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The integrationist revival: *A return to Prebisch's* policy prescriptions?

José Manuel Salazar-Xirinachs

*Chief Economist,
Central American and
Panamanian Federation
of Private Enterprise
(FEDEPRICAP).*

This paper revisits Raúl Prebisch's views on an issue that has become central to trade and development policy in the 1990s: the relationship between industrialization, regional economic integration and outward-oriented growth. The author argues that, whereas these elements have been interpreted as relatively separate components of Raul Prebisch's thinking, they are in fact organically related in the dynamic sequence of development policies formulated by Prebisch. Far from remaining locked into an inefficient import substitution industrialization path (hereinafter referred to as "ISI"), for Prebisch the gradual and negotiated incorporation into increasingly wider commercial relationships was the key to economic progress. Regional economic integration and periodical revisions of external tariffs to keep protection within moderate levels were essential ingredients for reaching a stage of reciprocal trade in industrial products with the centres, which Prebisch considered as the only option for breaking the centre-periphery asymmetries, increasing income and employment, and raising living standards in developing countries. Thus, the author concludes, rather than departing from Prebisch's long-term vision, the search for a new high-quality international insertion and the integrationist revival in Latin America might be interpreted as a reassertion of the sequence of policies originally envisaged and recommended by him. Going on to examine the usefulness of some of Prebisch's ideas for present discussions of international insertion and regional integration, the author argues that Raúl Prebisch's ideas on economic integration, outward-looking growth based on industrial export promotion, selectivity based on world income-elasticity criteria, and reciprocity, appropriately adapted to present conditions, are relevant for the rethinking of the strategy of international insertion complemented by regional integration which the Latin American countries are presently busily embarked upon.

I

Introduction

This paper revisits Raúl Prebisch's views on an issue that has become central to trade and development policy in the 1990s: the relationship between industrialization, regional economic integration and outward-oriented growth. Whereas these elements have been interpreted as relatively separate components of Prebisch's thinking, they are in fact organically related in the dynamic sequence of development policies formulated by him.

The main argument can be summarized as follows: Prebisch's analysis led him to conclude that industrialization was necessary for peripheral countries in order to absorb population growth, while raising productivity and living standards. However, it is often overlooked that the key issue for Prebisch was not to remain locked-in in an import substitution industrialization (ISI) path, but to use ISI as a transition policy that, aside from its own dynamic benefits (investment, employment, learning), would allow Latin American countries to reach a stage of reciprocal trade in industrial products with the centres. According to Prebisch's analysis, it was precisely the achievement of this reciprocal trade in industrial products with the centres that would break the negative results for the periphery of the centre-periphery model. Furthermore, in the dynamic scenario and succession of stages that Prebisch proposed as a long-term strategy, economic integration was an essential ingredient for efficient import substitution and subsequent industrial export expansion.

In practice, however, the development of ISI policies in Latin America departed radically from Prebisch's prescriptions in at least two fundamental respects: the persistence of extremely high levels of protection, and the very limited success in regional economic integration. Prebisch considered the simultaneous application of both policies—external tariff reduction and regional economic integration—critical to promoting industrial exports to the centres, and he repeatedly denounced the failure to implement his policy recommendations as a costly and misguided approach.

Unfortunately, numerous critiques of the "ECLA model" have failed to stress the fact that Prebisch's and ECLA's prescriptions were not followed in practice. A careful reading of Prebisch makes it very clear that, ironically—and for economists unfamiliar with Prebisch's thought also surprisingly—the present opening of trade regimes and the integrationist revival in Latin America might be interpreted as a return to the development path and the sequence of policies originally formulated by him. If there was a "lost decade" in Latin America it was largely due to the failure to follow the "rational" mix of policies for efficient industrialization recommended by Prebisch.

The above argument, developed in sections II to IV below, does historical justice to Raúl Prebisch's thought and demonstrates that he was no simple protectionist. A separate issue, discussed in section V, is the usefulness of Prebisch's ideas for present-day discussions of international insertion, export promotion and regional integration.

II

The need to industrialize

Prebisch's basic analytical instrument was the centre-periphery model. The economic dynamics of this model is given by the interaction between technical

progress, market structure and income flows. On the basis of this analysis, Prebisch concluded that the deliberate promotion of industrialization, together with the development of complementary activities (transport, trade, services), was a necessary policy for peripheral countries in order to absorb population growth while raising productivity, income and living standards.

■ The author wishes to express his thanks to Eduardo Lizano and Sylvia Saborío for their valuable comments on an earlier draft.

Prebisch justified the priority assigned to industrialization as a development strategy as follows: on the one hand, technical progress in primary activities makes the displacement of labour out of agriculture and traditional primary exports inevitable. Hence, these sectors cannot productively absorb the population growth nor labour made redundant by technical progress. The competitive structure of world primary commodity markets, the homogeneity of these products, and the condition of abundant labour supply in primary commodity production in the periphery, make it difficult, if not impossible, for exporting countries to appropriate the income gains of improvements in productivity. Instead, these benefits are transferred to consumer countries via lower prices.

On the other hand, market structures in the manufacturing sectors of the centres imply that economic agents (entrepreneurs and labour) have the capacity to appropriate the benefits of productivity gains. In addition, income elasticity of demand for primary commodities in the centres is low, while income demand elasticity for industrial products in the periphery is high. These asymmetries exert differential pressure on the relative prices of primary commodities and manufactures, leading to a secular deterioration in the terms of trade of the periphery.¹

III

Economic integration as an imperative for efficient ISI and a new outward-oriented strategy

According to Prebisch: "The urgency of the need for progressive forms of economic integration began to claim attention from the time of the secretariat's very earliest studies, subsequently reasserting itself..." (Prebisch, 1959a, vol. I, p. 466).² In one of his

Prebisch concluded, therefore, that as long as the periphery specialised in primary commodities and the centre specialised in manufactures, it would not be possible for the periphery to narrow down the income differences with the industrial centres, even if there were improvements in productivity. Peripheral countries would continue with lower average income unless they could change this pattern of international specialization by promoting exports of industrial products to the centres.

Breaking the fundamental asymmetries of the centre-periphery model therefore required a change in the pattern of specialization of the periphery towards the development of competitive exports of manufactures to the industrialized centres. Within this economic dynamics, ISI was not a long-term strategy, but was rather seen by Prebisch as a transitional strategy to achieve this new pattern of international specialization.

However, according to Prebisch, for ISI to be the basis for the promotion of industrial exports to the centres the simultaneous application of two policies was critical: progressive forms of regional integration; and appropriate incentive policies, especially periodical reforms of the protectionist tariff *vis-à-vis* the rest of the world. Let us now look at these elements in turn.

earliest contributions –his introduction to the *Economic Survey of Latin America 1948*, Prebisch warned that:

"It is necessary to define with precision the objective that is pursued with the industrialization policy. If it is considered as a means to achieve the ideal of autarky, in which economic considerations do not matter, any industry that substitutes imports would be admissible. But if the purpose is to increase what has been justly called the measurable welfare of the masses, we have to be clear about the limits beyond which more industrialization might imply a reduction of productivity" (Prebisch, 1949, vol. I, p. 105).

¹ For a formalization and discussion of the fundamental aspects of the centre-periphery model, see Spraos (1983).

