A Latin American Perspective on Trade Policies

Authors: **Marta Bekerman*** and **Santiago Rodríguez**

Centre for the Study of Economic Structures (CENES), Economics Research Institute, Buenos Aires University. E-mail: bekerman@econ.uba.ar

Marta Bekerman is an Economist from the University of Buenos Aires (Argentina), Master in Sciencies of the University of London (England), Professor of Development Economics of the Faculty of Economic Sciences of the University of Buenos Aires and Director of the Centre for Studies of the Economic Structure of that Faculty. She is also a member of the Research Career of the National Council of Scientific and Technical Research (CONICET) of Argentina.

Santiago Rodríguez is an Economist from the University of Buenos Aires (Argentina), teaching assistant of Development Economics and Industrial Organization of the Faculty of Economic Sciences of the University of Buenos Aires and researcher of the Centre for Studies of the Economic Structure of that Faculty.

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Abstract

This article looks at the trade policy guidelines that the region should follow in order to achieve dynamic international economic linkages, in the light of the international context, the theoretical debates on this subject, and some lessons that may be learnt from the study of successful cases. It is posited that in the countries of the region, trade policy can be an instrument for macroeconomic management, fiscal management and, at the microeconomic level, resource allocation. Its use as a second-best instrument is justified when there are constraints on the use of the best possible solutions. It is also held that there must be close coordination of the policies applied in the fields of trade, industry and technology in order to ensure high levels of investment in the tradeable sectors of the economy, a form of competitiveness based on constant increases in productivity, and an improvement in the region's specialization profile. Finally, emphasis is placed on the need to strengthen the institutions of Latin American States in order to ensure that their interventions in the economy have a suitable level of effectiveness.

I

Introduction

The consolidation of a long-term growth process in Latin America is closely linked with the achievement of dynamic linkages with the international economy. It is therefore important to define a trade policy capable of meeting the challenges faced by the region. At the same time, the specialized literature emphasizes that knowledge and scientific and technical progress are factors which determine the development of new comparative advantages. This means that the limits between policies in the fields of trade, industry and technology are increasingly vague. In other words, talking about trade policy in the limited sense (tariffs, non-tariff barriers, export drawback arrangements, etc.) can only give us an incomplete idea of the restructuring strategy applied by a country.

The aim of this article, then, is to make an analysis –in the light of the various contributions offered by the theoretical literature and by international experience- of the role of trade policy in those fields where public intervention can help to improve Latin America's international economic linkages. To this end, we begin by looking at the international context and the prospects opened up by the recently failed World Trade Organization´s (WTO) Ministerial Conference in Cancún (section II). An evaluation is made of the role of trade policy as a means of macroeconomic management (section III) and as an element affecting horizontal and specific microeconomic policies (section IV). The article then goes on to deal with the restrictions arising from the limited capacity of public institutions to effectively apply active policies (section V). Finally, in the light of the broad theoretical lines sketched in the article and the internal and external constraints due to the actual economic conditions prevailing in the countries of the region, an attempt is made to formulate some recommendations with regard to the trade policies that should be applied in coming years (section VI).

II

The international context and the WTO

In the 1980s and 1990s, the processes of globalization and regionalization became more deeply rooted in the international economy.

Globalization of the economy, in the sense of the growing interdependence of the various nations, was reflected in the fact that the growth rate of international trade, and especially of foreign direct investment (FDI) and financial flows, considerably exceeded the growth of the world's gross product.

The big increase in world trade began after the war, when a process of trade liberalization through successive tariff reductions agreed upon at the various GATT negotiation rounds was begun. The growth of FDI, for its part, was stimulated by the efforts to avert potential protectionist measures and the need to build stronger bases for competition (both in the area of marketing and in terms of the incorporation of technological progress). Finally, the increase in financial globalization was spurred by the growing trade imbalances, technological advances in the areas of information and communications, and the worldwide trend towards the deregulation of financial operations.

In this context, which has also been marked by the increasing pace of technological innovation, it is generally agreed that an export-oriented strategy, taking into account the distribution effects of that strategy, will favour the absorption and adaptation of technology and, hence, economic development, more than policies aimed exclusively at the domestic market.

Thus, this growing economic interdependence underlines the advisability of improving economic linkages with the international market, while at the same time redefining the degrees of freedom available to national policies.

It is necessary at this point to highlight two characteristics of this globalization process: the asymmetrical way it affects the peripheral countries, and the contradictions it involves.

Its asymmetrical nature is reflected in the fact that nowadays about 60% of world trade is accounted for by the United States, the EEC and Japan (WTO, 2005).[1] Also, in the first half of the 2000s, these countries together received around 66% of total world FDI, whereas the developing countries received only 24%. Besides, around 75% of that share went to only 10 countries, and 25% went to China. (United Nations, 2005)

[1] The considerable growth of China in world trade, which has led it to replace Japan from its position in the world ranking of exporters and importers, should be stressed

The contradictions of the globalization process, for their part, are reflected in the considerable increase in new types of protectionist pressures exerted by the industrialized countries (in striking contrast to the marked tendency to open up their economies showed by the developing countries since the 1980s). Thus, since the 1970s there has been a big increase in non-tariff barriers (voluntary export restriction agreements, countervailing duties, antidumping clauses, etc.) whose spread –especially to mature sectors such as iron and steel, textiles and agricultural products- has hit trade with SOME peripheral countries particularly hard. (Laird and Nogués, 1989; Fundación UIA, 1994).[2]

The reasons for this increase in protectionist pressures include the following:

i) The big increase in exports from Japan and other Asian countries first, and from China later, to the industrialized nations. Thus, the possibility of reaching higher levels of unemployment and idle capacity in traditional sectors generated pressures against a further penetration in the level of imports.

ii) The shortcomings of the international monetary system, which make it, sometimes, more difficult to correct –as for example by exchange rate adjustments- the big trade imbalances registered between countries.

iii) The absence of a clear leading power in international trade policy. The authority and leadership in trade matters exercised by the United States after the war were gradually eroded by that country’s increasingly protectionist stance as from the mid-1970s.

