

**Evolving Strategic Business Partnering Models between Latin American Countries and
Asia: An Analytical Study of Spatial and Temporal Dynamics**

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Research Report



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Por este medio le comunico que sus iniciativas

- A) Evolving strategic business partnering models between Latin American countries and Asia: An analytical study of spatial and temporal dynamics.
- B) B) Strategies of building customer values and brand through advertising by the multinational discount retail chain stores in Latin America.

han sido aprobadas como proyectos del Centro de Investigación en Gestión y Economía de las Organizaciones para operar a partir del 1 de agosto de 2004.

Le solicito comunicarse con el Dr. M. Schettino para la firma del convenio correspondiente.

Atentamente,



Dr. Rodolfo Loyola Vera

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PREFACE

There are large differences in gross domestic products by sectors among Latin American countries, and the majority of these differences are due to the value of industrial and service sectors. The structural reforms in countries of Latin America have been broadly focused in five major areas comprising international trade, financial markets, labor markets, and the generation and use of public resources. Consequently the financial development has improved, especially the depth of financial intermediation, private sector participation in banking, and the size and activity of stock markets. The economic integration and structural reforms in Latin America considered that import substitution in manufacturing sector would be synonymous with industrialization, which in turn was seen as the key to development. As far as the efficient generation and use of public resources are concerned, much has been done to make the value-added tax system efficient and to privatize public enterprises. In response to the liberalization of economies, which has been followed by a significant increase in their imports, was found primarily due to lower inflation, lesser government intervention, and fewer trade barriers. International trade has been the key indicator of the overall economic growth of Latin American countries.

The study reviews the approach to trade policy in early development research and evolution of thoughts integrating the economic and structural reforms in Latin America. The reference period for analysis of spatial and temporal data is 1950-2003. The aspects of trade and growth and problems of Balance of Payments and their relation with macroeconomic policy have also been discussed in the study. Further, this study analyzes economic integration between two economies: one central, with a large local market, and the other peripheral, with a small local market. Each economy has an imperfectly competitive manufacturing sector. It has been observed in the discussion that the trade liberalization creates a strong incentive for the imperfectly competitive industry to concentrate in the central region, near the large market. Additionally, the role of supporting policies to assure the success of trade liberalization is analyzed in the study.

The data for the study has been collected from the documents of ECLAC, IMF, UNCTAD, World Bank and WTO public resources on the internet. The statistical publications and data bases on the CD-ROMs of the above organizations have also been referred at the libraries of ITESM-

CCM and IIM, Indore (India). In pursuing this project I held discussions with Dr. Rodolfo Loyola, Dr. Teresa Liedo and the faculty members of the department. I am also benefited with the external referees' comments at various stages of project during data analysis and interpretations. I acknowledge the academic support provided by Dr. Maria Guisen Carmen, Faculty of Economics and Business, Universidade de Santiago de Compostela, Spain as a principal referee and other referees for extending their suggestions to improve the analytical contents of the study. A part of the results of this study developed as working study to facilitate inviting expert opinions was converted in to a research study and has been published in the journal of *Applied Econometrics and International Development* 5 (1), 2005, 45-64. In order to refine the study further, couple of working studys have also been drafted based on the results of the study and have been placed on the internet sites such as <http://www.econstudys.repec.org> . A seminar on the topic was also given to the participants of the doctoral program at ITESM-CCM and the deliberations thereof have added value to the study.

I extend my sincere thanks to the Research Committee of the Tec for approving this research project during the academic year 2004-05. I express my sincere thanks to Dr. Rodolfo Loyola, Dr. Teresa Liedo and Dr. Jorge Leon Pardo for extending all administrative support in carrying out this study. Finally, I acknowledge the efforts and time invested by Ms. Ananya Rajagopal, student of IIS career of ITESM-CCM in the statistical analysis of the study and performing the commendable job of analyzing the data through SAS and ARC software, testing the mathematical models and drafting the tables which have been incorporated in the report.

I hope this research report would facilitate the doctoral scholars of the university and faculty of the campus/university who are interested in pursuing future research in international trade and economy in reference to Latin America and Caribbean.

Rajagopal
ITESM-CCM

Chapter 1



Introduction

Scope of Research

There is a fast change observed in the world markets resulting into the new emerging markets across the countries. In this century China, India and Latin America and the emerging market based economies in Eastern Europe promise new opportunities for global trade. The Pacific region had shown time-bending leap in the past four decades as significant Asian population participated in the rapid transition in response to the global movement of trade and services. Asia may be portrayed as the fastest growing market for the top brands of western companies and at the same time the Asian companies began penetrating the western markets at low price-high quality strategy. While the luxury and fashion goods are dominating the Asian and Far-east markets, the specialized product like electronics and automobiles from Asian Markets are trying to capture considerable market share in Europe and North American countries. The emerging markets in the developing countries have shown a strong potential for change in preferences during the late 20th century. In most of the advanced countries the birth rate is declining while it is increasing in the developing countries. It has been observed that the technology has homogenized the world markets for variety of customer and industrial needs. The reduction in the tariff barriers, duties and liberalization process worldwide has further given a stimulus to the international marketing across regional boundaries.