² The page numbers for all quotations of Prebisch included here (except those for 1984) correspond to the two-volume edition of the *Selected Works of Raúl Prebisch*, edited by Adolfo Gurrieri and published by Fondo de Cultura Económica (1982). In all quotations, the italics correspond to Prebisch's own emphasis.

In this early work he includes a section entitled: "The limits of industrialization", and argues that:

"One of the limits is given by considerations regarding the optimal size of industrial enterprises. Latin American countries are, in general, trying to develop on one side of the border the same industries as on the other side. *This tends to diminish productive efficiency and conspires against the social objective that is being pursued. This is a very serious short-coming...* This parceling out of markets, with its intrinsic inefficiency, constitutes one of the main limits to the growth of industry. However, far from being insurmountable, a clear-sighted policy of economic interdependence could remove it and generate large mutual benefits".³

In the 1954 Quitandinha report (Prebisch, 1954),⁴ he devotes a complete section to the "Liberalization of inter-Latin American Trade" and warns that: "*Industrialization is developing in separate compartments and trade in manufactures between Latin American countries is very small*" (Prebisch, 1954, vol. I, p. 378). "*In a liberalized trade regime productive specialization, and its well-known advantages becomes possible, but in a regime of separate compartments high-cost production is frequently incurred due to the insufficiency of the national market*" (op. cit., p. 379). Therefore, as import substitution advances "*...towards products that can only be economically produced on a large scale, and this exceeds the size of the national market, the need to develop reciprocal trade among Latin American countries asserts itself*" (op. cit., p. 378).

Prebisch's ideas on economic integration are developed fully in his 1959 book *The Latin American Common Market*. Here he clearly formulates a dynamic scenario involving import substitution in the context of an expanding common market as an essential element for both sustaining a satisfactory rate of overall growth and promoting efficient industrialization, leading to a stage of mutually beneficial trade in industrial products with the centres. The starting point for his analysis is the thesis that: "The fundamental economic problem of Latin America is how to achieve a satisfactory rate of economic growth that would allow it to progressively reduce the income differences with the large industrial centres" (Prebisch, 1959a, vol. I, p. 469).

³ Prebisch also insists on these points in the *Economic Survey of Latin America 1949* (United Nations, 1951).

⁴ Report presented by Raúl Prebisch to the Fourth Extraordinary Meeting of the Economic and Social Council of the Organization of American States, held in Quitandinha, Brazil, 1954.

Based on the need to solve this "fundamental economic problem", he gives four related rationales for the importance of economic integration: i) a growth argument, ii) an efficiency argument, iii) an industrial export expansion to the rest of the world argument, which in modern language we could call an international competitiveness argument for regional integration, and iv) a reduction of external vulnerability argument.

1. The growth argument

According to this argument, the main obstacle to growth in Latin America is the balance of payments constraint imposed by the slow rate of growth of exports of goods and services relative to the high rate of growth of imports: a trend resulting from the basic centre-periphery specialization and its intrinsic asymmetries. To sustain a rate of growth of GDP higher than the relatively slow growth of exports, without running into this balance of payments constraint, the import coefficient (total imports/GDP) has to be reduced, and this can only be achieved through an intensive process of import substitution.

In this scenario: "The gradual implementation of a common market would make it possible to compensate, at least partially, the reduction in the import coefficient with the rest of the world required by the slow growth of primary commodity exports, through an increase in the coefficient of reciprocal imports" (Prebisch, 1959a, vol. I, p. 472). Prebisch provides empirical support for his argument by pointing out that while Latin America has an average global import coefficient of 7.7%, of which intraregional trade is only 1.7%, Europe has a global import coefficient of 18.5%, of which 50% is intraregional trade and the other 50% is trade with the rest of the world. The United States has a lower import coefficient with the rest of the world than Europe and even higher relative levels of intraregional—that is, interstate—trade. Thus, Prebisch concludes, the main source of growth within the common market would be precisely the reciprocal expansion of industrial exports among the members.⁵ By deliberately promoting

⁵ Research on trade flows in economic integration schemes has given a solid empirical foundation to this expectation, albeit in an unexpected way. This research found that the increase in trade among the members of integration schemes has taken place largely through specialisation in production and export of products of the same industries (intra-industry trade), rather than of different industries (Tharakan and Kol (eds.), 1989; Willmore, 1974).

economic integration, Latin American countries could significantly increase their rate of growth and industrialization:

"If a country sets itself to grow at a higher rate than the slow rate imposed by the growth of its exports, at present it does not have any other alternative than substituting with internal production most of what it imports. The common market will open another option: to develop industrial exports to the other member countries with the purpose of supplying itself with products that otherwise it would have had to substitute. In this way, *instead of trying to establish all sorts of import substitution industries, each country could specialize in those more appropriate according to its natural resources, the skills of its population and the possibilities of its own market*, and will use imports from the other members to satisfy other needs for industrial goods that could not have been satisfied by importing from the rest of the world" (Prebisch, 1959a, vol. I, p. 476).⁶

2. The efficiency argument

For Prebisch, an efficient process of industrialization would depend on the continuing and systematic expansion of markets. As shown above, ever since his early contributions to the *Economic Survey of Latin America* of 1948 and 1949, Prebisch emphasized the limits that a narrow market imposes for efficient ISI.

By 1959 Prebisch was strongly denouncing the actual course being taken by ISI and the resulting inefficiencies. He directly linked these to two factors: i) the lack of success in economic integration efforts, and ii) the exaggeration and abuse of protection.

As regards the former, "the chief weakness of the industrialization process consists in the fact that it has developed in watertight compartments, within which each country attempts to do the same as the rest, without specialization or reciprocal trade" (Prebisch, 1959a, vol. I, p. 495). And, "...if a common market is not organized, each country, forced by the inevitable need to substitute imports, would have to do it *at extremely high costs*. This is a very important point, *because industrialization is not an end in itself but an efficient means to increase average productivity and, with this, the living standard of the population*" (Prebisch, 1959a, vol. I, pp. 471-472).

Clearly, for Prebisch, economic integration was not just important but absolutely essential for an efficient ISI process.

3. The industrial export expansion to the rest of the world argument

Prebisch notes that: "It might seem somewhat paradoxical that these countries (in Latin America), that still require tariff protection, could compete in manufacturing in the territory of the large industrial centres. But this is precisely what the European countries are doing in the U.S. market. Furthermore, there are some Asian countries that are successfully developing textile and apparel exports to Europe" (Prebisch, 1959a, vol. I, p. 473).

The possibilities of expanding industrial exports to the rest of the world are determined by two factors, according to Prebisch: Latin American competitiveness, and the willingness of the industrial centres to grant market access to Latin America. Interestingly, the development of competitiveness, in turn, would critically depend on: i) the effective development of regional economic integration, and ii) the periodical revision of the external protective tariff. Thus, "[...] *the common market, by helping to lower costs, might boost certain lines of industrial exports*" (Prebisch, 1959a, vol. I, pp. 473-475).⁷

In 1961 Prebisch summarized what he considered as the three basic failures of industrialization. As failure number one he stressed the fact that "*all industrial activities are oriented towards the internal market. [...] Development policy has discriminated against exports. [...] It has subsidized – by means of tariffs and other restrictions – industrial production for internal consumption, but not that which could be exported*" [...] "*The common market constitutes a partial solution to this problem. [...] The development of industrial exports between Latin American countries will lead to lower costs of production and will give certain industries possibilities of exporting to the rest of the world. A policy of stimulus (to industrial imports from Latin America) and cooperation by the industrialized countries might intensify this movement*" (Prebisch, 1961, vol. II, pp. 85, 88 and 89).

