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Manufactured exports

from small Latin American economies:

the challenges ahead

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This article explores the challenges that small, less industrialized Latin American countries face in achieving sustained growth of manufactured exports. The improvement of export performance was one of the aims of the policy reforms adopted since the 1980s in line with the so-called Washington Consensus. The economic environment for manufacturing firms improved significantly, and growth of industrial production and exports was stimulated. Nevertheless, the manufacturing sector has not yet become a major engine of growth, and industrial exports have only recently started to increase. Moreover, manufactured exports depend to a high degree on strategies of foreign firms and are mainly concentrated in relatively less dynamic sectors of world trade. Notwithstanding the broadness and comprehensiveness of the Washington Consensus, additional measures are needed in order to achieve the systemic competitiveness of manufacturing industries. In this article, five challenges to economic policy in the countries in question are distinguished: i) the reform of trade and exchange rate regimes must be completed. In this regard, the maintenance of a high and stable real effective exchange rate has appeared to be very difficult in the 1990s; ii) public and private investment appear to show a crowding-in effect, and need to be stimulated simultaneously; iii) additional measures are needed to support openness and exports, and this calls for institutions to facilitate the technological capabilities and the export drive of domestic firms; iv) the social and political acceptability of these programmes needs to be enhanced, and v) it is necessary to learn to cope with new international trade rules in order to prevent such rules from becoming new barriers to the penetration of international markets.

I

Introduction

A significant reorientation of the macroeconomic policies and trade and industrialization regimes of a large number of Latin American countries took place during the second half of the 1980s and the early 1990s. The far-reaching adjustments that were implemented as part of stabilization and restructuring programmes reflect the new priorities in the region which are often referred to as the Washington Consensus. The main priorities have been in the areas of fiscal discipline, the reorientation of government expenditure, tax reform, financial liberalization, exchange-rate adjustment, trade liberalization, attraction of foreign direct investment, deregulation, and the establishment of property rights (Williamson, ed., 1990). The emphasis has been on "getting prices right" and on reducing the role of government to the creation of a stable and stimulating macroeconomic environment, the correction of market failures and the provision of public goods.

If we focus more specifically on the reorientation of trade and exchange-rate policies, it may be noted that in nearly all countries the average import tariff rates have been lowered significantly, tariff dispersion has been reduced, the use of non-tariff barriers to trade has been largely abandoned, and the real effective exchange rates (REER) have become more favourable to import-substituting and exporting industries. Moreover, most countries have become members of the World Trade Organization (WTO) and participate in one or more regional preference systems.

Notwithstanding the progress made in implementing the Washington Consensus and particularly in the reform of trade policy and exchange-rate regimes, it may be questioned whether the mix of policies currently pursued in the region will suffice to bring about the required transformation of the manufacturing sector and a new insertion in international markets.

The issue of sustainable growth of manufactured exports has been studied in particular for the larger Latin American countries, which have attained a relatively strong industrial base. The small and medium-sized economies, with a weaker industrial base, face different challenges and deserve specific attention in this respect. The project which served as a basis for the analysis and critical reflections presented in this article focused on the problems relating to the new insertion into world markets faced by a sample of small and medium-sized Latin American countries and generated a series of cross-country analyses as well as six country-specific studies (Buitelaar and Van Dijck (eds.), 1996).

As will be shown in the following section of this article, a substantial number of small and medium-sized countries have made significant progress in recent years in re-orientating their manufacturing sectors towards a more export-orientated growth pattern and in making them contribute more significantly to overall export income. At the same time, however, it is shown that the contribution of the manufacturing sector to overall production has declined rather than increased in several of the selected countries, that manufactured exports are largely concentrated in product groups that are less dynamic in world trade, and that the penetration of international markets is still very limited. In subsequent sections, a number of critical reflections are made on the policies currently pursued in those countries to promote a more diversified and dynamic export sector, and it is argued that government should take a more prominent position to stimulate systemic competitiveness and a successful and comprehensive insertion in world markets.

□ This article is based on the results of a joint research project carried out by ECLAC and the Center for Latin American Research and Documentation (CEDLA) of the University of Amsterdam, the main findings of which have been published in Buitelaar and van Dijck (eds.), 1996. The authors wish to thank Ramón Padilla of ECLAC for his assistance with the updating of tables.

II

Recent performance of the manufacturing sector

In order to put the challenges that lie ahead in a clear perspective, we shall begin by presenting a series of indicators relating to the development of the manufacturing sector in the selected countries during the period 1970-1994. Changes in the 1990s are shown on an annual basis to facilitate a balanced appreciation of the progress made in recent years.

As table 1 shows, the absolute size of the manufacturing sector in the selected countries is very small, the countries with the largest manufacturing base in 1994 being Venezuela, Colombia and Chile. It is noteworthy that during the period 1970-1994 the share of the manufacturing sector in GDP did not increase significantly, as might have been expected from studies of development patterns over time and across countries. On the contrary, the contribution of the sector to GDP increased only in Costa Rica, El Salvador and Venezuela, while in all other selected countries it decreased or stagnated, at least when measured in domestic market prices (in constant US dollars). However, it should be noted that liberalization measures introduced in the second half of the 1980s and early 1990s may have significantly narrowed the gap between domestic and international prices and consequently reduced the statistical illusion created by the use of domestic market prices for manufacturing output rather than international prices. Growth of manufacturing production was relatively high in the 1970s, dropped sharply during the first half of the 1980s and recovered in most of the selected countries in the second half of that decade. The recovery was particularly strong in Chile. In the course of the 1990s, however, growth rates tended to decline in most of the countries in our sample.