This study is based on extensive survey of literature and statistical analysis of the data available from the secondary sources. The strategic partnership model will be developed on analyzing the functional gap map in reference to the political, economic, legal and trade related factors. The broad objectives of the study are as following:

1. The study proposes to analyze the leading factors that are behind the proliferation of intra-regional and inter-regional Free Trade Agreements (FTAs) of Latin American countries.
2. To discuss the prospects for bilateral FTAs between Latin America and Asia, particularly focusing on Japan-Mexico and Japan-Chile FTA, and to develop a new approach to

cooperation between East Asia and Latin America, the East Asia Latin America Forum (EALAF), will be examined.

3. This study is aimed at documenting and evaluating the process of trade reforms in Latin America from the mid-1980s until 1993 and providing an analytical and historical discussion of the consequences of industrial policies in the region, from the early 1950s when import-substitution ideas were supported by the Economic Commission for Latin America to the 1990s when liberal regimes were embraced.
4. To review the policies based on strict import substitution, which combines high import tariffs with export promotion. The study also focuses to analyze the extent of trade reform in Latin America and evaluate the role of supporting policies to assure the success of trade liberalization.
5. The study also focuses on the evolution of productivity and exports, and it deals with several countries' experiences. The role of real exchange rates in the trade liberalization process is studied, and the recent trend towards appreciation observed in many countries in the region is scrutinized.
6. Finally the study proposes to develop the business partnering model for the Latin American countries to optimize its business potentials, build effective international relations and improve its economic conditions

The analysis in the study concentrates on the evolution of productivity and exports, and discusses factors variability in the Latin American region. The role of strategic alliances in the trade liberalization and international partnering variables will be analyzed in reference to non-parametric measures and the recent trends towards economic appreciation observed in Latin American countries in the region will be put through the process of appropriate qualitative and quantitative test to support the development of the model.

Developmental Issues on Latin American Trade and Economy

Despite an enormous literature that has analyzed the comparative experiences of Latin America and Asia in post-World War II trade policy, almost no attention has been paid to the comparative experience prior to the wars. Even a cursory look at the best available empirical evidence reveals

tremendous contrasts between the two regions. Latin America had the highest tariff barriers on earth before 1914; Asia had the lowest. Protected economy of Latin America showed an explosive growth performance during the post World-War II, while Asia registered some of the worst (Clemens and Williamson, 2002). Generally, global economic downturns have led to regulation and contraction, generating a situation where the hegemonic leader has to recast the rules for the new 'post-crisis' order. Since 1914 but especially from the 1930s onwards, the US felt responsible for leading a crusade towards free trade. The trade liberalization has become mixed with other causes, including the conflation of markets and political freedoms under US leadership. Often a menace of an enemy was necessary to garner consensus on further liberalization. After the 1930 crisis, when countries adopted *beggarchy-neighbor* measures, US took the initiatives to halt the wave of protectionism and thereby reduce political tensions (Tussie, 2003). Such move had affected the Latin American countries to develop an economic nationhood concept and work on developing trade and economic policies for mutual benefit.

For over 40 years after the Second World War, Latin America together with developing countries did not perceive the GATT as a friendly, fruitful institution to promote their interests, for a mix of both ideological and pragmatic reasons. Inward-oriented Industrialization and nationalist Ideologies of development prevailed, turning trade relations into the crux of the North-South debate. Few Latin American countries were members of the GATT and the remaining were remained either detached altogether or were sleeping partners in the GATT, with a nominal exception to this general trend marked by contributions to the working of the trade and economic dispute settlement mechanism (Weston and Delich, 2003). But by and large, the insignificance of developing countries' markets had so far been perceived as unworthy of the effort of pressing for their opening. The result was negligible obligations for developing countries together with disproportionately small trade liberalization in those sectors of immediate interest to them (Tussie,1987). The trade negotiations had at best a marginal impact on the domestic policy process and by the mid-1980s this picture had changed significantly. To begin with, several Latin American countries became major exporters of manufactured goods, including in the sectors in which it was previously assumed they lacked comparative advantages. Further, as competition among the major trading players intensified, the continued opening and greater contestability of Latin American markets became a more valued asset. The Latin American countries overcame

their former defensive policies and made a strategic shift in the 1990s when an institutional reforms approach to trade and financial liberalization was adopted. The countries of LAC region participated in the Uruguay round with a commitment towards unilateral reforms to signal the path to medium-term economic objectives and provide an anchor for reforms.