⁶ This argument is also the basis of his concept of *reciprocity* in inter-Latin American trade, analysed in section V below.

⁷ This scenario was formalized by Paul Krugman in Krugman (1984).

As regards the exaggeration and abuse of protection, in 1959 Prebisch observed that cost reductions for efficient import substitution had not occurred to a sufficient degree because "*since in many cases protectionist policy, in the shape of very severe import restrictions –if not bans– has been carried too far, the atmosphere of competition in the internal market has become appreciably less intense*" Therefore,

"The return to the customs tariff as an instrument of protection, the lowering of intraregional duties in some cases and their abolition in others, would do much to restore the spirit of competition, greatly to the benefit of industrialization policy. In this new environment, the gradual development of a flow of industrial exports to the rest of the world might be one of the objectives of Latin American trade policy. [...] It is thus possible to imagine reciprocally advantageous patterns of industrial trade which would have a significance very different from that of the traditional exchange of raw materials for manufactured products." In order to achieve that, however: "trade policy would have to be readjusted in keeping with the new state of affairs. Otherwise, the Latin American common market would not suffice in itself to foster trade with the great industrial centres" (Prebisch, 1959a, vol. I, pp. 474-475).

The fundamental importance Prebisch attributed to the promotion of industrial exports to the industrial centres is clear from the following:

"The gradual formation of a Latin American common market...opens up possibilities for the industrialized countries and for Latin American countries to take fundamental decisions for the world trading system... These decisions will determine whether development will continue to be inward-looking within the Latin American common market, with as much foreign trade as the growth of exports to the rest of the world would permit; or whether it would be outward-looking, not by reproducing the old forms of international division of labour, but by developing new forms that might powerfully contribute both to Latin American industrialization and to the movement in the industrial centres towards higher stages of technology and productivity" (Prebisch, 1961, vol. II, p. 95).

In his 1964 report to the Second United Nations Conference on Trade and Development, as Secretary-General of UNCTAD, he not only reiterates the above arguments but also includes a chapter entitled

"Industrialization and the need to export manufactures", where he again emphasizes in even stronger terms "the unavoidable need to develop industrial exports" (Prebisch, 1964, vol. II, p. 247).⁸

4. The economic integration and external vulnerability argument.

The external vulnerability of the ISI process was attributed by Prebisch to the failure to promote economic integration:

"One of the paradoxes of economic growth in Latin America is that countries that tried to reduce their vulnerability through industrialization have found themselves in a new type of vulnerable situation. This is due precisely to the fact that the substitution policy has occurred in watertight compartments. In the most advanced countries of Latin America, ISI has reached such extremes that imports have been reduced to those products that are essential for maintaining economic activity. Thus, when export earnings fluctuations reduce the capacity to import, given that the proportion of current consumption goods to which import restrictions can be applied is very small, it is necessary to apply these restrictions to essential products. [...] *While before, the economy was vulnerable on the demand side, now it is vulnerable on the supply side: the reduction of essential imports affects the level of employment"* (Prebisch, 1959a, vol. I, p. 478).

This shortcoming can be overcome, according to Prebisch, by promoting economic integration: "The establishment of a common market would make it possible to gradually correct this trade distortion and would help prevent it in the countries in which it has not already occurred" (Prebisch, 1959a, vol. I, p. 479). "In reality, the common market is a response to the objective of creating a new pattern for Latin American trade capable of meeting two exacting demands, namely, industrialization and the need to lessen the external vulnerability of the Latin American countries" (Prebisch, 1959a, vol. I, p. 468).

⁸In his 1984 retrospective article Prebisch characterized the late 1950s and early 1960s as the "third stage" of his thinking, whose distinctive features were strong criticism of the course taken by ISI policies, and emphasis on the urgent need to promote economic integration and industrial exports to the centres (Prebisch, 1984).

In conclusion, clearly Prebisch's long-term vision included a dynamic sequence starting from an inward-looking ISI process, efficiently developed through progressive integration into a common market and periodic revisions of the protective tariffs,

with the purpose of gradually changing the traditional pattern of specialization of the centre-periphery model into a pattern of mutually beneficial reciprocal trade in industrial products with the centres.

IV

The transition to outward orientation

Despite the importance given by Prebisch to the promotion of industrial exports to developed countries, an explicit analysis of the characteristics of the period of transition towards the new outward-looking stage is not found in Prebisch's writings until the early 1960s. However, even then the analysis does not enter into specific mechanisms nor policy instruments.

1. Import liberalization and resource reallocation

In 1961 Prebisch refers not only to the reduction but to the "eventual elimination" of protection in the following terms:

"As industrial export activities (to the centres) demonstrate their capacity to absorb at high productivity a growing proportion of the labour force, the differences in protection levels (with the centres) could be progressively narrowed down. *Of course, in reducing and eventually eliminating protection in a growing number of industries, some might be injured, but this would be compensated by the reallocation of factors to more efficient export industries.* However, it is not conceivable that in Latin American countries this policy of import liberalization could be an objective to be achieved in the short term. A very long period of time might be required for this, as well as for the process of technological assimilation and capital accumulation necessary to have a sufficiently strong industrial structure..." (Prebisch, 1961, vol. II, pp. 94-95).

2. The timing of industrial export expansion to the rest of the world

In his 1964 Report to the Second United Nations Conference on Trade and Development (UNCTAD), Prebisch criticises those that claim that ISI, even

within a common market, is an alternative to the expansion of industrial exports to the developed countries. Instead, he argues, the time has come to pursue them simultaneously.

He identifies limits for further ISI even within a common market for four reasons: i) certain groups of countries in Latin America do not reach a sufficiently large market size for efficient ISI beyond a certain point; ii) the development of a common market requires time, while the inefficiencies of ISI are already present; iii) trade relations with industrial countries, particularly in the area of capital goods, would greatly contribute to technical progress and innovation: "Growing trade (with the industrial centres) has the virtue of helping to rapidly propagate the goods in which technological innovations are incorporated. If developing countries close themselves within their own groups they would be continuously lagging behind in technical progress" (Prebisch, 1964, vol. II, p. 254), and iv) in a regional group there is the risk that small countries would depend too much on larger ones. The only way to avoid this is to diversify exports by trading significantly with the rest of the world.

From this, Prebisch concludes that the right policy is to simultaneously pursue regional economic integration and the promotion of industrial exports to the rest of the world: "There is in this area a clear interdependence. The development of industrial exports to the rest of the world will have beneficial effects on intra-regional trade. In turn, the growth of industrial exports within the region will prepare those industries to better compete with the rest of the world" (Prebisch, 1964, vol. II, p. 254).

Unfortunately, while in his 1959 book (Prebisch, 1959a) we find quite detailed discussions of the concrete instruments and steps to promote the common market, in his later work Prebisch did not go into

details as regards the policy instruments for simultaneously pursuing regional integration *and* promotion of industrial exports to the rest of the world. He reiterates the need for low levels of protection and the periodical reform of the trade regime, but does not discuss in detail these levels nor these reforms. The point remains, however, that since the early 1960s he gave great priority to both regional integration and the need to develop competitiveness and promote industrial exports to the rest of the world: precisely the agenda of most Latin American countries in the 1990s.