The laborious negotiations at the Uruguay Round had represented an effort to negotiate global rules to deal with protectionist pressures. Their results displayed the same asymmetrical features referred to earlier. There was stiffer discipline for the peripheral countries to apply economic policies (through the limits placed on certain subsidies linked to export expansion), but at the same time the industrialized countries tried not to lose their freedom to protect certain non-competitive sectors of their economies and to preserve their existing comparative advantages in the technologically most advanced sectors.

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[2] In the 1980s, for example, 44% of the anti-dumping actions and 61% of the countervailing duties applied by the United States, the European Economic Community, Australia and Canada were aimed at

In the last years, an attempt to deepen this tendency is observed on the part of the Core countries, through the incorporation to the negotiation agenda of the denominated Singapore Issues, since those rules could tend to limit even more the autonomy of the developing countries to implement sovereign policies.[3]

Nevertheless, the current negotiations that are taking place under the Doha Round, gives account of a strategic change on the part of the developing countries, which was reflected in the conformation of two groups of countries that showed a harder negotiation position than the one observed in previous periods. On the one hand, one group-initially led by China, India, Brazil and Malaysia- centred their complaints in the end on the agricultural subsidies in the developed countries, for internal production as well as exports.[4] On the other hand, the group of countries of Africa, the Caribbean and the Pacific (ACP), centered their position on criticism to the Singapore issues.

Also, the stagnation of the negotiation process has given rise to the end of the "Clause of Peace" (by which the possibility of initiating actions in WTO against the use of subsidy practices to the primary sector was postponed until the end of 2003), which has opened a new scenario for global negotiations.

In that scenario, WTO's effectiveness will depend on whether the root causes which gave rise to the growing protectionist pressures in the North can be reversed. In that sense, the experience of the last years has confirmed what some authors held ten years ago: the agreements reached at the Uruguay Round were not in themselves a sufficient condition for the attainment by the world economic system of the "in-depth integration" called for by the globalization process.[5] Indeed, to begin with, such

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restricting exports from developing countries (Fundación U.I.A., 1994).

[3] The Singapore Issues are: 1) transparency in governmental procurement, with the purpose of facilitating the participation of foreign companies; 2) protection of foreign investments, way to provide legal security to them; 3) facilitation of trade through the harmonization of customs norms; and 4) homogenization competition policy.

[4] The group showed more than 20% of world-wide agricultural production and 26% of the farming exports, as well as more of 51% of world-wide population and 63% of the agriculture employment. Their members initially were: Brazil, Mexico, China, India, Argentina, Bolivia, Chile, Colombia, Costa Rica, Cuba, Ecuador, Egypt, El Salvador, Guatemala, Pakistan, Paraguay, Peru, the Philippines, South Africa, Thailand, Turkey and Venezuela.

[5] According to Lawrence (1993), in-depth integration means going beyond the elimination of tariff barriers and moving towards the harmonization of all policies which can discriminate, albeit invisibly, against other countries.

integration could only take place at the level of regional trade agreements, which were therefore bound to increase (Lawrence, 1993).[6]

The regionalization of markets –the other major trend in the international economy- is a further factor which could hinder the success of the multilateral negotiations and WTO. This could mean that market access will be more secure for countries which have a chance of joining regional blocs. Even the less efficient firms of such countries may be able to undermine the export markets of more efficient producers through the greater economies of scale made possible by the expansion of the market (Hughes Hallets and Primo Braga, 1994).

The asymmetrical features of the globalization process, against the background of the climate of uncertainty prevailing with regard to WTO's future effectiveness and the strong progress being made in the regionalization processes, highlight the importance of promoting closer regional links among themselves for countries of Latin America.[7] In addition to the potential economic benefits that may be derived from broader markets, the consolidation of these regional spaces can help to increase the bargaining power of the region, both with respect to other countries and trade blocs[8] and within WTO itself.

However, it must be considered that the integration process that is taking place between the countries in the Southern Cone of Latin America, the MERCOSUR[9], is going through difficult times. In fact the potential benefits of MERCOSUR will depend sensibly on the coordination level and on the degree of commitment that is reached between the governments involved. In this sense, the harmonization of macroeconomic (specially exchange rate policies) and microeconomic policies, as well as the creation of supranational institutions with suitable levels of enforcement, are essential to obtain successful results.

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[6] Hughes Hallets and Primo Braga (1994) hold that it is easier to meet policy coordination aimed at the regional than at the multilateral level, because in the latter case it is hard to demonstrate a credible level of commitment by all the participants.

[7] Wonaccot and Wonaccot (1981) give a theoretical demonstration of the superiority of regional integration over trade openness in cases where countries face protectionist barriers in world markets.