Traditionally, the manufacturing sector was strongly oriented towards the domestic market, due to the anti-export bias in government incentives and the lack of international competitiveness of domestic industries. As shown in table 1, in most of the countries the contribution of manufactured exports to total GDP and the share of manufactures in total exports were rather low initially but increased significantly in

recent years, with the average growth rates of manufactured exports significantly exceeding the average growth of manufacturing production. Nevertheless, the contribution of manufactured exports to total GDP is still very limited, particularly in Ecuador and Venezuela. The contribution of manufacturing industry to total exports of goods has become particularly significant in El Salvador, Uruguay and Colombia, but it is still very limited in Ecuador, Venezuela and Chile. The growth of non-traditional exports has resulted in a more diversified export structure, as indicated by the declining values of the concentration index shown in the final rows of the table.

The aggregated data presented here, however, do not necessarily reflect an increase in the international competitiveness of domestic industries, since foreign-owned firms tend to play a significant role in the manufacturing sectors of most Latin American countries and this is even more true in the case of exports. The number of domestic firms directly engaged in exports of manufactures in a significant and systematic manner is rather small in most of the selected countries. This is even true of Chile, which introduced an outward-oriented policy as far back as the 1970s. Particularly in the Caribbean and in some Central American countries, exports of manufactures are to a substantial degree generated by foreign-owned firms located in export processing free zones. By offering substantial incentives to foreign investors, countries in these areas have attracted foreign investments outside as well as inside such zones.

The findings presented above may be summarized as follows. First, the industrial transformation of the selected economies has progressed only slowly during the period under investigation, and the recovery of industry did not play a leading role in overall economic growth in the second half of the 1980s and early 1990s. Second, the manufacturing sector has become more export-oriented recently, even though foreign firms play a significant role in the new export sectors. Third, the contribution of the manufacturing sector to total exports of goods in-

TABLE 1

Latin America: Manufacturing production and exports in selected countries
(Millions of dollars and percentages)

	Years	Chile	Colombia	Costa Rica	Ecuador	El Salvador	Guatemala	Uruguay	Venezuela
1. Value added in manufacturing (millions of 1990 US dollars)	1994	8 021	10 251	1 362	2 796	1 424	1 323	2 388	12 034
2. Share of manufacturing output, in 1980 constant US dollars, in GDP (percentage)	1970	24.5	22.1	15.5	15.9	15.2	16.6	26.7	17.5
	1980	21.4	23.3	18.6	17.7	15.0	17.6	28.2	18.8
	1994	20.6	20.4	19.0	14.7	16.5	15.2	19.3	19.5
3. Growth of manufacturing production (percentage)	1970-1980	-0.8	5.8	7.9	10.5	4.1	6.2	3.5	5.7
	1980-1985	-1.9	1.3	0.2	0.8	-2.2	-2.1	-6.2	1.8
	1985-1989	7.8	4.2	4.8	0.1	2.8	1.7	4.3	2.1
	1990	1.1	4.2	2.6	-5.0	4.9	2.4	-1.4	6.0
	1991	6.6	0.8	2.0	3.9	5.9	4.6	-0.5	9.7
	1992	11.0	5.9	10.3	3.6	9.8	3.3	1.5	2.5
	1993	5.1	2.3	6.4	2.5	-1.5	2.7	-9.0	-0.7
	1994	2.9	2.8	4.2	4.7	7.9	2.7	3.1	-4.1
4. Value of manufactured exports (millions of current US dollars)	1994	1 865	3 293	374	286	363	471	823	2 298
5. Share of manufactured exports in GDP (percentage)	1970-1975	0.8	1.8	4.7	0.3	5.0	5.2	2.1	0.3
	1985-1990	1.8	2.5	6.1	0.3	2.5	3.1	5.9	1.9
	1994	4.7	6.0	...	1.9	5.4	5.2	7.1	3.5
6. Share of manufactures in exports (percentage)	1970	4.4	8.1	19.7	1.7	28.7	28.0	20.4	1.5
	1980	9.7	20.4	34.3	3.0	20.1	24.2	38.2	1.7
	1990	9.8	25.3	25.7	2.6	22.6	23.7	39.1	10.7
	1991	12.7	33.3	24.5	2.4	40.6	27.9	40.1	9.6
	1992	13.2	31.8	25.6	4.0	47.8	29.9	40.8	11.0
	1993	16.1	39.9	...	7.1	46.1	30.7	42.2	13.3
	1994	16.4	36.9	...	7.4	44.7	31.3	42.9	13.8
7. Growth of manufactured exports (percentage)	1970-1990	13.4	12.6	9.7	10.9	2.0	5.5	14.6	19.6
	1991	22.5	42.5	0.1	10.3	-17.8	17.8	-4.1	-24.1
	1992	14.8	-9.0	17.4	73.1	79.9	15.5	4.6	8.3
	1993	14.3	34.9	...	78.4	24.3	6.2	2.6	32.0
	1994	24.3	10.8	...	33.4	9.8	14.5	21.5	13.2
8. Concentration index ^a	1980	0.406	0.579	0.316	0.547	0.380	0.310	0.235	0.674
	1992	0.308	0.238	0.303	0.467	0.238	0.219	0.176	0.555

Source: 1, 5 and 7 taken from IDB, 1992 and 1995.

2 taken from ECLAC, 1994 and 1996.

3 taken from United Nations, 1991, and ECLAC, 1996.