3. Reform of the trade regime

Mention has already been made of Prebisch's early emphasis on the need for periodic trade policy reform and liberalization to keep protection within moderate levels compatible with efficient ISI. In his contributions to the *Economic Survey of Latin America* of 1948 and 1949 he does not discuss explicitly the desirable levels of protection. There is, however, a discussion of the limits of industrialization, with strong emphasis on the problem of market size and on the need to expand markets through economic integration.

The first extended discussion of protection is found in his 1954 Quitandinha report. The bulk of his argument is a reassertion of the infant-industry argument for protection as an incentive to industrialization. At this stage he insists on the need for the level of protection to be kept within "reasonable" limits. Two basic constraints to the level of protection are considered: first, protection should be set in relation with its function of compensating for the productivity and wage differentials between the centres and the periphery, and second, protection should not be taken beyond the point where it may negatively affect world trade.

Efficiency limits for protection, and the need to liberalize trade regimes, did not become major con-

cerns of Prebisch until the late 1950s and during the 1960s. As seen above, his 1959 book includes strong criticisms of the fact that protectionist policy had been carried too far (Prebisch, 1959a). In a 1959 article published in the *American Economic Review* he insists that "Tariff protection... by itself does not increase productivity; on the contrary, if protection is excessive it tends to weaken the incentive to produce" (Prebisch, 1959b, vol. I, p. 451). In 1964, he returns to this issue and argues that:

"Industrialization based on import substitution has certainly been of great assistance *in raising income in developing countries, but it has done so to a much lesser extent that could have been the case had there been a rational policy judiciously combining import substitution with industrial exports*" [...] "*The excess of protection has isolated national markets from external competition, weakening and even eliminating the indispensable incentive to improve quality and reduce production costs in a private initiative regime.* Thus, it has tended to suffocate enterprise initiative as regards the internal market as well as exports" (Prebisch, 1964, vol. II, pp. 248 and 250).

These warnings notwithstanding, a major lacuna in Prebisch's thinking on this issue is the absence of a social and political analysis of protection, that is, of the interaction between the social groups that benefit from protection and the State's capacity to revise tariffs and incentives. By the 1960s it was clear that far from being rationally planned and adapted dynamically to the new conditions, as Prebisch recommended, the structure of protection in most Latin American countries was the outcome of a myriad of political pressures by interested groups. In most cases rent-seeking won over economic rationality, a lesson that has not been lost and has greatly helped to develop the political economy analysis of policy interventions (Krueger, 1974; Colander, 1984; Meier, 1990).

V

The present relevance of Prebisch's thinking

So far, we have done historical justice to Raúl Prebisch's thought and demonstrated, among other points, that he was no simple protectionist. A separate issue concerns the usefulness of some of Prebisch's ideas for present-day discussions of international insertion, export promotion and regional integration. Some aspects of this are selected for comment in this section.

1. Industrialization, selectivity and living standards

In addition to its contribution to relaxing balance of payments constraints on growth, Prebisch's preference for industrialization was based on two essential criteria: the need to break the fundamental asymmetry involved in the differential income elasticity of demand for primary commodities and for manufactures, and the positive externalities of industrialization in terms of propagating technical progress, upgrading work force skills and increasing productivity and living standards in the long term. The discussion of productive transformation strategies in Latin America can be enriched by taking these two criteria of Prebisch and developing their implications under present conditions.

The first criterion emphasizes the importance of promoting investment and developing competitive advantages in high income-elasticity products. Although this criterion does not exclude a number of high income-elasticity agricultural products, in which the periphery has comparative advantage, world trade trends and the experience of Japan and South-East Asia support Prebisch's preference for manufactures. Japan in the 1950s and South Korea in the 1960s successfully used the income-elasticity criterion to guide industrial policy (Shinohara, 1982; Johnson, 1982; Sáez, 1988; Amsden, 1989).

Recently, two separate work teams have developed the methodology and data bases needed to analyse the competitive position of countries relative

to the participation of their export sectors in high world income-elasticity product lines. In its Competitive Analysis of Nations project (CAN), the Economic Commission for Latin America and the Caribbean (ECLAC) developed an approach to competitiveness based on the relative participation of the countries' export sectors in the imports of the Organization for Economic Co-operation and Development (OECD).⁹ Two concepts are given specific definitions: positioning and efficiency. Positioning refers to the relative dynamism of an item in OECD imports: it is favourable when the item's participation in those imports increases and unfavourable when it decreases. Efficiency refers to the relative participation of a country in a specific item. The combination of these features makes it possible to distinguish four strategically different situations, as shown in figure 1.

The quality of the international insertion of each country in world trade is thus examined on the basis of its export composition according to this typology. This approach provides not only a rich framework to historically analyse "winners" and "losers" in terms of international competitiveness, but also important insights for prospective analysis and guidance for productive transformation strategies. For our purposes, the point is that this approach constitutes, in fact, a development of ECLAC's and Prebisch's earlier emphasis on centre-periphery asymmetries and the way to overcome them. Based on an adaptation of the export demand elasticity relative to world income criterion, this approach constitutes a useful first approximation (on the demand side) to the issue of how to improve the quality of international insertion.

⁹ See Fajnzylber (1991) and ECLAC (1992), chapter V.

FIGURE 1

Insertion in international trade: positioning and efficiency

		Relative positioning of products	
		Unfavourable	Favourable
Relative efficiency of countries	Low	WITHDRAWAL SITUATION	LOST OPPORTUNITIES SITUATION
	High	VULNERABILITY SITUATION	OPTIMAL SITUATION

Source: F. Fajnzylber, "International insertion and institutional renewal", *CEPAL Review*, No. 44 (LC/G.1667-P), Santiago, Chile, August 1991, p. 140.