Most of the Latin American countries began to open their international business opportunities to the rest of the world in 80's. This process has made significant improvement in the structural adjustments program along with the debt management strategies. It has helped the Latin American countries to overcome the industrial and trade policy of import substitution of over four decades. During the late 80's and early 90's a large number of countries began to lower their levels of protection and bent their energies towards international trade reforms with the increasing assistance of the multilateral institutions. Trade reforms process proceeded at a faster pace and tariff barriers were reduced significantly. There has been a significant transition in the international relations and business partnering of Latin American countries with the rest of the world in the post 80's period that has reflected in the economic and technological growth of some countries like Mexico, Brazil, Chile and Peru. The recent trade liberalization policies of the Latin American countries have sought to reserve the protectionist policies and open the scope for foreign direct investment and joint ventures in the public and private sector industries. Regional integration such as NAFTA, Mercosur and FTAA has been flourishing in Latin American countries since the 1990s. In addition to these multi-countries FTAs, many bilateral FTAs have also emerged both among Latin American countries and extra-regional countries. Liberalization originating in multilateral trade negotiations should in principle affect both Industrial and agricultural products in a balanced way. There is, for instance, no economic reason to limit offers of total tariff elimination to industrial products. In the same way that developing economies in the Uruguay round were expected to, and did, fall in line with more liberal trade regimes affecting industrial products, the new round should remove the obstacles that still affect agricultural trade at a much faster pace than further liberalization affecting industrial products. The information on gross national product at purchasing power parity rates (GNP-PPP) and total (imports plus exports) trade for most Latin American and Caribbean economies has been presented in Table 1.1, which reveals that the impact of further trade liberalization is likely to be greater in economies with greater trade flows.

Table 1.1: Latin American and Caribbean Gross National Product and Total Trade

Region/Trade Blocs	Country	GNP (in US\$ billion)	Total Trade (in US\$ billion)
Andean Community	Andean Community	523.0	79.4
	Bolivia	17.8	3.3
	Colombia	237.2	22.2
	Ecuador	32.3	8.6
	Peru	110.7	12.7
	Venezuela	124.9	32.6
Caribbean Community	Caribbean Community	30.6	17.8
	Bahamas	3.0	3.8
	Barbados	3.3	1.4
	Belize	1.1	0.5
	Dominica	0.4	0.2
	Grenada	0.6	0.2
	Guyana	2.8	1.2
	Jamaica	8.5	4.4
	St. Kitts	0.3	0.1
	St. Lucia	0.7	0.1
	St. Vincent and Grenadines	0.5	0.6
Trinidad and Tobago	9.4	5.3	
Central American Common Market	Central American Common Market	109.7	39.6
	Costa Rica	20.7	13.6
	El Salvador	25.1	6.5
	Guatemala	39.0	9.3
	Honduras	14.3	8.1
	Nicaragua	10.6	2.2
Mercosur	Mercado Común del Sur (Mecosur)	1525.7	154.1
	Argentina	414.1	46.6
	Brazil	1061.7	98.1
	Paraguay	22.5	3.6
	Uruguay	27.4	5.8
NAFTA	NAFTA		
	Mexico	752.0	278.4
Other Latin American Countries	Others		
	Chile	125.7	29.9
	Dominican Republic	39.1	14.5
	Haiti	11.0	1.4
	Panama	14.1	5.0
	Suriname	1.7	1.0

GNP-PPP data for all 1999 except for Bahamas, Barbados, Belize and Surinam data represents for 1998
Source: World Bank 2000, Trade data from IMF, 1998, ECLAC statistics, 2001

It emerges from trade data exhibited in the above Table that Mexico is by far the most important trading economy in Latin America: its total trade in 1999 accounted for nearly 45 per cent of total Latin American trade, representing almost three times total trade from the second most important Latin American trading nation - Brazil - and 80 per cent more than total Mercosur trade.

Mercosur's total trade was about 45 per cent of total trade in all other Latin American and Caribbean economies, Mexico excluded. The GNP- purchasing power parity (PPP) data (1999) of Mercosur represented 48.7 per cent of total GNP-PPP of the region of which Brazil accounts for 33.9 per cent, Mexico 24 per cent, the Andean Community (AC) as a whole about 16.7 per cent and Chile 4 per cent. All other economies together thus account for around 6 per cent of the aggregate. The data exhibited in the Table 1.1 shows the countries' comparative leverage in negotiations, given the small size of all Latin American and Caribbean economies compared to major developed economies. However, little indication of the importance of multilateral negotiations for each particular economy is made.

Economic recovery in Latin America remained subdued in 2003 as Brazil; the largest economy of the region stagnated and Venezuela's economy contracted by 9 per cent. Argentina's GDP recovered strongly which partially offset the decline of the previous years, while Mexico's economy continued to expand moderately. The volume of Latin America's merchandise exports rose by 5 per cent and the contraction of imports in 2001-02 was followed by only a moderate upswing. Nominal export growth of merchandise and commercial services, at 9 per cent and 7 per cent respectively, matched the average growth rates recorded in the 1990s. As the region's export expansion continued to exceed that of imports for both merchandise and commercial services, the regional trade surplus increased further.

The opening of business avenues to the other countries has posed many strategic control and legal issues in the South American region. A review of the antitrust activity in Latin America shows that all the larger countries have active competition agencies using modern economic theories and procedures that rely chiefly on administrative agencies rather than the courts. In many Latin American countries increased openness to international trade probably is more important to consumer welfare than increased local competition in tradable goods and services, but receives less attention (Bruce, 2003). However, no Latin American country appears to focus explicitly on the potential for helpful positive and negative incentive effects on economic behavior, and none appears to be engaged in systematic evaluation and measurement of the effects of its policies. Although Latin American and Caribbean countries have assigned a high priority to increasing exports in recent years substantially transforming their economies in the

process - export performance in most cases remains deficient. The interplay between economic freedom, Foreign Direct Investment (FDI) and growth has been found positive during the post 80's period in the Latin American countries. A study reveals that economic freedom in the host country is found to be a positive determinant of FDI inflows into that nation and FDI is positively correlated with economic growth in the host countries of the sample considered (Sanchez and Clavo, 2003). Besides, the arguments in favor of linking labor and environmental standards to trade measures are much more controversial as there are significant doubts on what would be the end impact on exactly those targets which are thought to be worthwhile to pursue. Compulsory minimum standards enforced through trade retaliation measures may end up further hurting abused workers and the environment, a result which is directly in contradiction with the alleged aims of such trade measures (Bhagwati and Srinivasan, 1996; Brown, Deardorff and Stern, 1996).