4 and 6 taken from World Bank, 1992 (country pages) and ECLAC, 1996.

8 taken from UNCTAD, 1993 and 1995.

^a Hirschmann index has been normalized to make values range from 0 to 1 (maximum concentration).

creased in all the countries in the sample, and this resulted in lower export concentration ratios.

It is reasonable to consider that increasing export-market shares is one of the principal aims of the economic reforms. An analysis is presented below of the changes in the market shares of eight countries in the total imports of manufactures of 24 OECD nations.

The import markets of the industrialized countries constitute the most demanding and competitive part of international trade, and for that reason this market share can be considered a good measure of success. The analysis was performed at the three-digit level of the Standard International Trade Classification (SITC), for the period 1977 (when SITC Rev. 2 was

TABLE 2

Latin America: Market shares in OECD imports of manufactures, 1977-1994
(Percentages)

	Chile	Colombia	Costa Rica	Ecuador	El Salvador	Guatemala	Uruguay	Venezuela
1. Total market share								
1977	0.01	0.06	0.02	-	0.03	-	0.05	0.02
1994	0.03	0.06	0.06	0.01	0.02	0.04	0.02	0.03
Annual average growth of this share	4.58	-0.43	8.48	3.23	-0.62	15.4	-6.43	3.06
2. Market share in dynamic sectors								
Year of inflection	1983	1987	1980	1988	1988	1983
1977 ^a	0.01	0.03	0.03	-	0.06	-	0.03	0.02
1994 ^a	0.02	0.05	0.09	-	0.04	0.06	0.01	0.02
Annual average growth of this share	3.11	2.82	5.97	1.43	-2.52	18.6	-9.8	0.26
3. Market share in stagnant sectors								
1977 ^a	0.02	0.08	-	-	0.02	-	0.06	0.03
1994 ^a	0.04	0.06	0.02	0.01	-	0.01	0.03	0.05
Annual average growth of this share	5.93	-1.92	9.05	4.24	-7.94	2.7	-4.27	3.68
4. Proportion of exports in dynamic sectors, 1994 ^b	45	49	49.9	41.6	43	28	55.9	41.6
5. Proportion of exports in stagnant sectors, 1994 ^b	55	51	50.1	58.4	57	72	44.1	58.4

Source: COMTRADE, using the CAN programme.

^a The relative dynamism of the sectors was calculated with base year 1977 and final year 1994.

^b The relative dynamism of the sectors was calculated with base year 1993 and final year 1994.

adopted) to 1994. Manufactured imports are defined as SITC sections 5-8, excluding divisions 67 and 68. The data source used (the United Nations Comtrade database) was analysed with the Competitive Analysis of Nations (CAN) software developed by ECLAC (Mandeng, 1991).

As table 2 shows, the overall market shares of five countries increased between 1977 and 1994, while those of three countries show a decline. A distinct pattern may be observed in the case of six countries that lost market shares at the beginning of the period but are gaining shares in the second half. The table also shows the year of inflection, with Chile, Costa Rica and Guatemala being the countries that were successful earlier in the 1980s, and Colombia, Ecuador and El Salvador representing cases where the trend reversed towards the end of that decade. For two countries, no clear change of trend can be discerned: Uruguay lost market shares in each of the 17 years, while Venezuela registers several periods of growth and decline.

The CAN software allows a distinction to be made between sectors with an above-average growth

rate of imports (dynamic sectors) and sectors with a below-average growth rate (stagnant sectors). As the data refer to current import values, price fluctuations may affect the relative growth rates. Moreover, the product mix of dynamic and static sectors is sensitive to the definition of the base year and the final year. For most countries, especially in South America, market shares in 1977 were larger in sectors that were stagnant during the period 1977-94 than they were in dynamic sectors.¹ Also, growth rates of market shares in stagnant sectors tended to be higher than growth rates in dynamic sectors. Thus, at the end of the period most South American countries continue to show higher market shares in stagnant sectors than in dynamic sectors. The sectors in which these countries participate may be characterized as industrial commodities which are strongly dependent on the availability of natural resources. Petrochemical industries in Venezuela, copper-based manufactures and wood products in Chile, and leather and wool manufactures in Uruguay are cases in point.

¹ For instance, the market shares of Colombia in 1977 were 0.08 in stagnant sectors and 0.03 in dynamic sectors (table 2).

The Central American countries show a different picture. Market shares at the beginning of the period were very low, and their increase reflects the participation of these countries in OECD imports of apparel, a product which makes intensive use of low-wage labour. At that time, apparel trade was a particularly dynamic part of OECD imports: the globalization of US apparel producers, which took advantage of special import provisions, dynamized international trade in these products. However, from 1992 onwards these sectors have ceased to be dynamic, and the Central American countries find themselves –like the South American countries in our sample– participating in sectors that were stagnant during the period

1993-94. In 1994, for example, 72% of the exports of Guatemala were concentrated in stagnant sectors, compared to 28% in dynamic sectors. It may be observed that Colombia is a case where the features of South American and Central American countries are combined, since Colombia exports both industrial commodities and apparel.

Both export drives, i.e. the natural resource-based industrial commodities exports of the South American countries and the cheap-labour-based apparel exports of Central American countries, seem to require an evolution towards exports with a higher value-added content in order to make the increase in market shares more sustainable.