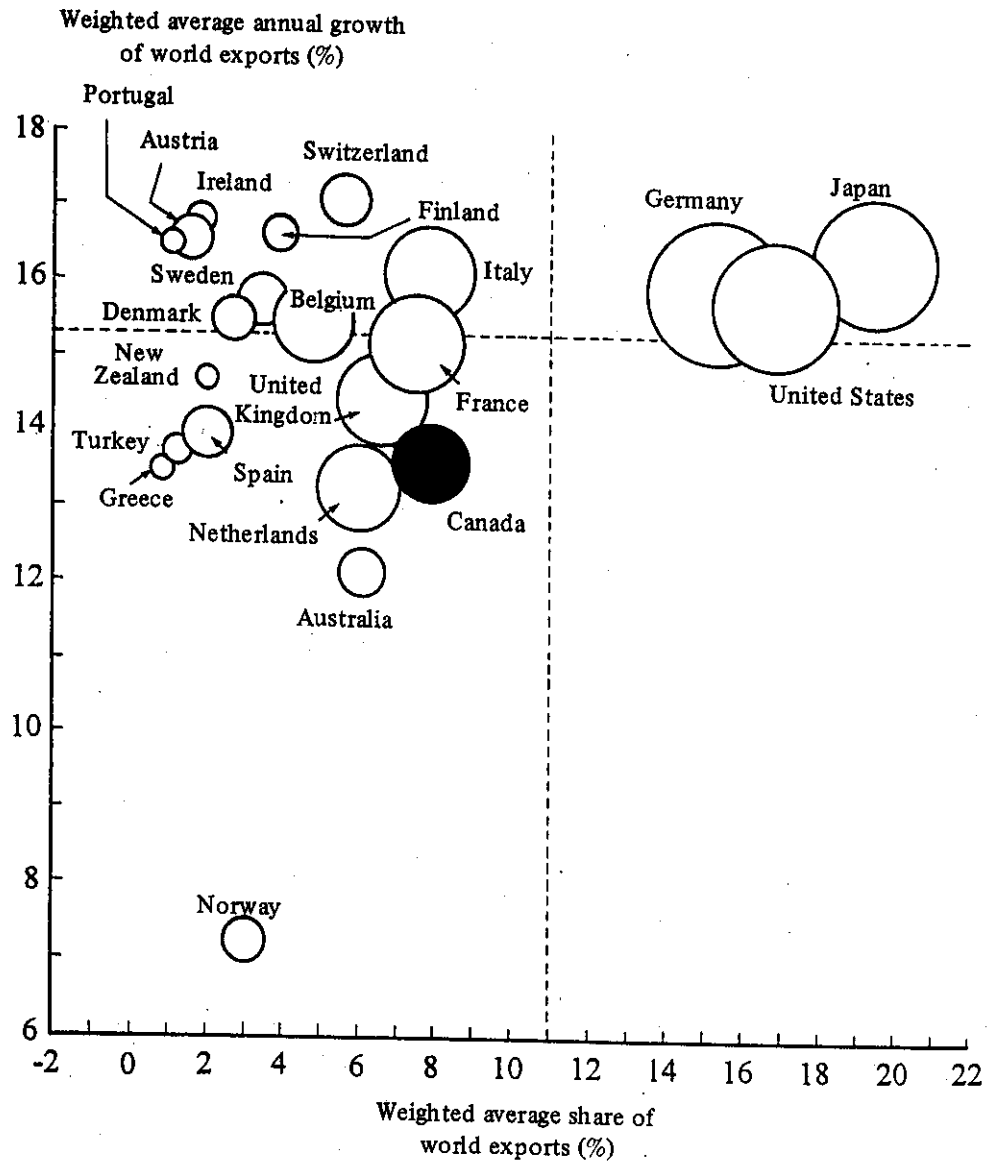
A similar approach has been simultaneously developed by contributors to the *World Competitiveness Report (WCR)*,¹⁰ although probably without being aware of its direct link with Prebisch's concerns. The 1990 WCR includes an analysis of the competitive performance of nations and their industries based on the concept of "national industrial portfolios". For each country, individual "portfolios" are constructed on the basis of export performance in 71 different industries during a number of years. A national industrial portfolio is a description of the overall composition and structure of the industries that operate in a country. The industrial portfolios of 22 OECD countries and 10 newly industrialized nations are given in figures 2 and 3. A growth/share matrix is used, analogous to the one pioneered by the Boston Consulting Group to diagnose the business portfolios of large

corporations. Each country's industrial portfolio is shown as a circle whose area is proportional to the total exports of the country during the period 1985-1989. The vertical axis shows the weighted average annual growth rate of the exports of the 71 industries for each country during that period. A country's position on this axis is determined by the composition of its exports: the extent to which it has specialized in exports from industries whose international trade is growing. The horizontal axis shows the weighted average market share for that country. In this case, the country's position is determined by its success in international trade in the industries that constitute its portfolio. Figure 2 shows clearly that Japan, Germany and the United States are the three leaders in international competitiveness. In terms of both the size and position of their industrial portfolios, these countries are in a group by themselves. Japan's position reflects its extraordinary ability to strategically manage its industrial portfolio. Its position on the vertical axis is a consequence of recent success in shifting out of low-growth industries into those of high growth. Similar success is shown in figure 3, particularly by Hong Kong, Taiwan and Korea. However, a comparison of positions on the horizontal axis shows, as expected, the smaller average market shares of the latter countries.

¹⁰ The *World Competitiveness Report* has been published annually since 1980 in Switzerland by IMD International and The World Economic Forum. The report is based on a quantitative methodology for measuring critical factors of competitiveness. The measurements generate a scoreboard comparing relative competitiveness among OECD countries and among a sample of newly industrialized countries. The concept of national industrial portfolios was developed by Professor Joseph D'Cruz, of Toronto University, Canada, who has contributed with a diagnosis of national industrial portfolios in successive issues of the Report. See D'Cruz (1990) and D'Cruz and Rugman (1992).

FIGURE 2

PRINCIPAL DEVELOPED ECONOMIES: INTERNATIONAL COMPETITIVENESS, 1985-1989^a

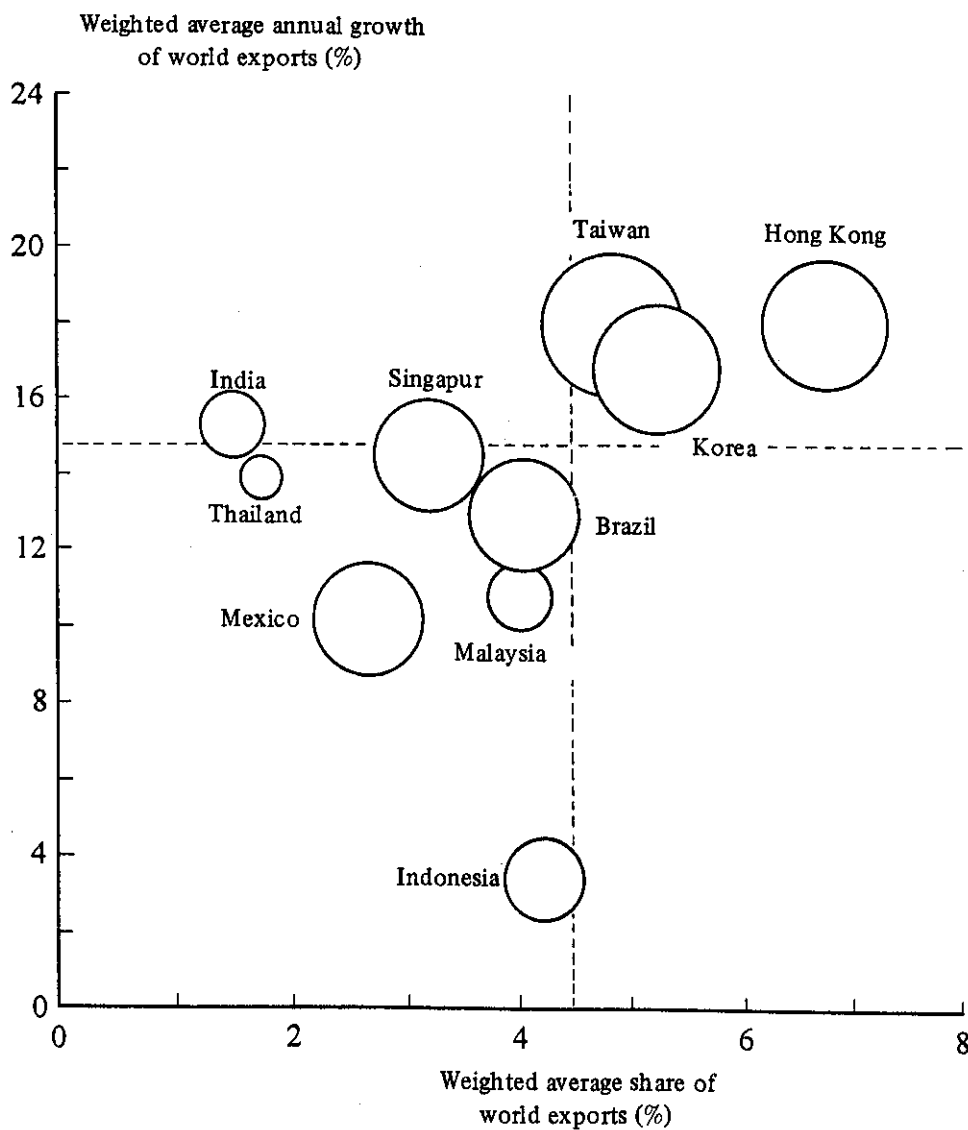


Source: Joseph R. D'Cruz, "National industrial portfolios", *The World Competitiveness Report 1991*, Lausanne, IMD International, and Geneva, The World Economic Forum.