The trade policy in Latin America and the Caribbean (LAC), for many years had involved very high levels of protection and of government intervention. The active pursuit of import substitution policies reduced the openness and efficiency of the regional economies. It also increased their external vulnerability, as they became dependent on a narrow range of export products, with little ability to absorb external shocks. This state of affairs changed markedly in the 1980s and 1990s, when most countries of the region moved to liberalize their trade regime. Trade policy reform in LAC in the 1990s has been both widespread and extensive, and the region now shows a fairly open trade regime. Such a sharp policy reversal clearly had an impact on trade flows, and those effectively underwent significant changes in the past decade. They also coincided with a number of other important changes in the LAC economies, including major structural reforms (with the privatization of many public enterprises and the deregulation of most domestic markets), a surge in investment (itself partly linked to the lower relative prices for capital goods resulting from higher openness), higher capital flows, and a more careful pursuit of macroeconomic policy aimed at preserving financial stability to foster sustainable growth (Loser and Guergil, 1999).

Economic integration and growth in trade within the Latin American region have created a need for new and major business developments. In this context, the private sector has emerged as the

driving force behind international trade and legal initiatives related to trade agreements such as the Andean Pact and Mercosur (Common Market of the South). A survey of the legal history of economic integration reveals that harmonization occurs in areas such as banking, environment protection, insurance, securities, liberal professions, international securities exchange regulations, and transportation (Buscaglia and Long, 1996). The South American customs union known as Mercosur has contributed significantly to regional trade liberalization. But by encouraging trade within the group at the expense of trade with nonmembers, Mercosur may limit member countries' access to high-technology imports, an important stimulus to growth. The foreign direct investment policies of the host countries significantly affect the trade movements and such dimensions may be observed in establishing the business relations with Japan- the giant of Asian business. The sets of relationships between the real exchange rate and foreign direct investment, and between foreign direct investment and trade, support two channels through which the real exchange rate affects trade: a direct effect on the relative price of goods and an indirect effect through foreign direct investment (Goldberg and Klevin, 1997).

Serious challenges to the hegemony of neo-liberalism have been experienced as the dominant form of economic organization since the end of the Cold War. This resistance is not uniform, nor is it restricted to one site or group of actors. Besides, in many instances, resistance is more to practice than to principle. Events in Asia and Latin America represent low s triumph of liberalism in a post-Cold War era in the region (Higgot and Phillips, 1999). These factors are more critical for bringing about productivity growth and structural change in the Latin American region. Even for Latin American countries with a more developed industrial base (Argentina, Brazil, Mexico), dynamic efficiency effects from trade liberalization do not come about automatically (Dijkstra, 2000). The scope for intra-Latin trade of dissimilar products based on comparative costs has expanded modestly in recent decades while exports of primary products have declined in importance for Latin America, they still play a significantly large role. The potential for trade of differentiated, but broadly similar, manufactures has increased among Argentina, Brazil, and Mexico, but not for intra-Latin bilateral trade involving smaller countries.

The financial investment and banking opportunities matter significantly, determining the international trade and economic growth. Foreign entry into domestic banking markets remains a

contentious issue. Whether privatizing a state bank in Brazil or selling a failed bank in Japan, the proposed sale of a large domestic financial institution, possibly to a foreign acquirer, frequently results in a major controversy. Many Asian countries have yet to experience major foreign penetration of domestic banking markets, while Latin American countries have privatized many of their banks and have encouraged foreign banks to enter their domestic markets. Because many Latin American countries opened their markets during the 1990s, and because they have experienced exchange rate and banking crises as well as severe fluctuations in their macroeconomies over this period, Latin American countries provide a good laboratory for understanding the effects of foreign bank penetration (Joe and Rosengren, 2000). However, in building bilateral trade and common markets, it is necessary for the Latin American countries to resolve the regional economic disparities and look for partnering with potential countries in the rest of the world. Markets around the world are becoming more competitive because of changing operating and regulatory environments. One such change--the loosening of trade restrictions--is a macroeconomic policy shift that should have a microeconomic impact on industrial efficiency. Specifically, competitive pressure should discipline or eliminate inefficient producers (Alam and Morison, 2000).

Development of Trade Relationship among Asian-LAC Countries

The trade partnering between Latin America and Asia is yet to be explored while trade between the European Union and Latin America is growing in importance, currently amounting to \$100 billion a year. However, there are potential problems for European businesses seeking to move into this market. The North American Free Trade Agreement linking Canada and the USA with Mexico has had a serious impact on European trade with Mexico and the Free Trade Area of the Americas, which aims to further the economic integration of the western hemisphere, and an increasing tendency towards dollar orientation in Latin America will pose additional challenges to European trade and investment in the region. The historical perspective of the trade agreements in the global market place is exhibited in Table 1.2.

