] used to describe transactions involving an exchange of information without unilateral or collective commitments to utilize that information. Consultations can take place directly among governments, bilaterally and multilaterally, or with the intermediation of international institutions such as the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD)." (p.9)

"[The second term is] used to denote instances in which governments make clearly defined, mutual commitments to alter their own policies in order to pursue a common objective or help each government to pursue its own objectives. Coordination involves a 'package' of policy changes that would not take place in its absence." (p.11)

"[The third term is] used to denote situations in which governments take specific measures to achieve objectives but do not make mutually binding commitments about their national policies." (p.12)

"... international monetary history has been full of consultation and a good deal of collaboration but that there has been very little full-fledged coordination." (p.13)

The record for Latin America is even poorer: it has been confined, until now, to some scattered consultation undertakings. Yet, there is room for a cautious optimism, since macroeconomic stability and policy harmonization are highly complementary objectives. So, as long as the fight against inflation is kept as a top priority in the region, the better will be the prospects for cooperation among governments; and, conversely, responsible commitments to the latter objective will reduce the costs of obtaining the former, as Francesco Giavazzi and Marco Pagano (1988) have explained.

3. Industrial policy and free trade: is it possible?

For an economy that is unable to affect world prices, an ideal trade regime should have three basic norms. First, local production should be, in principle, exposed to international competition, without tariffs, subsidies, and other trade barriers. Second, sectoral exceptions should be strictly temporary and implemented under transparent rules. Third, local production should be protected from unfair trade practices with internationally accepted instruments.

Taking a closed economy as the starting point, the management of a trade reform oriented towards the above regime may imply a careful plan for gradual phasing out of tariffs, privileges, and administrative controls. But, such effort can be defeated by a volatile exchange rate, as we have seen, and by other flaws of macroeconomic policy.

Nowadays, every open economy faces an intricate challenge in regard to industrial policy. During the last 20 years, technical progress has allowed a dramatic reduction in information and data processing costs, through innovations such as personal computers, modems, and fax machines. A major consequence of these changes is the present trend towards globalization in the world economy, that signifies, among other things, a standardization of business practices and expectations. Until recently, only transnational corporations were able to maintain weekly contacts with their clients and partners in different countries. Today, small firms have on line access to international data banks, and can watch the daily behavior of their foreign competitors. In this context, several conventional instruments of industrial policy (such as tariffs, quotas, and capital controls) become anachronisms that are incompatible with the material base of contemporary society. They are either worthless or unnecessary sources of commercial complaints at home and abroad.

However, it is intrinsic to technical progress the continual re-creation of uneven conditions of competition, and this characteristic has been particularly intense in the recent past. This generates two sources of protectionist pressures. On the one hand, innovating firms lobby for regulations that will allow them to extend the period during which they can extract schumpeterian rents from their new technologies. Such regulations seldom imply explicit barriers to merchandise trade, but to the knowledge embodied in the innovations, i.e., legislation on patents, trade marks, licensing, and other instruments to preserve intellectual property. On the other hand, industries that suddenly became obsolete push for temporary relief, in order to restructure and regain international competitiveness.

Thus, while the gains from the current globalization trends become more appealing, domestic industries press their governments for privileges in order to enter into the game of international competition. This is the contemporary dilemma of industrial policy: How to create special conditions for capital accumulation at home, without establishing direct constraints on the international movements of citizens, goods, and financial resources.³

The European Single Market is the most ambitious, though partial, solution yet conceived for this dilemma. In a document entitled *Industrial policy in an open and competitive environment*, issued in November 1990, the Commission of the European Communities defined the industrial strategy to be followed by its members after 1992. The core of that strategy is a compromise between free trade, macroeconomic stability, and structural adjustment. In fact, it is a policy to reinforce three characteristics of the European conduct in the recent past, "which continue to be of high relevance for the

³ This paper's format does not allow an extended discussion of the industrial policy dilemma. For further elaboration, see Araujo Jr. et al (1992).

future:

"(i) first, policy was based on the recognition that European Community economies, in particular in the industrial sector, are confronted with a permanent need for structural adjustment. The correct reaction to these challenges does not lie in quick-fix solutions but in measures designed to strengthen the industrial and technological base. Such a policy must be applied over a sufficient period of time to strengthen industry's confidence;

"(ii) second, policies conducted both at macro- and micro-levels must be mutually reinforcing and they must be based on a broad consensus among Member States ...;

"(iii) third, policies followed also require a high degree of consistency and transparency." (EC, 1991, p. 8)