[8] This idea could be extended to the process of negotiation with the US regarding an American Free Trade Area.

[9] Mercosur is integrated by Argentina, Brasil, Paraguay and Uruguay. Chile and Bolivia are associated states.

III

Macroeconomic Policy and Trade Policy

The first condition which must be satisfied in order to achieve suitable international economic linkages is to reach appropriate levels of investment in the sectors in which the economy is to specialize internationally. This opens up fields of action for macroeconomic policy which range from investment incentives in general to specific incentives for investment in tradeable or non-tradeable sectors.

In order to achieve a favourable climate for investment it is above all necessary to ensure a stable global setting which makes it possible to plan in the longer term, and to make sure that the system of relative prices offers the information and incentives needed to take fullest advantage of comparative advantages.[10] Equally important are public policies which affect the parameters of the saving and investment functions and efficient organization of the financial system which makes it possible to channel savings to productive projects.[11] In its macroeconomic dimension, trade policy can play at least two important roles: as an instrument for the generation and distribution of fiscal resources, and as one of the decisive elements in the real effective exchange rate.

The first of these roles is important because consolidation on the fiscal front is an essential condition for macroeconomic stability. On the basis of the neoclassical theory of domestic distortion it may be concluded that, in the absence of "non-distortionary" taxes (the mythical fixed-total tax) and the presence of serious costs and limitations on the capacity for fiscal revenue collection, trade policy may present itself as a second-best fiscal instrument (Corden, 1974).[12] The extent to which it is advisable to use trade policy as a revenue-raising instrument, however, must be weighed against the possible costs in terms of distortion deriving from this management of tariff policy.

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[10] Macroeconomic stability is also a necessary prior condition for ensuring the effectiveness of microeconomic policies (Rodrik, 1993).

[11] These aspects –especially the existence of arrangements for short- and long-term financing at suitable rates- are essential factors for building up a truly competitive production system. Since this is a very well-known issue, we will not go into it in greater detail here.

[12] If, for example, we analyse the frequent changes in Argentina's tariff structure since the late 1980s, we see that in many cases the decisions to raise the level of protection were motivated by fiscal considerations.

Moreover, the increase in revenue may be neutralized if, in order to avoid an anti-export bias, fiscal export incentives are increased at the same time.

The second role is of fundamental importance because, in addition to ensuring a sound macroeconomic setting which will promote investment in general, it is essential to make sure that an adequate proportion of this investment goes to the tradeable goods sector. (Kuwayama,1998) The key price determining the incentives to invest in the tradeable or non-tradeable sectors is the real effective exchange rate (for exports or imports). There is a problem here, however. In contrast with what the theory of comparative advantages implicitly assumes, the real exchange rate does not adjust automatically to its equilibrium level (or at least to that level which ensures trade balance equilibrium in conditions of full employment).

Both the theoretical literature and the experience of the Asian countries highlight the importance of a high, stable real exchange rate (with the same theoretical justification as macroeconomic stability in general). In a process of increasing trade openness such as that experienced by many countries of the region, the real exchange rate which is capable of bringing the trade balance into equilibrium may be higher, because of the need to promote the reallocation of resources to the tradeable sector (Fritsch and Franco, 1992; Kuwayama,1998;).[13] Successful cases of export-oriented openness (such as that of South Korea) are examples of the application of policies which simultaneously combined trade openness with devaluation in terms of the real exchange rate (Amsden, 1986).

When a country loses the capacity to fix the real exchange rate in the midst of a stabilization, external adjustment processes can become extremely costly, since the level of activity then becomes the main adjustment variable. In this context, trade policy –acting as a purely macroeconomic instrument- can be used to make up for possible deviations in the real exchange rate[14]. It must be considered, nevertheless, that this way to correct a deviated exchange rate may lead, in a longer period, to a greater deviation of the real exchange rate.

[13] This is because the improvements in efficiency deriving from this are not usually –at least in the short term- big enough to offset the initial negative effect on the trade balance.

[14] The same function is served by all measures (in the area of trade policies or not) which seek to reduce the costs of the export sector.

The deviations in the real exchange rate could take place either in the form of overvaluation, as could be observed during the 1990s in different Asian and Latin American countries[15] or, on the contrary, in processes of undervaluation. A recent example of the latter took place in Argentina by the end of 2001 when the currency board that characterized the exchange policy in that country during the 1990s was abandoned leading to an overshooting of the real exchange rate. In this case, both the mentioned functions that can be fulfilled by the commercial policy have had a preponderant role.

The strong devaluation of the Argentine currency real exchange rate against the dollar was one of the determining factors of the economic recovery, impelled initially by the external trading sector goods (mainly due to a process of import substitution). On the other hand, the export taxes on some primary goods (which show a strong comparative advantage) played an important role to increase fiscal resources[16]. The resulting increment was used to finance social plans which were urgently required given the social distress linked to the deep economic crisis[17]. Additionally, given the composition of the country's export basket (heavily based on wage goods) the export taxes were used as a stabilizing instrument of the internal prices, restraining inflationary inertia and helping to mitigate its erosive impact on real wages. In that sense it could be say that, in the Argentina´s post devaluation time, trade policy played an important fiscal and redistributive role.