Table 1.2 Regional Trade Agreements in Global Market Place
(as of January 2003)

Period	Developed-Developed	Developed-Developing	Developed-Transition	Developing-Developing	Developing-Transition	Transition-Transition	Total
1958-1964	2	0	0	1	0	0	3
1965-1969	0	0	0	0	1	0	1
1970-1974	5	3	0	2	0	0	10
1975-1979	0	5	0	1	0	0	6
1980-1984	2	1	0	1	0	0	4
1985-1989	1	1	0	2	0	0	4
1990-1994	3	3	12	5	0	6	29
1995-1999	3	7	10	4	12	28	64
2000-2002	0	11	4	5	4	6	30
Total	16	31	26	21	17	40	151

In this table, developed countries include Canada, USA, EU, EFTA, Japan, Australia, and New Zealand; transition countries include the former Soviet Union, Eastern and Central Europe, the Baltic States and the Balkans; the remaining countries are classified as Developing.
Source: World Trade Report-2003, WTO, P 47.

The countries of Pacific Rim are emerging in the 21st century as the new international business power over the developing countries. The Pacific Rim comprising of South Korea, Singapore, Taiwan, Hong Kong, Malaysia, Thailand, Indonesia and Philippines is growing as an economic powerhouse by improving the regional trade treaties and exports to European and North American countries. These countries have created a strong manufacturing potential in electronics and natural resources. The consumption of construction materials like steel is higher in the region than in the United States and also the demand for semiconductors are increasing over the European Union. The Committee on Trade and Investment (CTI) of Asia Pacific Economic Cooperation (APEC) organization works to reduce impediments to business activity in 15 key areas outlined in the Osaka action agenda - tariffs and non-tariff measures, services, standards and conformance, customs procedures, intellectual property rights, competition policy, government procurement, deregulation, rules of origin, dispute mediation, mobility of business people and implementation of World Trade Organization (WTO) obligations. The committee¹ is focusing on the following priority areas during 2004:

¹ Asia Pacific Economic Cooperation : APEC Secretariat www.apecsec.org.sg

- Trade and investment facilitation (including IPR).
- Implementation of the APEC Transparency Standards.
- Implementation of Pathfinder Initiatives
- Contribution to the APEC Structural Reform Action Plan, and
- Support for World Trade Organization

APEC Member Economies are working to eliminate tariff and non-tariff barriers to trade. Elimination of these barriers will help Asia-Pacific countries to achieve the common goals resolved in various ministerial meetings of the APEC member countries, encourage greater and freer trade and investment flows and create new business opportunities and jobs in the Asia-Pacific region. It has been further resolved by the APEC nations that sustainable economic development requires empowering people and strengthening societies for globalization. This process requires more effective, better focusing and strengthening global economic and technical cooperation. Also it has been envisaged that increasing the interaction of Asia-Pacific rim countries with international financial institutions, the private sector, and other outside organizations would pay long-run gains of globalization.

The United Nations Economic Council for Latin America and Caribbean (ECLAC) observed that Latin America and the Caribbean accumulated a surplus in goods and services of about \$25.5 billion, and a current account surplus of about \$2.8 billion during 2003 as exports from the countries of this region grew by 8.3 percent in the same reference period due to better prices and higher-volume sales for basic goods such as copper, oil, coffee, cotton, wool and sugar. Chile secured a "major advance" with its recently implemented free-trade agreement with the United States. El Salvador, Honduras, Guatemala and Nicaragua successfully concluded negotiations in 2003 for a free-trade pact with the United States, joined by Costa Rica and the Dominican Republic in 2004². Productive activities in Caribbean community and common market (CARICOM) also reflect the changing mode of doing business in a globalization environment with Trinidad and Tobago, Jamaica, Bahamas and Barbados being ranked at 1, 11, 23 and 24 respectively with regard to the "transnationality index" of developing economy host territories for

² UN Economic Commission on Latin America and Caribbean (ECLAC): Caribbean Trade and Investment Report, 2000

the year 1996. The transnationality index is based on the average of the share of FDI inflows as a percentage of gross fixed capital formation for the last three years; FDI inward stock as a percentage of GDP; value added of foreign affiliates as a percentage of GDP; and employment of foreign affiliates as a percentage of total employment and the rankings of the above mentioned four countries in 1997 were 1, 15, 20 and 24, respectively³. The performance of merchandise trade in Latin America during the past five decades has been exhibited in Table 1.3. The data reveals that Mexico is the largest exporting countries among the other LAC countries.