^a The circles are proportionate to total exports in the period. Weighted average growth: 15.3%. Weighted average market share: 11%.

FIGURE 3

NEWLY INDUSTRIALIZING ECONOMIES: INTERNATIONAL COMPETITIVENESS, 1985-1989^a

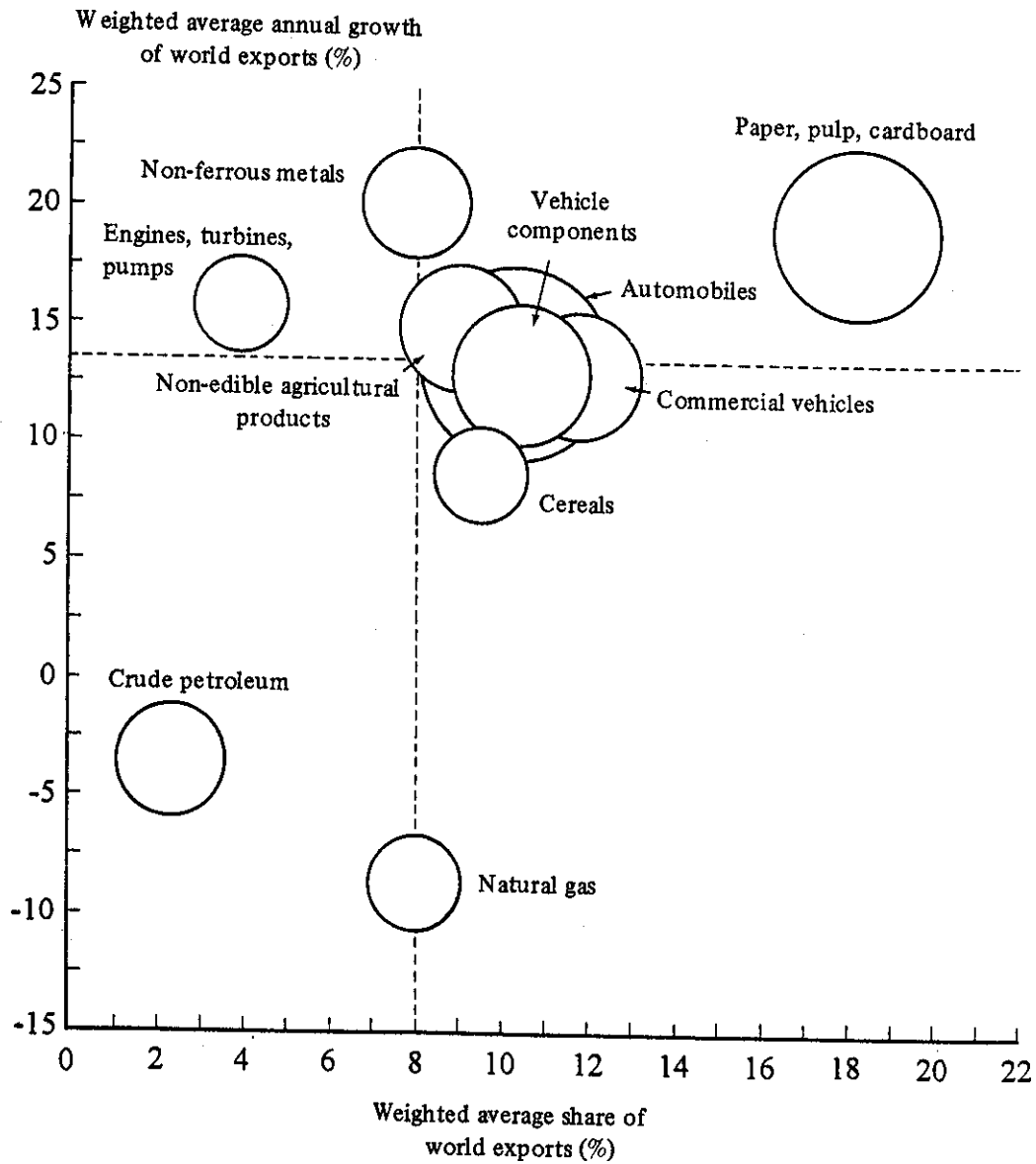


Source: Joseph R. D'Cruz, "National industrial portfolios", *The World Competitiveness Report 1991*, Lausanne, IMD International, and Geneva, The World Economic Forum.

^a The circles are proportionate to total exports in the period. Weighted average growth: 14.7%. Weighted average market share: 4.5%.

FIGURE 4

CANADA: INTERNATIONAL COMPETITIVENESS OF THE 10 LEADING INDUSTRIES, 1985-1989^a



Source: Joseph R. D'Cruz, "National industrial portfolios", *The World Competitiveness Report 1991*, Lausanne, IMD International, and Geneva, The World Economic Forum.

^a The circles are proportionate to total exports in the period. Weighted average growth: 13.6%. Weighted average market share: 7.9%.

As an illustration, Canada's industrial portfolio is presented in figure 4 (only the ten most important industries are displayed). In this case each circle shows: i) the relative attractiveness of the industry, as measured by the rate of growth of world markets; ii) the relative competitive position of the country in that industry, as measured by the country's market share, and iii) the relative importance of that industry in that country's portfolio, as measured by the area of the circle.

In conclusion, both of the above-mentioned approaches to the performance and relative competitive positions of countries contain and generalize important elements of Prebisch's concerns with international trade patterns. In particular, they are powerful tools for diagnosing and discussing the quality of international insertion of particular countries and can also be interpreted as modern adaptations and refinements of Prebisch's criterion of export demand elasticity relative to world income. To the extent that countries succeed in shifting their industrial or productive portfolios from low-growth to high-growth industries or product lines, they would be making progress towards eliminating one of the fundamental asymmetries of centre-periphery trade that concerned Raúl Prebisch.

Prebisch's second reason for giving industrialization high priority, initially via import substitution but later through the promotion of industrial exports to the large markets in developed countries, concerned industry's unique capacity to foster technical progress, learning and upgrading of skills, contributing in this way to the fundamental objective of increasing living standards. International experience and industry and country case studies also support the key importance of work force skills in achieving this objective (Freeman, 1987; Amsden, 1989; Porter, 1990).