As well, in the case of Argentina and other countries of the region, the productive structure shows a great heterogeneity such that a few very competitive sectors with static comparative advantages (related to natural resources) coexist with others with low international competitiveness (producers of manufactured goods, specially those intensive in labor and knowledge). In this context, trade policy could be used to compensate for productivity differentials by the introduction of export taxes on the most competitive sectors as a way to define different levels for the real exchange rates. This scheme, which is being currently applied in Argentina, should, however,

[15] Because of the use of an exchange rate anchor in a context of downward rigidity of nominal prices (absence of deflation), because of a dollarized form of price formation, because of the impact of capital inflows from abroad, or because institutional aspects related to rigidities in established contracts.

[16] In fact, the incomes from export taxes reached 13% of the total federal revenues during 2003.

[17] Around two million people received a subsidy given to unemployed heads of households.

evolve towards the convergence of the real exchange rates, as different sectoral productivities converge.

On the other hand, the real exchange rate plays a relevant role in the processes of regional integration. The harmonization of the exchange rate is one one of the pillars of the coordination of macroeconomic policies and a basic requirement to get a successful constitution of an unified economic space. In the first place, exchange rate stability (real and nominal) precludes, in the microeconomic plane, by reducing one of the main sources of uncertainty in the integration processes, the exchange risk. (Tavares de Araújo, 1992). Secondly, the coordination of exchange rate policy can allow each country individually to maintain exchange rate stability with greater facility (by establishing barriers to domestic lobbies), as well as to limit opportunistic behaviors related to steep variation in the exchange rate on the part of partner countries. (Carrera and Sturzenegger, 2000).[18]

The recent experience of the MERCOSUR gives an account of the harmful effects that can derive from the lack of coordination of macroeconomic policies between the members of a regional block. The great instability at the end of the 1990s characterized by strong real devaluations in Brazil first and Argentina later, lead to recessionary processes and a reverse gear in the integration process. The abrupt change in the relative prices generated spurious gains of competitiveness with strong asymmetries within the block. The lack of dispute settlement and mechanisms of compensation prevented the neutralization of the adverse effects, giving rise to commercial conflicts and to a strong fall in regional trade.

IV

Microeconomic Policies and Trade Policy

[18] Exchange rate stability can be reached, according to Kenen (1989), by means of different degrees of commitments between the governments: consultation, allowing the exchange of information between them; collaboration, where there is an advance towards consensual objectives, but that do not imply restrictions on national policies; and coordination, where the governments are committed to alter their policies with the intention of subordinating them to certain supranational goals.

As the process of macroeconomic stabilization is consolidated, there is a need to carry out a number of additional policies of a markedly different nature from those aimed at securing adjustment. These policies can have various names: microeconomic or mesoeconomic policies, policies aimed at securing systemic competitiveness, etc. For simplicity sake, in this article we will give the name of microeconomic policies to all those, which, by their nature or objectives, are aimed fundamentally at improving the productivity and pattern of international specialization of the economy.

1. Horizontal policies

a) *Doing away with anti-export bias*

The existence of tradeable goods sectors with adequate levels of productivity does not necessarily mean that their output is directed to the international market, for apart from the absolute profitability of export operations (which is determined basically by the comparative efficiency of the sectors and the exchange rate) it is also necessary to take into account their relative profitability compared with sales in the domestic market. Trade policy plays a decisive role in this respect.

As noted in the previous section, in certain contexts trade policy can be used to compensate for deviations in the real exchange rate. In order to fulfil this purpose without causing fresh distortion, however, barriers to imports and incentives for exports must move simultaneously and proportionately to each other. Otherwise, tariff barriers which are not offset by export incentives lead to a general disincentive to trade known as an anti-export or antitrade bias.[19]

The main argument in favour of applying policies with an anti-export bias (the argument of the optimum tariff whereby a large country can use its monopolistic or monopsonic power to improve its terms of trade) is hardly applicable to countries of the region, except in a few isolated cases concerning certain scarce natural resources (for

[19] In such a case, firms in tradeable goods sectors estimate that it is better to sell in the protected domestic market than to face the lower prices prevailing in the international market. In turn, trade protection makes imported goods more expensive and thus distorts demand in favour of locally made goods. There is thus a simultaneous reduction in the incentives to export and to import, which leads to a decline in levels of trade.

instance, the case of the soya in Argentina and Brazil). Another case in which it could be justified, mentioned in the previous section, is that of the countries with an “unbalanced productive structure”. Here, an export tax for the most competitive sector of the economy (primary goods producer) would help to maintain a high real exchange rate, closer to the equilibrium level of the industrial sector.

The experience of Southeast Asia (especially South Korea and Taiwan, Province of China), however, shows that it is not necessary to apply a system of total trade openness in order to avoid anti-export bias. The same result can be obtained through administrative mechanisms (arrangements for export drawbacks, temporary importation, export processing zones, etc.), which, if used efficiently, provide virtually free-trade condition for producers of exportable goods (Wade, 1990).

An anti-export bias is not only induced by trade policies, however. It also occurs when certain market imperfections have a bigger impact on external trade operations than on domestic sales. Three of these imperfections are worthy of special mention: insufficient information on foreign markets, inability of the capital market to provide finance for exports, and the economies of scale required for the international marketing of new products. In view of the world situation described in section II of this article, public policies designed to overcome such market imperfections are increasingly important when it is desirable to move into new niches in foreign markets and improve a country’s international specialization profile.