The instruments of this strategy are the same used by other industrial countries, particularly Japan: State purchasing power, public support for industrial R&D, and "positive adjustment policies" (i.e., temporary protection whenever needed). To be sure, the whole strategy was explicitly inspired by the Japanese experience:

"In Japan, the industry has grown and gained strength along a number of different paths. Japanese growth is not solely the result of market forces, but rather of long-term strategic planning in which the public authorities play a central part. The objective was to rebuild the Japanese economy and commercial technological interdependence with a view to achieving a very strong presence on the world market. The method used has been to consolidate and exploit an economic and political system which ensures close cooperation between the public authorities and industry, accompanied by selective public financing. It has given rise to structural protection of the domestic market and strong horizontal and vertical integration of the industrial groups, banks and distribution." (EC, 1991, p. 29)

There is only one way to reconcile a Japanese style of industrial policy with the commitment to trade openness and macroeconomic stability: the simultaneous growth of public

Table 1

Tax Burden in Latin America and in OECD Countries
(Government revenue as a percentage of GDP)

Country	1981	1982	1984	1985	1986	1987	1988
Argentina	26.0	22.7	23.1	28.0	28.1	26.5	23.4
Australia	31.9	32.4	33.3	33.7	34.4	34.2	33.6
Austria	47.8	46.7	47.5	48.5	48.2	47.8	46.8
Belgium	43.4	45.1	45.6	45.9	45.1	45.8	44.3
Brazil	23.9	23.5	22.8	23.4	26.4	25.0	23.8
Canada	38.5	39.1	38.7	38.7	39.5	39.6	40.4
Chile	32.8	32.4	33.6	35.9	35.0	34.5	38.2
Colombia	16.9	18.1	19.5	20.9	23.4	22.0	21.6
Denmark	52.1	51.2	55.5	58.5	58.3	59.2	59.5
France	45.1	45.9	47.5	47.6	47.1	47.6	47.1
Germany	44.8	45.4	45.3	45.6	44.9	44.4	43.7
Greece	29.1	32.3	34.8	34.6	35.7	36.9	35.1
Italy	34.1	35.9	37.4	38.0	39.0	39.3	39.9
Japan	29.1	29.5	30.4	31.2	31.5	33.4	34.3
Mexico	20.8	23.6	23.6	24.7	23.6	24.6	24.3
Netherlands	53.5	53.8	54.1	54.3	53.0	53.4	52.2
Norway	51.8	51.9	53.0	55.1	54.7	53.7	...
Portugal	33.3	35.4	37.3	35.9	37.6
Spain	31.2	31.4	33.2	24.5	35.0
Sweden	57.7	58.3	59.2	59.2	60.7	61.8	...
United Kingdom	42.4	43.0	42.3	42.3	41.5	40.7	...
United States	31.6	31.1	30.7	31.2	31.4	31.9	31.5
Venezuela	36.1	34.5	37.2	31.0	29.5	30.4	21.8
EEC Average	41.3	42.2	43.0	43.3	43.1	43.9	44.4
OECD Average	35.6	35.9	36.0	36.5	36.6	37.0	36.2

Sources: OECD Economic Outlook, Historical Statistics (Paris, 1990)
ECLAC, Economic Survey of Latin America and the Caribbean,
1990 (Santiago, 1992)

expenditure and tax burden. Table 1 registers this fact. It shows the evolution of tax burden - i.e., the share of GDP that obeys to governmental criteria and not to market signals - in Latin America and in OECD countries between 1981 and 1988. Not surprisingly, Japan and most EC economies (except Germany and the United Kingdom) reveal a clear upward trend, whereas, among OECD countries, there is not a single case of downward trend. On the average, tax burden jumped from 41.3 to 44.4% in the EEC, and remained around 36% in OECD countries, during this period.

Therefore, in several OECD economies, after a decade of fiscal reforms, privatization programs and public sector restructuring, the State became, in fact, stronger and better prepared to face the contemporary dilemma of industrial policy. In Latin America, however, the record is diverse. As table 1 shows, among the six largest economies of the region, only Chile has been able to keep a performance similar to the OECD pattern, albeit far from EEC levels.

This is a fundamental problem in Latin America: the disparity between the demand upon public resources and the State taxation power. In the past, it was circumvented through inconsistent macroeconomic policies, with its well known consequences: inflation, balance of payments disequilibria and exchange rate instability. Today, its solution remains as the major prerequisite for the success of any trade reform in the region.