III

The challenges ahead

Notwithstanding the significant changes in policies and the great efforts to stimulate and diversify exports, the domestic industrial base for trade of the small and medium-sized Latin American countries is still weak and the contribution of domestic firms to their exports of manufactures is relatively small. The prospects of a successful new insertion in world markets depend critically on the relationship between governments and the private sector, and particularly on the capability of governments to create an atmosphere that is conducive to investment in the tradeable goods sectors. These countries face challenges that require new initiatives by government and the private sector that are vital to a successful industrial transformation in the long term.

On the basis of the country studies included in the research project, we distinguish five such challenges: i) completing the reform of the trade and exchange-rate regimes; ii) stimulating private and government investments; iii) implementing additional government measures to support openness and exports, and to improve the quality of human resources and technological capabilities; iv) improving the social and political acceptability of the economic reform strategy, and v) coping with new competitors in international markets and new rules and regulations in the world trading system.

1. Completing the reform of the trade and exchange-rate regimes

The significant changes in the trade and industrialization regimes that were introduced in the course of the 1980s and early 1990s have resulted in a more competitive and export-oriented setting for the manufacturing sector. Tariff rates were slashed in many of the countries, as was the coverage of non-tariff barriers in most countries. As shown in table 3, by 1994 average tariffs had declined to low levels, although in many countries the rates of dispersion were still substantial. The policies of liberalization and stabilization were accompanied by significant changes in exchange-rate regimes.

Table 4 shows the adjustments made in the real effective exchange rate (REER) during the period 1985-1994. The index is defined as the local currency price of foreign currency, so that a rise in the index signifies a depreciation. Very significant depreciations were effected in Ecuador, Venezuela and Colombia in the second half of the 1980s. The REER tended to fluctuate rather strongly in the second half of the 1980s in El Salvador and to a lesser extent in Ecuador. In the early 1990s, exchange rates tended to appreciate in all countries in the table except Costa Rica. The appreciation was particularly strong in Uruguay, Colombia and Ecuador. These fluctuations

TABLE 3

Latin America: Trade liberalization in selected countries, 1985-1992

	Tariff rates (percentages) ^a	Tariff dispersion		Coverage of non-tariff barriers (percentages)		
	1985	1991-1992	1994	1994	1985-1987	1991-1992
Chile	36.0	11.0	10.96	66	101	-
Colombia	83.0	67	11.57	640	732	10
Costa Rica	92.0	16.0	11.74	788	8	-
Ecuador	50.0	18.0	11.91	628	593	...
Guatemala	50.0	19.0	10.82	707	74	60
Uruguay	32.0	12.0	14.74	586	141	...
Venezuela	30.0	17.0	11.80	604	441	50

Source: Prepared by the authors, with data from the World Bank and UNCTAD.

^a Tariff rates include tariffs and para-tariffs.

TABLE 4

Latin America: Real effective exchange rates in selected countries, 1985-1994

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Chile	73.0	86.4	93.1	99.6	97.3	100	96.9	91.7	91.0	89.2
Colombia	54.6	73.2	82.1	85.2	88.3	100	96.7	88.6	84.3	75.3
Costa Rica	76.1	84.6	93.2	101.8	98.1	100	109.6	107.5	109.2	106.0
Ecuador	49.5	61.5	80.0	106.5	92.1	100	95.3	94.6	82.3	77.7
El Salvador	93.5	114.1	100.4	88.0	89.2	100	97.3	96.3	87.5	83.2
Guatemala	70.0	71.8	74.0	79.8	82.6	100	85.0	80.5	79.3	75.8
Uruguay	85.8	87.0	89.2	94.6	90.4	100	87.7	81.9	69.9	66.3
Venezuela	51.1	61.2	85.4	76.5	89.9	100	93.6	89.6	86.7	90.3

Source: IDB, 1995, country tables.

and the recent tendency towards currency appreciation may have disruptive effects on the new export activities of these countries as well as on other sources of foreign exchange such as traditional exports and tourism. The very success of a credible policy of stabilization and early liberalization of the capital account has induced the return of flight capital and an inflow of foreign investments which may have created a new form of overabundance of foreign exchange, resulting in a tendency towards over-valuation of the domestic currency. This complicates the process of completing the reforms.

Completing the reform of the trade and exchange-rate regimes fits in with the Washington Consensus: "getting prices right" is in many cases a precondition for industrial development that has not yet been met and requires further policy changes. Notwithstanding the significant adjustments referred to above, some tariff and non-tariff barriers are still

in place, domestic price regulations are in force, and market barriers frustrate the entry of newcomers (and especially of small firms) into the marketplace. Moreover, governments are often not capable of establishing exchange-rate regimes that support industry and export diversification in a consistent manner in the longer term. This is particularly true of countries that are heavily dependent on the production and export of only one or a few primary products and are potentially vulnerable to the "Dutch disease".

It should be noted, however, that "getting prices right" is not a synonym of government abstention, as State intervention may be needed in order to do away with market imperfections created by the private sector, to improve the smooth and flexible functioning of markets, and to correct positive and negative externalities, although preferably such interventions should not interfere with a free-trade regime.

It is very hard to generalize regarding the optimal speed of liberalization in the light of the experience of Latin American as well as other countries. Crucial factors in this regard are the efficiency of domestic industry and its capability to transform itself into an internationally competitive sector in the short term, producing product categories and qualities that are in demand abroad, and the expectations of the private sector with respect to the sustainability of the policy mix that is required to operate in open markets. Shock reforms may be justified in order to reduce the possibilities for pressure groups to block or retard reforms, but such a strategy may have high economic and social costs. If a shock-type approach is required, additional measures may be needed to reduce its negative effects on employment and the current account of the balance of payments during a transitional stage (Linnemann, 1996).