The successful experience of Southeast Asia shows that big efforts have been made in each of these areas. In the opinion of several authors, the system of export financing applied by South Korea was the instrument which contributed most to the success of that country’s export strategy (Rhee, 1989). This system was channelled through the banks, by rediscounting and automatic financing mechanisms set up by the Bank of Korea. Likewise, both Korea and Taiwan, Province of China, have tackled the problem of economies of scale involved in international marketing. South Korea was successful in stimulating the development of big private marketing firms, from whom it demanded specific minimum levels of capital, export volume and number of offices abroad. Taiwan, Province of China, whose export potential is based on small and medium-sized enterprises, applied an active international marketing policy through trade offices set up in the main world trading centres.

In any case, the policy recommendations designed to deal with these market imperfections are very well known and, in the final analysis, all countries apply them to some extent. The differences lie rather in the intensity with which they are put into effect. International experience shows us that it is precisely the countries which have gone furthest in the development and application of these policies which have achieved the most substantial benefits in their international trade linkages.

b) Negotiating access to foreign markets

According to the traditional neo-classical approach, trade openness is the best option, even when other countries apply distortionary trade policies (tariffs, export subsidies, etc.). In that case, it is held, the right approach is to use the international forums in order to negotiate the wider spread of such openness at the multilateral level (Krueger, 1990).

The rejection of some simplifying assumptions (perfect competition in international markets, constant returns to scale, etc.) has caused some theoretical approaches (including the new international trade theory) to depart radically from neo-classical theory.[20] Basically, they question whether it is really best, in situations of strong foreign protectionism, to apply a policy of indiscriminate free trade. In such circumstances, it is suggested that trade policy –or the threat to use trade policy- should be employed as a means of furthering negotiation aimed at facilitating access to markets which are protected or subsidized by other nations (Tyson, 1990; Dornbusch, 1990).[21] In this context, as already noted in section II, regional integration processes such as MERCOSUR offer potential advantages in terms of strengthening the bargaining power of their member countries to deal with the biases and imbalances that exist in international trade relations. [22]

c) *Policies in support of productivity and trade policy*

[20] For a collection of articles on strategic trade policy, for example, see Krugman, 1987.

[21] This approach has had a lot of influence on current United States trade policy. We have already referred to the bilateral negotiations –through reciprocity clauses- which that country carries on in segments connected with new technologies.

[22] The negotiations that are taking place between MERCOSUR and the European Economic Community, with the aim to reduce the agricultural subsidies applied by the European countries, are an example.

In order to consolidate a dynamic export sector it is necessary not only to ensure suitable levels of investment in tradeable goods sector but also to make ongoing efforts to improve their productivity. It is true that competitiveness can be increased at certain times through macroeconomic variables (such as the exchange rate) or by the reduction of certain costs (such as direct or indirect wage costs, taxes, etc.) which affect the export sector, but in order to ensure a sustained process of export growth which is compatible with improvements in the population's standard of living –that is to say, in order to achieve high levels of true competitiveness- it is necessary to promote higher productivity (Fajnzylber, 1988).

The main role in this field is played by policies on industry and technology which are aimed, among other things, at ensuring that there is a "critical mass" of skilled labour, developing a suitable physical infrastructure and network of suppliers, and promoting technological research and development.

A similar role is played by policies aimed at making up for market information shortcomings (asymmetric information), such as policies in the fields of industrial extension services, provision of advice to small and medium-sized firms, improvements in coordination among the agents of production, etc. Some authors stress that it is important that before incorporating new capital goods, firms should make suitable changes in their production organization techniques to fit in with the new technological paradigms, through the introduction of total quality control, "just in time" production, etc. (Kaplinsky, 1988). This is why it is so important that the State, through specialized bodies, should help the private sector (and especially small and medium-sized firms) in this restructuring process.

Trade policy instruments can play an indirect buy important role in these fields. Firstly, policies aimed at lowering the cost of buying capital goods (through tariff reduction or elimination)[23] undoubtedly favour the modernization of industrial facilities. When fixing the tariffs on capital goods, however, it is necessary to take into account not only their incidence on industrial costs but also the opportunity costs of the fiscal resources thus committed and the possible effects on local capital goods producers, since the latter sector can be an important vehicle of technological progress.

[23] This policy may be seen as a microeconomic instrument aimed at raising the productivity of the economy or, in more general terms, as an indirect way of raising the real exchange rate.

Secondly, it may be noted that many countries have successfully used export behaviour as a means of evaluating the effectiveness of various types of incentives for investment and technological development. This approach –which gives such instruments a trade policy dimension- is based on the idea that in some production sectors effective access to international markets is fairly convincing proof that those sectors have developed the capacity to produce goods with acceptable levels of price and quality. Although these are not necessarily the best instruments from the point of view of economic theory, they can be second-best mechanisms when limited public monitoring capacity or the technological complexity of the goods in question make it too difficult to monitor the attainment of given price and quality goals.

Finally, the formation of regional trade blocs is another trade-related policy which can have a big impact on production efficiency. When local producers are exposed to greater competition but at the same time given preferential access to a broader market, this can give a big boost to the conversion process and to economies of scale and specialization. Trade among similar types of countries can also help to raise workers' skills (Amsden, 1986) and to promote innovation (Rodrik, 1993).

The importance of the coordination of policies, microeconomic in this case, between the members of an economic block, must also be highlighted here. The lack of coordination of industrial and technological policies can lead to strong asymmetries that undermine the process of productive integration, also generating an institutional competition between different governments to attract FDI, generally by means of policies of fiscal incentives. The case of the MERCOSUR is an example in which the lack of coordination led to these results.