Present conditions are, of course, very different from those of the 1950s and 1960s, but the strong link Prebisch established between industry, labour skills and long-term living standards remains a crucial issue that is receiving renewed attention. Robert Reich, for instance, has cogently argued that globalization is increasingly producing an international or global labour market, encompassing Asia, Africa, Latin America, Western Europe and increasingly Eastern Europe and the Soviet Union. The standard of living of the nationals of particular countries increasingly depends, according to Reich, not on the

profitability of the corporations nationals own, but on the value national labour forces are able to add to the global economy through their skills and insights (Reich, 1991). This is another theme that deeply concerned Prebisch and that should be reexamined under a new light in the present stage of international insertion into an increasingly global world trade and investment system.

2. The concept of reciprocity

Prebisch's treatment of the issue of reciprocity is also of interest for present discussions of regional integration and international insertion. He discussed reciprocity in two contexts: in centre-periphery trade, and in intra-Latin American trade.

a) *Reciprocity in centre-periphery trade*

Centre-periphery trade asymmetries led Prebisch to conclude that protection has different effects in each region, with important consequences for the way reciprocity should be conceived. The fact that income-elasticity of demand for industrial imports in the periphery is higher than income demand elasticity for primary commodities in the centres implies that:

"Under equal per capita growth rates, industrial import demand in peripheral countries will tend to grow at a higher rate than primary commodities import demand in the centres. If population growth in the peripheral country is higher than in the centre, this disparity in import growth rates will be accentuated. If income growth in the peripheral country is higher than in the centres, the disparity is further intensified" (Prebisch, 1954, vol. I, p. 366).

Therefore, if a peripheral country sets itself to reduce or even to maintain the income disparity with the centres it will have a persistent tendency to balance of payments disequilibrium. Thus, Prebisch argued, maintaining a moderate level of protection in the periphery is a way to correct this bias and limit imports to the level allowed by its payment capacity. Furthermore, as long as protection is kept within limits, it would not reduce the growth of world trade. In contrast, protection by the industrial centres against primary commodity imports from the periphery accentuates the bias and tends to retard development in the periphery and to slow down the growth of world trade.

Conversely, Prebisch argued, the reduction or elimination of protection in the centres has an

implicit reciprocity component, because the resulting increase in the periphery's exports will lead to a correlative increase in its imports of industrial products. This would occur even without tariff reduction in the periphery, due to its higher income demand elasticity for industrial imports. Thus, "The traditional concept of reciprocity, under which peripheral countries are asked to grant duty concessions similar to those granted by the centres, does not take into account this *implicit reciprocity*" (Prebisch, 1959b, vol. I, p. 457).

Prebisch applied this analysis in commenting on U.S. trade policy and observed that:

"...tariff concessions agreed by the U.S. with developing countries have their own implicit counterpart: the higher international purchasing power generated by higher U.S. imports will tend to turn itself directly and indirectly into a higher international demand for U.S. exports. In reality, the U.S. predicament vis-à-vis Latin America could not be more favourable. As long as these countries maintain protection within limits, it would not be the tariff level but the volume of U.S. imports (from Latin America) that will determine the amount of Latin American imports (from the U.S.)" (Prebisch, 1954, vol. I, p. 374).

Two observations are relevant on the above analysis. First, Prebisch does not take into account trade in services and capital flows: factors which could contribute to relax the foreign exchange constraint to some extent. He mentions these factors but puts them aside "for simplicity's sake". The sustainability of growth without falling into a binding balance of payments constraint, when trade in services and capital flows are considered, is certainly a major issue at present, particularly for economic management during the transition to liberalized trade.

Second, the practical importance of implicit reciprocity depends on actual trade structures, which increasingly diverge substantially from the postulated centre-periphery specialization. However, particularly in the context of possible U.S. - Latin America free trade negotiations as part of the Enterprise for the Americas Initiative, implicit reciprocity as conceived by Prebisch may provide a strong justification for a differential and prolonged phase-out of tariff and non-tariff barriers for Latin American countries. It is interesting to note that, in relation to the future outward-oriented stage based on reciprocal trade in industrial products with the centres, Prebisch argued that: "Once this objective has been achieved, the

traditional concept of reciprocal concessions might gradually recover its validity" (Prebisch, 1961, vol. II, p. 94).

b) Reciprocity in intra-Latin American trade

Prebisch was concerned about the low coefficient of intra-regional trade versus total trade in Latin America, and about asymmetries or polarization effects between countries as a source of difficulties for regional economic integration. Reciprocity was conceived as a way to tackle these problems. It required that member country imports be financed by their own additional industrial exports: "It is essential (for the success of the common market) that the country that increases its imports (from Latin America) be able to pay for them by increasing its own industrial exports, in addition to its primary commodity exports. Otherwise, this policy will not promote that country's own industrialization, and it would boil down to transferring to other Latin American countries the foreign exchange that was previously used in paying imports from the rest of the world" (Prebisch, 1959a, vol. I, pp. 499-500).

Reciprocity, therefore, would involve efforts to balance trade in industrial products and promote industrial exports. It was also conceived as a way to deal with the distribution of costs and benefits of integration and ensure the continued commitment of countries to the integration scheme. A number of points should be made in this respect.

First, despite several decades of integration efforts, Prebisch's concern with the low coefficient of intra-regional trade relative to total trade in Latin America is still valid. In fact, a major concern in the approach calling for a move towards a Hemispheric Free Trade Area, as proposed by the Enterprise for the Americas Initiative (EAI), is the need to avoid a hub-and-spoke pattern of trade, with the United States as the hub and very small trade among the Latin American spokes (Wonnacott, 1991; Lipsey, 1992).

Second, under present conditions some trends associated with globalization, such as the growth of intra-industry trade, the new sourcing practices of global enterprises, and the growth of trade in services and in knowledge-intensive activities, suggest the need to redefine reciprocity by moving away from a narrow definition in terms of the balance of trade in industrial products. Nevertheless, the concept of reciprocity remains valuable because it focuses attention

directly on foreign-trade structures and their effects on the pattern of development (Antonelli, 1989; Rowthorn and Wells, 1987).

Third, Prebisch was realistic as regards the difficulties of achieving reciprocity narrowly defined: "The possibility should be accepted, of course, that the competitive strength of certain countries would make their exports dominant in the market of less competitive countries, without the latter being able to correlatively develop their exports. It is essential to prevent this type of situation from provoking restrictive measures" (Prebisch, 1959a, vol. I, p. 500). In order to allow "the smooth functioning of the common market" and prevent restrictive measures, Prebisch discussed in some detail four types of measures which are of interest for present-day regional integration efforts: i) More competitive and advantaged countries should stimulate their own imports from the common market by accelerating the rate of elimination or reduction of their own tariff and non-tariff barriers (NTBs); ii) less competitive countries should receive significant technical and financial cooperation to develop industries and improve competitive advantages; iii) less competitive countries should be assured, by appropriate safeguards, that if despite corrective measures in terms of cooperation and faster liberalization by the more developed countries, their unfavourable situation persists, they would be able to reduce the rate of reduction or elimination of tariffs and NTBs; iv) a multilateral credit facility (clearing house) is recommended in order to save on the use of hard currency and induce countries to commit themselves to deeper liberalization than they would be prepared to do otherwise (Prebisch, 1959a, vol. I, pp. 499-514).