With regard to adjustments in the exchange-rate regime, experience indicates that the choice of such a regime depends on the economic environment of a country. A pegged-rate system is attractive for small countries that have a dominant trade relation with one partner, as is the case of the Central American countries. In countries with a more diversified structure of export destinations, an exchange-rate system pegged to a basket of international currencies may be called for, while countries with an export structure dominated by one or a few export commodities with widely fluctuating international prices may find a floating nominal exchange rate more appropriate (Visser, 1996).

However, a number of factors may reduce the options open to the government to pursue an effective exchange-rate policy. First, the availability of abundant natural resources and the dependence on few exportable commodities may cause "Dutch disease" effects that hamper the drive to export manufactures. Cases in point are Colombia with coffee and illegal exports, and Venezuela and Ecuador with oil exports. In some small economies, such as those of Central America, Dutch disease effects may arise even through the abundance of foreign aid. If a stable nominal exchange rate is not possible, at least a stable real exchange rate is called for in order to promote exports.

Second, if the exchange rate is to be used as an instrument to stimulate exports, it is necessary to free the foreign exchange market from restrictions that artificially keep the exchange rate down. The dangers

of dual and multiple exchange-rate systems are that they can easily be abused for political motives. Payments restrictions and dual and multiple exchange-rate systems pose a threat to economic welfare. A crucial question in this context is how to bring about the liberalization of the international payments system. No standard recipes can be given. Simultaneous liberalization of the capital and current account, or liberalization of the capital account even before the liberalization of the current account, may seriously jeopardize efforts to implement exchange-rate regimes that favour a better insertion in the international economy. Whichever way capital flows –in or out– it may be wise for the authorities to maintain their grip on it. It would probably be wise to ease restrictions on capital imports slightly when the current account is liberalized. Empirical analysis shows that adjustments in the exchange-rate have a significant effect on the value of exports, in particular manufactured exports. However, success in the liberalization of the international payments system must be accompanied by international marketing efforts of domestic firms and institutional support from export-promotion institutions.

Third, the exchange rate is not an instrument that can easily be controlled by the local monetary authorities. As shown above, a stable REER is not easy to come by, and wide fluctuations from year to year have an adverse effect on the profitability of the tradeables sectors. The nominal exchange rate itself is no longer under the direct control of the Central Bank in most countries, while open-market operations are constrained by the need to maintain minimum reserve levels. The domestic rate of inflation has thus become the main target in most cases (Fitz-Gerald, 1996).

2. Stimulating Investment

During the 1980s, both private and public investments declined dramatically and investments in infrastructure and education were delayed and neglected in most countries in the region. Moreover, the share of private investment in GDP decreased significantly, as for example in Colombia and Venezuela, although not in Chile. Private investment has been hampered by high real interest rates, and these low investment rates have tended to reduce overall economic growth. A statistical analysis including 31 Latin American and Asian countries shows that there are significant

relations between changes in the shares of investment, domestic savings and exports in GDP during the 1980s. This indicates that improvement of export performance and strengthening of international competitiveness require stimulation of investment and domestic savings. Domestic saving, as a proportion of GDP, is particularly stimulated by high real interest rates (Van Dijck, 1992). Moreover, Riedel has shown that government capital expenditure and an appropriate macroeconomic climate, as reflected by the minimization of government-induced market distortions and an open trade regime, stimulates the rate of return on private investments (Riedel, 1992, p. 62). In the same vein, the World Bank review of the best practices in trade policy reform underlines the importance of government investments that are complementary to private sector investments in order to strengthen the export sector (Thomas and Nash with S. Edwards *et al.*, 1991, p. 109).

The Washington Consensus emphasizes the role of sound macroeconomic policies in stimulating investment and the return of flight capital and foreign investors. However, structural adjustment programmes as implemented in Latin America in the 1980s did not contain specific provisions for investment promotion and an industrialization policy, and industrial policy and investment stimulation measures were dismantled. Rather, the programmes assumed implicitly that with trade liberalization, stabilization and devaluation, private investment in tradeable sectors would rise and competitive industries would emerge.

Three observations can be made in this regard. First, a crowding-in phenomenon can be observed, as a lack of public investment in infrastructure such as transportation and telecommunications has a negative impact on foreign direct investment. Second, reduction of public investments in technological development, R&D, education and training has reduced the capacity of domestic firms to compete internationally. Third, the elimination of specific credit and technical assistance programmes for small firms has reduced their ability to enter the industrial sector.

Complementary to these observations, Tavares de Araujo (1996) notes that a minimum package for stimulating private investment in manufactures should include a high and stable real exchange rate in equilibrium, as discussed earlier, efficient public spending on R&D and technological infrastructure

financed through an increase in taxes, and an institutional framework to regulate the competition process by strengthening discipline, enhancing mobility and improving resource availability. Moreover, fiscal policy should be systematically committed to the reduction of tax rates and the broadening of the tax base, leading to a higher tax burden for society at large. It is important to maintain a tax system compatible with the levels of public investment required by the current international patterns of technical progress and welfare.