2. Specific Policies and Trade Policy

So far, we have looked at macroeconomic or microeconomic policy instruments which affect competitiveness in general, without limiting ourselves (at least explicitly) to certain types of industries or activities. We shall now take up a different problem: that of deciding whether the economic authorities should remain neutral with regard to the types of sectors in which the nation is to specialize, or whether there are sound reasons for giving special incentives to certain sectors.

In the simplest version of neo-classical theory, all sectors are considered equal. On the basis of this assumption, the best policy is free trade, which makes it possible to take the fullest advantage of the possible benefits of international specialization. Selective policies, in contrast, are held to distort the pattern of comparative advantages and to reduce well-being.

More sophisticated analyses, however, have given rise to various theoretical arguments in favour of the formulation of selective policies, even in the case of trade policy.

In neo-classical theory, it is recognized that the existence of market imperfections may give rise to arguments in favour of the formulation of trade policies of a selective nature.[24] Since many market flaws (externalities, indivisibilities, distortionary regulations or taxes, etc.) affect different production activities in different ways, the pattern of international specialization resulting from the application of free trade policy may not be optimal. In most cases, the market distortions are of a domestic nature, and the best policies for correcting them do not involve the use of trade policy. In the absence of first-best instruments, however, such policy may have a role to play as a second-best solution.[25] While the first-best policies may be formally neutral (as for example in the case of measures to overcome capital market imperfections), second-best trade policy probably has to take on a selective character (higher protection for sectors which, because of the predominance of small and medium-sized firms, higher technological risks, or other reasons, are more sensitive to lack of credit).[26]

It may be inferred from the foregoing discussion that if policies of trade openness are not accompanied by optimal policies designed to overcome the existing

[24] A great deal has been written on the theory of internal distortions analysed here. See, for example, the enlightening work by Corden (1974) and the analytical summary by Martirena-Mantel (1988).

[25] This use of trade policy as a second-best instrument plays a leading role in the theoretical justification of tariffs which are graduated, rather than having a uniform level, in the light of the degree of processing of goods. The argument would appear to be that the various distortions which affect the production of goods (transport costs of raw materials, distortionary taxes, etc.) increase their incidence with each stage in production. Thus, it is proposed that a progressive tariff structure may serve to restore a neutral scheme of incentives (Fundación U.L.A., Consejo Académico, 1994).

[26] A similar case in which the commercial policy can be used as a second best instrument is when it is applied with the objective to limit the overproduction of a certain good in the presence of externalities. For example, currently in Argentina, the soya export taxes could be used as a means of limiting their production, since it reduces the tendency to soya monoculture (with its implication in the deterioration of land) movings resources from other more labour intensive sectors and with greater amount of productive linkages.

market imperfections, they will probably not lead to an increase in well-being. At the same time, if the distribution of the optimal subsidies involves costs, selective trade protection may become the best policy alternative (Corden, 1974).

Another very well-known and well-supported argument is that of infant industries. Neo-classical theorists have put in doubt the validity of this argument, linking it with the existence of certain market imperfections basically associated with short comings in capital markets (Martirena-Mantel, 1988).[27]. Here, trade policy can only be used as a second-best instrument.

The formulation of assumptions which simplify traditional theory has given rise to other lines of theory which have taken up once again, in a strengthened form, the line of thinking implicit in the infant industry argument, to which we will briefly refer below.

The New International Trade Theory starts by rejecting the assumptions of perfect competition and constant returns to scale.[28] This means that there are clear differences between sectors of production in international trade, as some sectors give only normal yields, whereas others give monopoly rents. It is also posited that the main source of relative productivity in the sectors with monopoly rents is not the factor endowment of the country but the capacity of its inhabitants to establish certain industries and reach the most desirable scales in their operation. The pattern of specialization thus includes a random or arbitrary element (Krugman, 1988). This may be linked to the existence of trade policies (tariff protection, export subsidies, etc.) which favour national monopoly firms (Brander, 1986).

In countries with small markets (without firms which are big enough to alter the rules of international strategic competition), there is still room for the application of trade policies in sectors with normal yields which can use indirect economies of scale, linked, for example, to transport and international marketing (Krugman, 1988). Likewise, regional integration processes (with the consequent increase in market size) also increase the possibility of making effective use of strategic policies that permit the

[27] At the empirical level, the various experiences in the promotion of infant industries display very disparate levels of effectiveness (Bell,, Ross-Larson and Westphal, 1984).

[28] See, inter alia, Brander and Spencer (1981), Helpman and Krugman (1985), Brander (1986) and Grossman (1986).

achievement of economies of scale. It is also necessary to coordinate industrial and trade policies, since these can affect the form assumed by the intra-regional specialization pattern (Ocampo, 1993).

Although pro-interventionist deviations have been widely criticized by various authors (many of them belonging to the same school of thought), there is a tendency to accept the fact that strategic trade policies can affect the pattern of international trade, and as we have already seen, this has important implications for international negotiations.[29]

Other schools of thought have highlighted the role of technological change, notably the neo-Schumpeterian authors and those linked with the new theories on economic growth.[30] These lines of thought (specially the neo-Schumpeterian ones) identify a new source of heterogeneity between sectors, noting that technological development is neither exogenous nor homogeneous among them. Some sectors display greater capacity for technological innovation, which allows them to attain higher rates of productivity growth and enables them to win Schumpeterian rents in international trade. Others take on the role of strategic sectors because of the strong externalities they transmit to the rest of the production system through the spread of technological innovations.