As in the case of exchange rate instability, this is an issue to be settled in the long run by a patient combination of sustainable domestic policies and international negotiation. The tasks to be accomplished on the domestic front have been carefully described by the ECLAC document *Changing Production Patterns with Social Equity* (1990): In most countries, they will require broad fiscal reforms geared to reduce tax rates and to enlarge the tax base of the economy, which are objectives that only become feasible

after several years of public expenditure directed towards education and income distribution. The next section presents the obstacles to be faced on the international front.

4. Free trade and protection: the bargaining process

Writing in 1817, David Ricardo, one of the founding fathers of the free trade idea, dedicated Chapter 19 of his *Principles of Political Economy and Taxation* to discuss the problem of "sudden changes in the channels of trade":

"A great manufacturing country is peculiarly exposed to temporary reverses and contingencies, produced by the removal of capital from one employment to another. The demands for the produce of agriculture are uniform, they are not under the influence of fashion, prejudice, or caprice. To sustain life, food is necessary, and the demand for food must continue in all ages, and in all countries. It is different with manufactures; the demand for any particular manufactured commodity, is subject not only to the wants, but to the tastes and caprice of the purchasers. A new tax too may destroy the comparative advantage which a country before possessed in the manufacture of a particular commodity; or the effects of war may so raise the freight and insurance on its conveyance, that it can no longer enter into competition with the home manufacture of the country to which it was before exported. In all such cases, considerable distress, and no doubt some loss, will be experienced by those who are engaged in the manufacture of such commodities; and it will be felt not only at the time of the change, but through the whole interval during which they are removing their capitals, and the labour which they can command, from one employment to another."
(p.263)

Some 130 years later, when the General Agreement on Tariffs and Trade (GATT) was drafted, its Article 19, entitled "Emergency Action on Imports of Particular Products", dealt with the same problem in the following (perhaps cryptic) terms:

"If, as a result of unforeseen developments and of the

effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession." (p.36)

The aim of that Article was lest the problem identified by Ricardo become a stumbling bloc to the process of trade liberalization that was about to start among GATT member countries. Its underlying principle was the recognition that every diversified economy is permanently submitted to protectionist pressures, due to technical progress or other "unforeseen developments". According to this precept, in order to establish an open trading system, based upon solid and transparent rules, the best way is not by labeling all forms of protection as illegal practices, but through an agency able to regulate the interplay between domestic policies and international interests.

James Meade, who had a profound influence over the GATT text (see Harrod, 1972), was very positive about this vision. In 1942, he wrote a document that outlined the British position in regard to the organization that should regulate international trade after the war. In his words:

"Multilateral trading and the removal of trade restrictions do not, however, imply *laissez-faire*, and are in no way incompatible with a system of state trading. We shall wish to co-operate with the United States ... to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers. At the same time, we must aim at the formulation of such action by means which do not automatically preclude countries such as the USSR, which may be assumed to desire to continue a system of state trading, nor prevent us, if we so desire, from continuing a system of state

importation for certain products." (Meade, 1987, p. 401)⁴

Although well conceived, the safeguard measures provided for in Article 19 never came to be applied, because GATT members have been unable to agree upon the appropriate rules for such actions (see Winham, 1986). Hence, whenever the OECD countries needed to enact temporary protection to any sector, they adopted schemes outside the GATT norms (the so-called "gray-area measures": "Voluntary Export Restrictions" (VERs) arrangements, "Orderly Marketing Agreements" (OMAs), Multifiber, etc.) or made improper use of existing ones (indiscriminate resort to antidumping and countervailing duties).

After a debate that lasted for nearly 50 years,⁵ the Uruguay Round of Multilateral Negotiations finally reached consensus on a draft of a Code on Safeguards that, although not yet sanctioned, will provide an adequate international framework to deal with the problem of temporary protection. The great novelty is that it accepts as a legitimate practice the trait common to all "gray-area measures": the allocation of export quotas among supplying countries.

⁴ Curiously, this document only came to be published in 1987 by the periodical *The World Economy*.

⁵ This debate seems to have started in October 1943, with the provocative note Lord Keynes sent to an officer at the US State Department: "As you know, I am, I am afraid, a hopeless sceptic about this return to nineteenth century *laissez faire*, for which you and the State Department seem to have such a nostalgia.

I believe that the future lies with -

- (i) State trading for commodities;
- (ii) International cartels for necessary manufactures; and
- (iii) Quantitative import restrictions for non-essential manufactures.