Table 1.3 Merchandize Trade in Latin America (1963-2003)

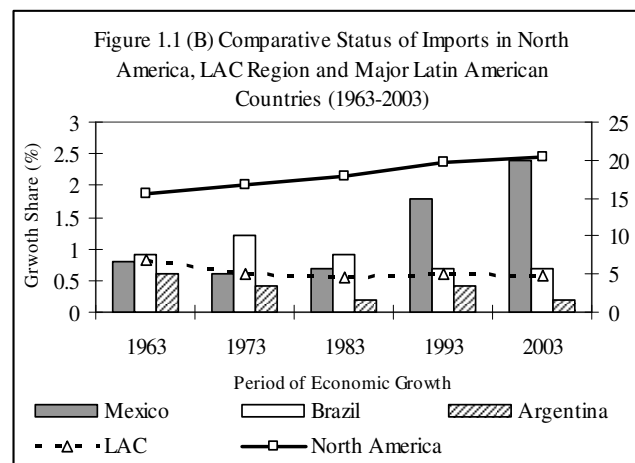
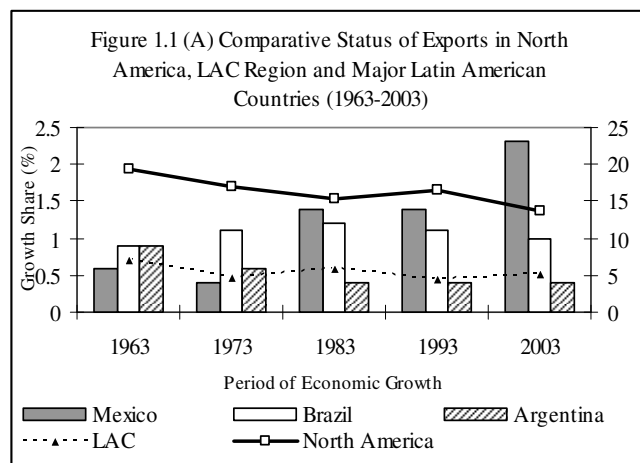
Country/Region	(Share in Percentage)									
	1963		1973		1983		1993		2003	
	E	I	E	I	E	I	E	I	E	I
Mexico	0.6	0.8	0.4	0.6	1.4	0.7	1.4	1.8	2.3	2.4
Brazil	0.9	0.9	1.1	1.2	1.2	0.9	1.1	0.7	1.0	0.7
Argentina	0.9	0.6	0.6	0.4	0.4	0.2	0.4	0.4	0.4	0.2
Latin America & Caribbean	7.0	6.8	4.7	5.1	5.8	4.5	4.4	5.1	5.2	4.8
North America	19.3	15.5	16.9	16.7	15.4	17.8	16.6	19.7	13.7	20.5
World	100	100	100	100	100	100	100	100	100	100

E=Exports, I=Imports

Source: World Trade Statistics 2004, WTO.

The recovery in the region's merchandise trade was held back by the sluggish growth of shipments to North America, its principal market, and the failure of some countries in the region to grasp the opportunities provided by the rise in global demand for primary commodities, in particular fuels. The recovery in intra-regional trade, by 9 percent in 2003, did not fully offset its contraction in 2002. The share of intra-regional trade in exports stayed at 15.6 percent in 2003 or more than five percentage points below the 1977 peak level of 21 percent. Merchandise shipments to Western Europe and Asia advanced by 17 percent and 20 percent, to new record levels. Exports to China, the region's largest market in Asia, surged to \$9.2 billion, only slightly less than the region's shipments to Africa and the Middle East combined. Exports to the transition economies and Africa rose by more than one third, but even combined account for less than 3 per cent of the region's merchandise exports. The relative growth status of exports and imports in the Latin American region and North America is exhibited in Figure 1.1 (A) and (B).

³ World Investment Report, 2000, p 25



Canadian companies have been able to expand their sales in the US thanks to innovative design and high quality products. Exports of men's and boy's tailored clothing have been particularly successful abroad, accounting for 32.5% of total foreign shipments. Besides these products, Canada is also renowned for its outerwear, furs, leather goods and children's wear. With NAFTA, the apparel industry has become very trade-oriented: exports represented over 41.0% of total shipments in 2000 compared to 17.4% in 1994 and only 5.0% in 1989. Exports of Canadian apparel have risen over 180% since the inception of North American Free Trade Agreement (NAFTA), mostly as a result of increasing shipments to south of the border. In 2000, Canadian shipments made up 1.9% of the US import market (up from 1.2% in 1994). Exports to the European Union, Canada's second market, have increased more moderately (17.1%) in the past five years and have actually declined since 1998, as a combination of trade barriers, strong local industry, and a relative depreciation of the Euro (especially in the past two years) have dampened the competitiveness of Canadian firms. Since NAFTA, American companies have been restructuring their operations by shifting a growing part of their productive capacity to Mexico and the Caribbean (there is a bilateral trade agreement with the region), decreasing their dependence on supplies from Asia. As a result, imports from Mexico to the US have grown strongly since 1994, causing their share of the American import market to rise from 5.7% to 15.8% in 2000. By the same token, US-bound shipments from Asia made up 19.4% of that market in 2003, down from 34.0% in 1994. Unlike their American and European counterparts, Canadian apparel companies have not resorted extensively to offshore production⁴.