In terms of policy connotations, these contributions can be interpreted in two different ways. Firstly, from the standpoint of neo-classical theory it may be concluded from the above arguments that the technologically more advanced sectors display more pronounced market imperfections than the rest of the economy.[31]

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[29] The main line of such criticisms are: the impossibility of knowing for sure which policies are best; the possibility of reprisals (either unilateral or resulting from the application of the WTO rules) which can lead to a worse situation than in the beginning, and governments' lack of freedom to withstand corporate lobbying (Grossman, 1986). It is also argued that strategic policies aimed at certain firms (in order to create "national champions") may help to aggravate market flaws in the area of competitions (Richardson, 1993).

[30] For an instructive summary of the ideas of the first group of authors, see Dosi, Freeman, Nelson, Silverberg and Soete (1988). Among the best-known works of the second group are the pioneering studies by Romer (1986) and Lucas (1988).

[31] Examples of such imperfections include those connected with the formation of human capital (which is used to different extents by the different sectors) and the capital market (which is biased against projects involving technological risks and long lead times).

The second possible reading highlights the fact that as in other sectors with increasing returns, the comparative advantages of the technologically advanced sectors do not derive solely from the factor endowment but from public and private efforts to develop capacity for technological innovation in specific areas. Public industrial and trade policies aimed at the leading sectors thus take on a strategic character, since they make it possible to secure the extraordinary benefits generated by those sectors.[32]

V

Institutional Limitation

Although the theoretical analyses discussed above justify the use of active trade and industrial policies, in practice there is no general agreement on their advisability. The various arguments levelled against them are based mainly on doubts about whether the public authorities are fitted to effectively design, apply and monitor policies which in theory appear to be optimal (especially when such policies are of a selective nature). Three types of problems are generally mentioned: the inability of the public sector to obtain all the necessary information, the inefficiency which is typical of public administrative mechanisms, and the generation of perverse forms of business behaviour in the private sector in an effort to seek non-productive rents.[33]

Although this is not the place to go into such problems in detail, there are some elements that must be taken into account when weighing the advisability of applying active trade policies.

Firstly, one should not take extreme positions such as assuming that the State can do every thing or, alternatively, that bureaucratic shortcomings are worse than imperfections in the market, so that no action should be taken at all. The administrative capacity and autonomy of the State are not exogenous, but can be modified by public policies. Thus, various studies by international organizations reflect the need to

[32] Indeed, the authors of the New International Trade Theory themselves have been shifting their interest from static economies of scale to economies based on technological learning and innovation. See for example Grossman and Helpman, 1991.

[33] With regard to these types of arguments, see Grossman (1986), Porter (1990) and the studies on corporate rent-seeking behaviour by such authors as Krueger (1974).

strengthen (in both administrative and budgetary terms) the public institutions responsible for policy in the areas of trade, industry and technology in order to turn them into satisfactory means of intervention, even though they may not be ideal solutions (OTA, 1990; Najmabadi, Banerji and Lall, 1992; ECLAC, 1990).

The fact that there are a number of cases of successful intervention suggests that it is possible to considerably reduce the negative effect of bureaucratic shortcomings. The strengthening of public institutions not only helps to explain the marked differences between the results obtained in the past by the Asian countries, on the one hand, and the Latin American nations on the other, but would also appear to be a necessary condition and challenge for the future performance of the latter.

Secondly, the obstacles standing in the way of effective public intervention are not the same in all fields of action. It is generally accepted that horizontal microeconomic policies give rise to fewer difficulties than selective ones as regards the problems of obtaining the necessary information and avoiding the risk of capture of public agencies by private interests. Likewise, specific policies applied in sectors with a more competitive market structure (especially those where small and medium-sized firms predominate) would appear to be easier to keep under control than those applied in highly concentrated sectors with strong lobbying power.

On the other hand, economic coordination within the framework of processes of regional integration can allow for an advance in the institutional fortification of the member countries. The advantages of a shared sovereignty are diverse. In the first place, it enables the establishment of barriers to the domestic lobbies, limiting rent seeking behavior. At the same time, it "ties the goverment's hands" leading to greater stability in adopted policies and limiting institutional competition (war of subsidies, new nontariff barriers, competitive devaluations, etc.). Also, coordination generates a scenario of greater transparency, when requiring the generation and dissemination of information, which, in the case of the Latin American governments, would not take place habitually otherwise. This allows the resolution of a relevant problem of these economies: to make compatible their own policies in order to be able to coordinate them with those of its partners. Also, coordination enables member countries to increase or maintain the credibility and reputation of their individually considered governments and the block taken together. In order to obtain these objectives, the creation of supranational institutions with sufficient autonomy and enforcement capacity (of the type of the existing ones in the European Union) becomes essential. (Tavares de Araújo, 1992; Bekerman, Sirlin y Soltz, 1995)

VI

Conclusions and Policy Recommendations

In an international setting marked by increasing globalization and, at the same time, heightened trade friction, the countries of the region need to strengthen their place in the international economy by improving their export profile. Some Latin American countries (such as Brazil or Argentina) have recently experienced strong devaluations of their currencies. This, nevertheless, is not sufficient to develop a genuine competitiveness. Success in such an endeavour is inevitably linked to industrial restructuring processes which will increase production efficiency and make possible the incorporation of new comparative advantages. In this context, regional integration developments among developing countries, such us MERCOSUR in Latin America, can act as a catalytic element which will facilitate and strengthen the restructuring process.