Yet all these future instrumentalities for orderly economic life in the future you seek to outlaw." (Cf. Harrod, 1972, p.672)

Export quotas have an interesting peculiarity: the rents they generate are shared between the domestic industry and the foreign suppliers. Depending upon the criteria used in their distribution, it is possible to reach a situation where all costs of protection are exclusively paid by local consumers, without any harmful impact on international interests. This outcome can also be produced by other means. For instance, a subsidy that equalizes domestic prices to international standards will do the same. But, what is important is that measures of this kind have two virtues⁶: (a) they do not create trade disputes; (b) they leave the government with an instrument - i.e., the explicit and segregative burden over local society - to shrink the power of protected industries and to enforce a reasonable expiration term for the benefits.

As it is not known whether or when the GATT Code on Safeguards will be sanctioned, several analysts have argued that a Western Hemispheric Free Trade Area (WHFTA) is attractive to Latin American countries because it offers a way to bypass US protectionism. However, unless the WHFTA has provisions for temporary protection, it is hard to believe that, if ever a large US industry were seriously damaged by LA competitors, the latter interests would prevail over the former. NAFTA has made some progress in this matter with its chapter on "Emergency Action". Although less comprehensive than the GATT draft on safeguards, and valid only for the transition period (i.e., the first 15 years), that chapter is a sign that, at least, the issue is being considered.

This is a topic on which international organizations such as the Inter-American Development Bank and the World Bank can give a timely contribution, by using their influence and technical capabilities to accelerate the ongoing GATT negotiations. After completing a trade reform, any developing country will have two

⁶These measures also can be instrumental to deal with the industrial policy dilemma described in section 3.

major targets in its multilateral agenda: market access for its exporting industries and fair rules for technology transfer. The bargaining power of such countries would be substantially improved if the Uruguay Round were concluded with an effective Safeguards Code and a balanced legislation on Intellectual Property Rights. Hence, any support in this direction would be welcomed.

5. Conclusion

In Latin America, the expression *unilateral trade liberalization* often implies a criticism. The underlying reasoning is that trade partners should be pressed to pay concessions in return for the benefits they are about to receive. Although appealing, as mercantilist ideas sometimes are, this argument has a *non sequitur*. In order to extract multilateral concessions from a trade reform, a government must be able to carry out a strategy in three steps. First, a reform is designed; then, its potential multilateral effects are bargained; and, finally, the new regime starts to be implemented. But, unfortunately, potential effects are worth nothing, since trade reforms have no credibility until the government proves its capacity to enforce consistency among the current national policies. So, there is no mercantilist game to be played.

However, the acknowledgment that free trade does not signify *laissez-faire* is far from being the conventional wisdom among economists. For instance, one conclusion of Nogués and Gulati's study on Latin American trade regimes "is that antidumping regulations should not be introduced." (p.iii) The discussion made in the present paper runs in the opposite direction: A basic prerequisite for the long run stability of an open trade regime is the support from an institutional framework, internationally accepted, able to provide efficient tools for temporary protection, and to hamper unfair trade practices.

This is the main reason why the GATT is not an alternative, but a complement to regional integration. To be sure, in a post-Uruguay Round era, a WHFTA will be even more interesting to Latin America. It will offer, under a less uncertain world trade system, two critical ingredients to the region: better conditions to control exchange rate instability, and larger welfare gains to be extracted from economies of scale and scope. In this context, Chile, Mexico and Brazil will play three distinct and complementary roles.

The Chilean experience will help to simplify the WHFTA negotiating agenda, by providing an unambiguous illustration of the border line between homework and international bargain. After several years of unilateral reforms, Chile became, indeed, the only Latin American country ready to manage the industrial policy dilemma and to sign a free trade agreement with the United States. If reasons related to geography and history were not so influential, that country could have been the first in the region to join the WHFTA.

But, as geography and history do matter, it was for Mexico to play that role, which includes, among others, two assignments. The first is the generation of empirical evidence regarding the costs and benefits of economic integration, that will pave the way for future negotiations inside the WHFTA. The second is to advance the institutional building process, that already has a first outcome: NAFTA is a wider treaty than its predecessor, the Canada-US FTA.

Despite its historical importance, the agreement between Canada and the US was tailor-made for a bilateral bargain, whereas NAFTA has several instruments to assimilate newcomers. Besides an explicit accession clause, its chapters on emergency actions, competition policies, intellectual property, and institutional provisions have shaped a framework that can lead beyond a conventional free trade area.

Finally, without Brazil, the Enterprise for the Americas Initiative would be confined to a NAFTA with some southward incursions. This will be a likely outcome if the current Brazilian crisis lasts longer than the ongoing revisions in the US foreign policy.

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