In the framework of the external co-operation and development policies of European Union, the European Investment Bank (EIB) operates in 77 African, Caribbean and Pacific (ACP) countries. The ACP countries, with a population of some 600 million, have established a special relationship with the European Union through successive Conventions; the latest is the 2000 Cotonou Agreement signed in June 2000. The EIB has been the developing partner of most of the ACP countries over 25 years and as many as 40 countries of the region. Under parallel provisions EIB also supports investments in 20 overseas countries and territories mainly in the Caribbean and Pacific which have constitutional links with certain European community countries. The Pacific Rim offers a variety of opportunities for American and European companies for the products and services that range from telecommunication instruments to the aircraft seats and

⁴ Export Development Council : The Canadian Apparel Industry, EDC, 2000 (<http://www.edc.ca>)

banking services and a host of other products. Although it is a competitive market, the region is growing economically cohesive that attracts production sharing possibilities with the industrial countries. The Asian producers outside Japan have gained more than one fourth of the global market share for personal computers Japan and the Pacific emerging triad comprising Singapore, Taiwan and South Korea provide most of the capital and expertise for the rest of the countries of the region that have enormous labor and natural resources.

Hong Kong also contributes significantly to the development of international trade in the Pacific region. Japan is Canada's second largest national trading partner (after the United States), taking 2.1% of total exports, and is the fifth largest source of foreign direct investment (FDI) in Canada. Canada is a leading supplier to Japan of a number of products of key export interest, such as lumber, pulp and paper, coal, meat, fish, oilseeds and prefabricated housing. While resource-based exports continue to represent much of our trading relationship, Canada is an increasingly important source of sophisticated, value-added, technology-driven products and services imported by Japan. In 2003, Canada's total merchandise trade with Japan was \$22 billion. Canadian exports to Japan have declined steadily since the mid 1990s, Canadian exports to Japan declined again to \$8.1 billion in 2003 from \$8.4 billion in 2002. In 2003, Canada exported \$1.4 billion in services and imported \$1.9 billion⁵. The long-term trend in Japan is toward a growing demand for cost-competitive and innovative imports, which represents a significant market opportunity for Canadian exporters. The Asia Pacific region has been the fastest growing trade block over past three decades though it had experienced downturn in 1998 and extended after shocks. East Asia is the principal export market for American goods. The transpacific trade has grown over 50 percent of its transatlantic trade by the end of 20th century.

Trade Agreement Pattern in LAC countries

There are large differences in gross domestic products by sectors among Latin American countries, and the majority of these differences are due to the value of industrial and service sectors. Although the sectoral economic activity has been increased, in per capita terms this value

⁵ Government of Canada : Report on Canada's International Market Access Priorities- 2004, Department of Foreign Affairs and International Trade, Opening doors to the world, Chapter 6, 2004

decreased due to the demographic growth that Latin American countries (mainly Mexico and Brazil) had experienced during the last decades. In terms of external trade, it has been found that the outward orientation as the ratio between total exports and GDP increased from 16.1% in 1990 to 32.7% in year 2000. Panama had the highest level in this area (66.5%). Modest growth returned to Latin America and the Caribbean in 2003 and regional GDP advanced by an average 1.3 percent, after a contraction of 0.6 percent in 2002. Argentina continued recovering rapidly after its acute crisis. Brazil, Mexico and Uruguay shared in the broadening of economic recovery during the year. The Andean countries performed well, with Chile, Colombia and Peru recording growth above 3 percent. However, ongoing political uncertainties caused Venezuela's economy to deteriorate further during the first half of the year. Central America grew by an average 3.1 percent and looks set to sustain growth, thanks to the recently signed Central America Free Trade Agreement⁶ (CAFTA). The rate of change in the merchandize export in the Latin American countries during 2002 in most of the countries in the region except Costa Rica, Ecuador, Peru and St. Kitts Islands other have shown a downward trend.

The Central American Free Trade Agreement (CAFTA) negotiated between the U.S. and Central America offers opportunities and challenges for the five countries including El Salvador, Guatemala, Honduras, and Nicaragua that joined in 2003 and Costa Rica that was included in January 2004. Mexico, Nicaragua, Jamaica and Honduras always were over the mean. During the years 1990, 1995 and 2000, Mexico, Cuba, Panama, Argentina, Brazil, Chile and Uruguay reached incomes above 2000 dollars per capita in the service sector⁷. On the other hand, there are some countries like Haiti, Honduras, Nicaragua and Bolivia with incomes below 500 dollars per capita. Latin America's merchandise exports increased slightly as the decline in intra-regional trade was balanced by increased shipments to other regions. The recovery of commodity prices in the course of the year and the upturn in the US economy contributed to this rise. While most Latin American countries saw a reduction or stagnation in their imports, those of Costa Rica increased by 9 per cent. Mexico benefited from the recovery of the US market while for Costa Rica, the recovery in semi-conductor shipments boosted both imports and exports. The Table 1.4 exhibits the trade performed by the countries within the trade agreements as partnering countries.