This restructuring will be taking place, in some countries, in the midst of high indebtedness and fiscal constraints which mean that there is no easy solution. In this case, it is necessary to emphasize the application of policies which foster the other basic means of increasing exports: improvements in the levels of productivity and comparative efficiency. Until such measures bear fruit, the use of trade policy as a second-best macroeconomic strategy –in order to offset possible deviations in the real exchange rate or as a supporting instrument on the fiscal front- should not be ruled out.

Macroeconomic stability is a necessary condition for the development of new comparative advantages, but if cannot of itself guarantee such advantages.[34] As the successful countries of Asia have shown, a dynamic place in the world economy also requires more intensive application of horizontal microeconomic policies designed to increase productivity and consolidate market positions abroad.

[34] Some authors are highly critical of what they describe as "the short-sighted attitude of macroeconomic adjustment schemes, which ignore the more distant horizons that should guide the strategic decisions of public and private agents" (Tavares, 1990).

In that field, it is necessary to define a rational strategy of optimal policies in the areas of trade, industry and technology aimed at dealing with the major market imperfections which, in the countries of the periphery, hit the technologically most advanced sectors particularly hard. These policies should include industrial extension measures for small and medium-sized firms (specially in the field of modernization of the organization of labour and the development of value chains), promotion of research and development activities, incentives for the training of human resources, etc.

One of the areas where most work remains to be done is that of public policies to improve the supply of information on foreign markets and to promote marketing enterprises to increase in particular the viability of exports of small and medium-sized firms. Another aspect of fundamental importance is the provision of export financing at reasonable interest rates.

Another aspect of trade policy which is worth highlighting in this context is the progress made by regional integration processes. These offer the possibility of increasing productivity (by taking advantage of economies of scale and specialization) and improving bargaining power in international forums. In order for regional integration processes to bear fruit to the full, however, there must be a broad coordination of macroeconomic and microeconomic policies within them. The absence of such coordination and the persistence of certain imbalances at the microeconomic level may lead either to a weakening of the integration process or to the consolidation of intersectoral specialization patterns (of the North-South type) in the area, which will prevent some countries to obtain full benefit from integration. In that sense, the integration process in the Southern Cone of Latin America, MERCOSUR, is a clear example of the obstacles to the development of a full common market area owing to the lack of coordination of macro and microeconomic policies.

As regards the use of selective trade policies (such as protection or special subsidies for certain sectors which are in the course of retooling), the experience of the Asian countries shows that such measures must be of a temporary nature and must be subject to the fulfilment of certain goals by the sectors involved. Thus, the application of selective trade policies in sectors which are highly concentrated and have strong lobbying power requires, at the very least, that the State should have the necessary institutional capacity to ensure proper monitoring of the fulfilment of private sector commitments.

This means that there is a pressing need to carry out institutional reconstruction measures in order to ensure the capability to apply policy instruments more effectively. Meanwhile, it would seem advisable to limit selective policies, as far as possible, to sectors where small and medium-sized firms predominate and there would be greater capacity to impose discipline on the private sector. When applying selective trade policies it is also necessary to bear in mind the need to avoid giving rise to an anti-export bias in the sector in question and an undesirable burden of effective negative protection on export sectors, which use the goods thus protected.

These policy strategies must be seen within the context of the recent changes that took place in the international negotiations scene, where a stronger position by the less developed countries can be observed. In this context, two clearly differentiated scenarios could arise which should affect in different ways the possible trade policy strategies of the developing countries. In a first alternative, negotiations within the framework of the WTO could be restructured to allow for the continuity of multilateral trade negotiations although under a slower process (given the resistance of the US and Europe to eliminate their agricultural subsidies) and with greater participation of developing countries.[35]

This possible scenario would turn out propitious for reconsidering the strategy to be followed by the developing countries. These countries will definitely benefit if they obtain a greater access to international agricultural markets and if the anti-dumping mesures implemented by developed countries are substantially reduced. Nevertheless, it is necessary to avoid the situation that this leads to a deepening of the pattern of specialization for the poor countries, particularly biased towards the primary production. Therefore, when considering a long term development strategy, the developing countries should be negotiating not only the elimination of agricultural subsidies by the rich countries, but also, a greater flexibility to be able to implement policies linked to

[35] The degree of protagonism that the developing countries could reach at the multilateral negotiations level will be bound to the degree to which they can agree to coordinate their interests and proposals.

trade performance (even reviewing regulations already approved by the Uruguay Round). Obtaining that flexibility would make it easier for them to develop dynamic comparative advantages.

A second scenario, opposed to the previous one, is that emerging from a consolidation of the protectionistic pressures in the countries of the north and from a deepening of the differences between countries of the south that emerged in recent meetings. In this case it can be expected, on the one hand, a consolidation of the the markets regionalisation trends and a sprouting of a new protectionism, no longer based exclusively on the Nation States, but increasily extended to regional blocks. On the other hand, it could help to consolidate the proliferation of bilateral agreements of the type reached by the US with different countries. It is in this scenario where Latin American countries will have to strengthen their alliances at the regional level and with other less developed countries even more, as a way to improve their productive and negotiation capacity in relation to third countries and regions.

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