In order to stimulate private investment, particularly in export sectors, the expectations of the private sector must be in line with the strategy that the government envisages. The structural adjustment that accompanies the opening of the economy must be supported politically by the public and by investors and producers in the private sector. Necessary preconditions for this to happen are consistency in government policies, a clear longer-term perspective for economic development, and a strong commitment of government to such long-term objectives. In view of the history of debilitating policies and the limited capacity of many governments—particularly in the smaller countries—to interact with the private sector and steer the course of development in an efficient manner, this may indeed be a major challenge. In this area, important lessons may be learned from the successful East Asian countries which have managed to create a reliable and stimulating general atmosphere for industry without burdening society at large with the costs of inefficiency and inward-orientation.

3. Additional and selective government interventions

In order to gain a competitive edge in international markets, governments may have to play an active supporting role well beyond the creation of a supportive macroeconomic environment and an adequate contribution to the development of infrastructure and human capital formation. More specific interventions and types of support for industries with a potential competitive advantage have been considered at the theoretical level and have been implemented in practice by governments of open and competitive economies such as the so-called miracle economies of East and Southeast Asia.

Clearly, globalization and technological progress have rendered traditional industrial policy instru-

ments obsolete (Tavares de Araujo, 1996). Technological progress has strengthened the demand for protectionist policies, but protectionism is not a viable option any longer. The question is how to create special conditions for capital accumulation at home without establishing direct constraints on the international movement of citizens, goods and financial resources.

Neither theory nor international experience provide clear guidelines for the use of specific industrial policy instruments at the sectoral or enterprise level in order to stimulate international competitiveness (Krugman, 1988). In the Latin American countries analysed here, no serious attempts have been made to implement industrial policies to accompany the process of trade liberalization. Peres (1996) reviews a number of industrial policy proposals termed "policies for industrial competitiveness". Interesting approaches have been adopted since 1994 in Colombia and Costa Rica, but their execution has proved difficult due to institutional weaknesses. As studies of the East Asian experience have shown, the impact of specific types of government interventions in support of technological development and export growth is difficult to assess (World Bank, 1993). Also, some efforts to shift comparative advantages by stimulating capital- and skill-intensive sectors have involved substantial fiscal and overall welfare costs (Van Dijk, 1992 and 1995). Consequently, the case for pursuing such types of industrial policies is not yet proven.

New institutions may be required to facilitate the export drive of domestic firms. There are no *a priori* reasons for government to be involved in the establishment of export-promotion institutions. Nevertheless, export reconnaissance and marketing institutions may have some of the characteristics of quasi-public goods and may require a government initiative for their creation.

In the past, many government export-promotion institutions and mechanisms have failed, possibly due in part to the rather unfavourable policy framework in which they had to operate (Hogan, Keesing and Singer, 1991, pp. 10-15). Hence, a reorganization or recreation of such institutions is required, in which three areas may be distinguished: direct financial support, fiscal incentives, and a cluster of export-promotion mechanisms and instruments. In the area of direct financial support, all the country studies refer

to the inadequate functioning of the domestic capital markets. High interest rates and sub-optimal allocation of credit were major constraints on investment, and moreover domestic investors lacked access to international financial resources. In the case of Costa Rica, it was reported that security was more important to banks than the profitability of the projects. Two specific issues have been commented upon in the case studies: the low level of development of export-financing schemes and the poor results achieved with special industrial reconversion funds. The latter problem is partly explained by the fact that very few firms were under pressure to reconvert. Improvement of the functioning of domestic capital markets should be given priority over the establishment of special reconversion funds.

Moreover, the experiences with fiscal incentives indicate that, in order to be successful, incentives for non-traditional exports should be an integral part of any export-oriented growth strategy, but practical implementation problems have limited the contribution of the systems actually in use, with the exception of the Chilean case. Further efforts should be made to simplify the systems, limit red tape and design features that guarantee access of small exporters to the incentives.

Finally, the effectiveness of export promotion institutions has been limited in many cases by budget constraints, low levels of competence and inadequate coordination. Improved cooperation between the private and public sectors is required in order to support exports in an efficient manner.

4. Improving the social and political acceptability of economic reform

During the 1980s social conditions deteriorated significantly, as reflected by an increase in average urban unemployment to over 10% by the mid-1980s. More specifically, the contribution of the manufacturing sector to total employment declined. In particular, employment in large manufacturing establishments went down rapidly, while employment in small enterprises as well as in the informal sector increased. Wage indicators for the manufacturing sector declined more sharply than per capita GDP. Moreover, in a number of countries—such as Chile, Costa Rica, Ecuador and El Salvador—government spending on health and education went down as a proportion of overall government spending, although the corre-

sponding proportion remained stable or increased in countries such as Uruguay and Venezuela. Primary school enrolment declined or remained unchanged in seven out of the fourteen Latin American countries analysed. This trend is worrying in view of the critical role of education and skill formation in the process of economic growth and industrial development. Lack of progress towards universal primary education and towards significant increases in secondary education is also a source of continued income inequality. Furthermore, there is evidence that although expenditure in the 1980s on education became more concentrated on the poor, the opposite is true of expenditure on health (Van der Hoeven and Stewart, 1996).

Compensatory programmes and social investment funds were established to mitigate the costs of the adjustment. Latin America has played a pioneering role in the development of social investment funds in the context of structural adjustment programmes. So far, however, many of these funds have not been sufficiently efficient and effective in reaching their target groups. A study by Stewart and Van der Geest (1995) shows that the proportion of non-deserving among the recipients of the funds was large, with Chile as the major exception because of effective targeting. Likewise, the proportion of persons in the target group who were not reached by the programme was large in the case of Costa Rica, but once again Chile's performance in this respect was much better. Public expenditure may be focused more effectively on the poor in several ways: by targeting expenditure specifically on the poor, by diverting an important part of public expenditure to social expenditure, and by raising the overall level of public expenditure in general.