Clearly, these types of measures are relevant not only to Latin American integration, but also, and even more forcefully, to integration into any larger trade bloc. Elsewhere, we have argued that the acute asymmetries between prospective members of a Western Hemisphere Free Trade Area (WHFTA) that includes the U.S., Canada and Latin America suggest the need to exercise asymmetric or relative reciprocity by adopting several policies that are essential to make a free trade area among such a heterogeneous group of countries viable (Salazar-Xirinachs and Lizano, 1992, chap. 2). These include: i) differential phase-out periods for the elimination of tariff and non-tariff barriers; ii) transitional support measures

from the more developed to the less developed member countries; iii) technical and financial cooperation, particularly to upgrade standards (products, processes, the environment, intellectual property); iv) support for improvement of the investment climate and the development of long-term competitiveness (science and technology, training and other factor upgrading policies). The latter would be aimed at accelerating the transfer of technology, improving export services, and removing supply side inflexibilities in the less developed partners.

3. Regionalism versus multilateralism

Some analysts fear that the U.S. endorsement of regionalism, the Europe-92 programme, and other regional integration efforts will tilt the balance away from multilateralism and lead to fragmentation of the world trading system (Bhagwati, 1992). Others, however, welcome regional initiatives as a means of delivering locally what seems impossible to attain globally (Krugman, 1992; Summers, 1991; Dornbusch, 1990).

In all his main contributions Prebisch shows a consistent concern with the impact regional economic integration might have on the international trading system and with the limits protection should have in order to avoid adverse effects on world trade. In this respect, he developed a number of related arguments.

First, he argued that in view of the income-elasticity asymmetries, moderate protection in developing countries is necessary to manage the foreign exchange constraint, but this would not affect world trade negatively: on the contrary, to the extent that protection helps to raise income in developing countries it might actually contribute to the expansion of world trade:

"There are two kinds of protectionism in developing countries. First, protectionism that contributes to promote the structural changes required by economic development without reducing imports below the volume corresponding to external payments capacity and without reducing world trade nor weakening its growth rate. Secondly, protectionism that goes beyond the limits required by import adjustment and that adversely affects world trade" (Prebisch, 1954, vol. I, p. 368).

In contrast, according to Prebisch, protectionism in the centre would be highly negative to world trade

and to multilateralism: it would seriously affect exports and income growth in the periphery, and would therefore also reduce the centre's industrial exports to the periphery. The dynamism of the world trading system is determined, he argued, by the economic behaviour of the centres, the periphery having basically a passive role. By opening up to the periphery's exports the centres can create purchasing power for their own industrial exports to developing countries. Conversely, if the centres limit their imports, this would reduce foreign exchange earnings and import capacity in developing countries, and would force these countries to intensify their own protectionist policy (Prebisch, 1954, vol. I, pp. 371-373): "*It is beyond doubt that any country, large or small, that resorts to protectionism when it has no disparities to correct in foreign trade elasticities would exert a negative pressure on world trade. The larger the country, the larger its influence and its responsibility*" (Prebisch, 1959b, vol. I, p. 459).

Thirdly, Prebisch insisted that a regional group or common market can greatly help to improve world trade and multilateralism, if it meets certain conditions. A common market, with its large potential for increasing trade in industrial products, "*could break*

the old patterns of trade according to which each Latin American country orients its trade towards the industrial centres, with very weak trade flows with other countries in the region" (Prebisch, 1959b, vol. I, p. 460). Two conditions are essential, according to Prebisch, in order to maximize the contribution of regional integration to world trade and multilateralism: efficiency in the industrialization process, which in turn requires protection to be moderate, and a sufficiently large integrated market. As regards the former, cost reductions brought about by the common market would justify a reduction of average tariff levels *vis-à-vis* the rest of the world, in comparison with the alternative scenario of an inefficient ISI process continuing in fragmented markets. Thus, he argued, the common market offers the opportunity to negotiate, as a trade bloc, reciprocal tariff reductions *vis-à-vis* the rest of the world, which would be beneficial for international trade.

As regards the second condition, market size might be insufficient even when relatively small countries integrate. Therefore, for economic integration to render all its potential benefits: "it should have a *multilateral character*, and involve the largest number of countries possible" (Prebisch, 1954, vol. I, p. 379).

VI

Final observations

We have shown that, far from remaining locked-in in an inefficient import substitution industrialization path, for Prebisch, gradual and negotiated incorporation into increasingly wider commercial relationships was seen as the key to economic progress. Regional economic integration and periodical revisions of external tariffs to keep protection within moderate levels were essential ingredients for reaching a stage of reciprocal trade in industrial products with the centres, which Prebisch considered as the only option capable of breaking the centre-periphery asymmetries, increasing income and employment, and raising living standards in developing countries. Thus, rather than departing from Prebisch's long-term vision, the current search for a new high-quality international insertion and the integrationist revival in Latin America may be interpreted as a reassertion of the

sequence of policies originally envisaged and recommended by Prebisch.

In addition, Raúl Prebisch's ideas on economic integration, outward-looking growth based on industrial export promotion, selectivity based on world income-elasticity criteria, and reciprocity, appropriately adapted to present conditions, are relevant for the rethinking of the strategy of international insertion complemented by regional integration in which Latin American countries are presently busily engaged.

We have not argued, however, that the present-day case for international insertion and regional integration is based on exactly the same reasons Prebisch had in mind. New reasons for regional economic integration and cooperation emerge when integration is seen as functional and complementary to

international insertion: a topic which has been analysed elsewhere.¹¹ The characteristics of the world economy and of Latin America are now very different from those of the 1950s and 1960s. We now live in the context of a different "technological paradigm". Globalization, the increasing importance of trade in services, the move from the high-volume to the high-value enterprise based on knowledge and information-intensive activities, and new sourcing practices of global firms are all features that are fundamentally changing the international and local economies and that should be taken into account. In particular, the relative attractiveness of countries as locations for investment emerges as a major issue in the analysis of international insertion strategy and its domestic policy requirements. What we have tried to show is that, in addition to the validity of his overall long-term vision of the development process, a number of Prebisch's specific concerns are relevant today:

i) The income-elasticity criterion is a useful approach for assessing the relative competitive positions of countries and guiding productive modernization policies to improve the quality of international insertion.

ii) The link between labour skills and living standards remains a crucial issue that is receiving renewed attention.

iii) Prebisch's concern with the low coefficient of intra-regional trade compared to total trade in Latin America is still valid, despite decades of inte-

gration efforts, and assumes renewed importance in the context of the formation of a Western Hemisphere free trade area.

iv) Economic integration as a means of relaxing the foreign exchange constraint is a controversial proposition when trade in services and capital flows are taken into account. However, sufficiently large capital inflows over time to sustain growth are a sensitive issue for economic management during the present transition to freer trade in Latin America, and Prebisch's point remains valid: by deliberately promoting economic integration, countries could significantly raise their rate of growth and industrialization.

v) Existing trade asymmetries between prospective members of economic integration areas strongly suggest the need to give practical meaning under present conditions to Prebisch's concept of relative reciprocity and to complementary policies to ensure the viability and fairness of free trade areas that integrate countries at very different stages of development.

vi) Finally, also relevant today are the two essential conditions Prebisch emphasized in order to maximize the contribution of regional integration to freer world trade and multilateralism: efficiency in the industrialization process, which in turn requires protection to be moderate, and a sufficiently large integrated market. Moderate protection, in addition, reduces the trade-diversion costs of integration.

(Original: English)

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¹¹ See ECLAC (1990) and Salazar-Xirinachs (1993).

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