Now that the first stage of policy reform –i.e., liberalization and stabilization– has been implemented to a large extent in most of the countries in Latin America, second-stage reforms are required to ensure sustainable growth. In this stage, governments will not only have to maintain macroeconomic stability and attractive conditions for private investments but will also have to devote their attention to consensus-building, as a major component of a sustainable and reliable climate for investment (Naím, 1995). Haggard has rightly stressed the role of institutions designed to facilitate political decision-making, and he considers the organization of the

decision-making process to have been a key factor in the success of the East Asian developmentalist State (Haggard, 1990).

5. Future prospects and constraints in the global economy

Finally, we must refer to two major external challenges to Latin America's new insertion in the world economy: the increasing number of competitors in global markets, and the new rules and regulations pertaining to regional trade systems as well as the world trading system at large, which may either facilitate or hamper the new outward-oriented industrialization policies in Latin America.

The so-called export-push model has been implemented by many countries all around the world, and competitive export-oriented production sites have been established by many of them. In Asia, two generations of "tigers" have been succeeded by countries such as China, India and Vietnam which pursued inward-oriented policies for a long time but are now on the road to trade liberalization and export-push strategies. China, in particular, has become a new centre of gravity in world trade and investment flows. The newly-liberalizing economies in Eastern Europe and the former Soviet Union are also becoming new sources of supply of a wide range of manufactured products in world markets. Integration into the European Community will give some of these countries a competitive edge over outsiders that compete in the European market. Also, some of the countries of Northern Africa may become competitors in a narrow range of unskilled-labour-intensive products in European markets, and their competitive position will be strengthened by free trade arrangements between the European Community and the North African region that are envisaged for the year 2010. This world-wide export drive and intensification of international competition only strengthens the arguments made earlier in favour of a reliable and supportive macroeconomic environment and the provision of additional facilities for export firms, provided there are sound economic arguments for such interventions.

The world-wide trend towards regionalization may create new opportunities as well as obstacles for Latin American exporters. By now, about 100 preferential trade agreements (PTAs) have been notified to the WTO, and nearly all the countries in the world

participate in at least one such preferential system. The Latin American countries, in particular, have revitalized their existing PTAs and also created a large number of partly overlapping PTAs among themselves. Moreover, they have started to participate in PTAs with the USA and the EC. The intensification of regional integration is reflected in the increasing share of intra-regional exports in total exports of manufactures in recent years. These arrangements may generate traditional advantages of trade creation and the exploitation of economies of scale, but they may also generate the disadvantages of trade diversion for insiders and outsiders. Generally speaking, however, in a world in which countries have been liberalizing their trade regimes prior to the establishment of preferential areas, and in which they have committed themselves to further multilateral liberalizations, the risk of strongly trade-diverting preferential agreements is significantly reduced.

It is in the interest of the Latin American countries to participate in predominantly trade-creating free trade areas and to contribute to the establishment of a liberal multilateral trading system or open regionalism. NAFTA has eroded the preferential access to the United States market previously enjoyed by the Central American and Caribbean countries under the Caribbean Basin Initiative, the Generalized System of Preferences and the Guaranteed Access Levels Programme. If the establishment of a Free Trade Area for the Americas (FTAA) should materialize, this would offer all Latin American countries preferential access to the United States market, to the disadvantage of producers in Asia and Europe. On the other hand, PTAs between the EC and countries in Eastern Europe and North Africa, and among members of APEC, may have trade diversion effects for Latin American countries: hence the interest of the latter in establishing their own preferential arrangements with the EC and in becoming partners of APEC.

The world-wide export drive has been strongly stimulated by the far-reaching changes in international trade rules (GATT, 1994). The rules governing world trade have been profoundly changed with the ratification of the results of the Uruguay Round negotiations, although the implementation of the new trade rules will take many more years and will most likely be contested in a number of cases. Most importantly, trade-weighted average import tariffs for

manufactured goods will be reduced by 38% in developed countries and by 20% in developing countries to average levels of 3.9% and 12.3%, respectively. In general, these tariff cuts will take place in equal steps over a five-year period starting in January 1995. However, the cuts will be below the average in some sectors of particular importance to Latin American countries, such as textiles and clothing, leather, footwear, travel goods, fish and fish products. Moreover, the 37% reduction of the tariff differential between unprocessed and processed products may stimulate the pre-export processing of primary products. The abolition of the Multifibre Arrangement and the integration of the trade rules for textiles and clothing in the WTO may also be of great importance to some Latin American countries, although in this case the most substantial liberalization steps are likely to take place only at the end of a ten-year period.

The adjustments made in the GATT/WTO rules on anti-dumping measures and safeguards may have significant effects on Latin America's export prospects. Anti-dumping cases have become the preferred channel through which industries suffering from foreign competition petition for protection against foreign suppliers. Traditionally, anti-dumping measures were applied mainly by industries in developed countries against competitors which also came from developed nations, but more recently they have also been applied against competitors from newly developing countries. The new rules are more precise and may limit abuse. The new agreement on safeguards limits the length of time that such protectionist measures may be used, requires compensatory concessions, and restricts the use of safeguards against developing countries. The agreement prohibits the use of so-called voluntary export restraints (VERs) or orderly marketing arrangements (OMAs).

There are two important reasons for strengthening the capacity of the WTO to supervise and discipline regional preference systems: to avoid losses of well-being due to trade diversion effects for non-participants of these preference areas, and to reduce the risk that such areas might become stumbling blocks on the road to an open multilateral trading system. Therefore, the Understanding on the Interpretation of Article XXIV of the WTO refers to the need to make overall assessments of the effects of PTAs and to lib-

eralize internal trade among the parties within a period of ten years. The WTO Committee on Regional Trade Agreements (CRTA) will be in charge of assessing compliance of PTAs with Article XXIV.

It is hard to overestimate the importance of the significant improvements in the dispute settlement mechanism of WTO. The new mechanism is faster and leaves less opportunity for the accused party to prolong and block the procedure. The first experiences with the new mechanism have been very encouraging for exporting Latin American countries. The dispute over the quality standards set by the United States for petroleum products imported from Venezuela and Brazil is a case in point. The United States had introduced these quality standards for imported products as a measure to combat air pollution, but the Panel decided in favour of Venezuela and Brazil in January 1996 and so did the Appellate Body in April 1996. Subsequently the United States adjusted its import regulations in this regard.

Social and environmental standards may play an increasingly prominent role in international trade relations in the future, and determined initiatives by Latin American governments may be needed to prevent such standards in OECD countries from becoming new types of *de facto* barriers to imports. The relationship between the multilateral trade system and such standards has become extremely controversial in the WTO, and the conflicting views that exist in this respect, particularly between developing and developed countries, will make it very hard to include such standards in the WTO rules in the short run.

The crucial issue in the controversy on social standards is whether the WTO rules will permit the use of trade sanctions to enforce compliance with selected ILO core labour standards. The USA has applied such standards in bilateral and regional trade arrangements and has been in favour of the establishment of WTO standards in this respect. Social standards were included in the Caribbean Basin Initiative of 1983 and in the USA's GSPs since 1984. Labour laws and rights were also referred to in the NAFTA side agreement on labour cooperation. More recently, the Harkin Bill proposes to prohibit imports of goods whose production has involved child labour.

Already in 1987, the USA proposed the establishment of a GATT Working Party on social standards and trade, but the proposal was resisted, particularly by developing countries. At the Marrakesh meeting

in April 1994, the United States attempted to have the issue explored by a WTO working group. At the annual ILO conference in June 1994 which celebrated the 75th anniversary of the Organisation, strongly opposing views were put forward on the role that the ILO should play in furthering the application of ILO core conventions and on the use of social clauses in trade agreements, particularly by the WTO. Again, at the fifth conference of labour ministers of developing countries in New Delhi in January 1995, countries took a firm position against social clauses in trade agreements, while however supporting a stronger role for ILO in setting standards (Van Dijk and Faber, eds., 1996).

The issues of trade and the environment have become increasingly interwoven. Thus, trade regulations have been included in 17 out of 127 international environmental treaties. Moreover, NAFTA has been the first major regional trade agreement including environment-related measures. On the occasion of the signing of the Final Act of the WTO Marrakesh meeting, the decision was taken to establish the Committee on Trade and Environment (WTO/CTE). Among the issues to be addressed by this committee are the links between the WTO system of rules and multilateral environmental agreements (MEAs), and between those rules and environmental policies such as eco-taxes and charges, eco-labelling, packaging and recycling requirements, and product standards and technical regulations. The international pressure for linking the environmental agenda with international trade rules makes it all the more appropriate for Latin American governments to introduce principles of sustainable development and to take determined measures to prevent environmental standards abroad from becoming bottlenecks for trade expansion in the future.

Notwithstanding uncertainties regarding the appropriate and timely implementation of the GATT/WTO agreements on the liberalization of world trade and on the future application of the new trade rules and dispute settlement procedures, it is safe to conclude that the new rules of conduct for the world's trading nations have clearly become more favourable to small exporting countries and fit in with the new industrialization policies of those countries, which will make them increasingly dependent on free and undisrupted access to the large markets of OECD countries.

IV

Final observations

The policy setting in many small and medium-sized countries in Latin America has become more conducive to the sustainability and growth of an internationally competitive manufacturing sector. The progress towards a stable macroeconomic environment of low inflation and moderate fiscal deficits, the commitment of governments to market-friendly policies, openness of markets, renewed access to the international capital markets and the improvements in the rules and institutions that govern international trade have been important contributions in this regard. The renewed regional co-operation has also stimulated manufactured exports.

As noted earlier, the shares of manufactured products in international markets are rising, manufactures are becoming a more substantial part of total exports, and the ratio of exports to GDP has increased in most of the selected countries. Nevertheless, this does not mean that manufacturing industry has again become an engine of growth in the smaller Latin American countries. In those nations, the share of industry in GDP is stagnant and the export structure is concentrated in less dynamic sectors of world trade.

The policy agenda for strengthening industrial development comprises three main areas: the completion of the macroeconomic reforms, a more active stance by governments regarding industrial development, and higher priority for social policies. With regard to macroeconomic reforms, the maintenance of a high and export-stimulating real exchange rate has been difficult to achieve and will require additional efforts. Also, domestic savings need to be stimulated in order to increase the level of investment and to reduce the dependence on foreign capital.

Second, increased competition in international markets and demanding production standards pose new challenges for exporters. Therefore, joint public and private-sector initiatives and supportive institutions are required to improve technological and managerial capabilities and to increase the productivity of human resources.

Third, social acceptability is a major challenge to the completion of the reforms, particularly in view of the limited positive effect on employment that industrial exports have had so far. Consequently, complementary social policies deserve high priority in the context of market-oriented reforms.

(Original: English)

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