⁶ World Bank : Report on Latin America and Caribbean, Regional Overview, 2003

⁷ Guisan , M.C. and Aguayo, "Education, Indústary, Trade and Development of American Companies in 1980-99". *Applied Econometrics and International Development*. Vol. 2-1, 2002, pp. 83-106

Table 1.4: Trade by Regional Trade Agreements (1990-2003)

Regional Trade Agreements	Share (in Percent)			Annual Percent Change (in percent)			
	1990	1995	2000	1995-2000	2001	2002	2003
NAFTA (3)	19.6	19.8	25.8	11	(-)6	1	8
Mercosur	0.8	1.6	1.4	2	(-)6	(-)26	10
ASEAN	4.6	6.9	5.7	1	(-)8	4	10

Source : World Trade Statistics-2004, WTO

Latin America's exports by product group varied in 2003 as exports of ores and minerals, iron and steel, fuels and food increased between 15 per cent and 21 per cent while exports of automotive products and clothing stagnated and those of office and telecom equipment contracted. The region's recovery in commercial services exports was driven by a sharp rise in transportation services, which increased by 13 per cent, to \$12.1 billion. Other commercial services exports decreased to \$15.5 billion in 2003, mainly due to a further sharp decline in Mexican exports. Looking at the merchandise trade performance of individual countries one notices that 30 out of 35 countries recorded positive value growth, the best result since 1997. The arithmetic average growth for exports and imports was also stronger than the weighted average of the region, indicating that many smaller traders performed better than the regional average in 2003. The variation in the trade performance of individual countries in the region continued to differ sharply in 2003. While Brazil, Chile, Uruguay and some oil exporters (such as Ecuador, Trinidad and Tobago and the Netherlands Antilles) reported merchandise export gains of between 16 per cent and 21 per cent, those of Venezuela and several Caribbean islands decreased. In respect of commercial services exports, the strength of the recovery in Argentina's exports and the double digit growth in Chile, the Dominican Republic, Panama and Jamaica contrast with the stagnation of the services exports of Mexico and the decline of those of Columbia in 2003. Despite the continuation of low prices for a number of primary commodities, exports of many Central American and Caribbean countries recovered strongly. Economic activity in Western Europe remained subdued as Germany, the largest economy, experienced declining domestic demand. Domestic demand growth remained positive in the rest of the region, but was sluggish in several other countries. In the euro zone, public consumption was the most dynamic expenditure category while private consumption slowed down and fixed investment in the enterprise sector

fell nearly 3 per cent. In the midst of this poor economic situation, further progress was made in the process of European integration⁸.

It has been observed during the post-reforms period in the Latin America, a high level of intra-regional trade is positively related to the overall value of trade, market size, the depth of integration and income levels. Both the European Union and NAFTA have larger markets, higher income levels, larger trade volumes, and are more deeply integrated than ASEAN, Mercosur and the Andean countries. The latter regional trade agreements (RTAs) report a far smaller share of intra-trade than NAFTA or the European Union. In contrast to developments in the early 1990s, when intra-RTA trade was growing faster than extra-RTA trade, the record has been mixed for both the second half of the 1990s and in the 2000-03 period. Between 1995 and 2003, the share of intra-regional trade in the exports of the six RTAs increased only in the case of NAFTA. On the import side the record is mixed, with the share of intra-trade decreasing for the EU(15), NAFTA and CAFTA, but increasing for ASEAN, Mercosur and ANDEAN. As the first mentioned RTAs are all net importers of fuels, the rise in oil prices boosted the extra-regional trade share. Much of the expansion in South-South trade in automotive products has taken place in Latin America; although its exports of automotive products to developing countries are largely confined to other Latin American countries (more than 90 per cent of exports are intra-regional).

Mercosur countries and more recently Mexico have become significant market outlets for developing countries exporting automotive products. Mercosur's share in Latin America's imports of automotive products from developing countries increased markedly between 1990 and 1995, but fell sharply thereafter. This development can be attributed to a rapid increase in Mexico's imports from Brazil in recent years while intra-Mercosur trade shrank. Mexico's imports of automotive products from developing countries have increased strongly, as Mexico liberalized its trade regime and has succeeded in establishing itself in the global automobile production network.

Starting in the mid-sixties of the 20th century, the European example inspired a number of trade-oriented integration arrangements in the Latin American region such as the Latin American Free

⁸ World Trade Organization: World Trade Report 2003, pp 30-42

Trade Association, which later became the Latin American Integration Association (ALADI), the Central American Common Market (MCCA), the Caribbean Community and Common Market (CARICOM), the Andean Group, later the Andean Community; and more recently, the Southern Common Market (Mercosur), the Group of Three (G3) and the Association of Caribbean States (ACS). There are many bilateral alliances as well. Latin American countries have been living a renaissance since 80's. Most economies are stabilized, living standards are higher, direct foreign investment has surged, democracy has been institutionalized and most countries have demonstrated a desire to integrate themselves into the new global economy by opening their economies to international trade and investment. In the 90's the Latin American countries have liberalized their economies, which has been followed by a significant increase in their imports. This improvement was primarily due to three factors: lower inflation, less government intervention, and fewer trade barriers. International trade has been the key indicator of the overall economic growth of Latin American countries.

Several regional free trade agreements signed over the past decade--such as Mercosur, the Central American Common Market, the Andean Community, and the Caribbean Common Market--demonstrate the region's understanding of the benefits of free trade. Countries like Chile have gone even further in their trade liberalization efforts, signing bilateral agreements with Mexico and Canada after being unable to sign an agreement with the entire NAFTA bloc. In terms of scope, sectors of interest and coverage, there are three levels of sub-regional arrangements: (i) customs unions currently being finalized, e.g., the Andean Community, Mercosur, MCCA and CARICOM, (ii) first-generation free trade accords with a commercial emphasis, and (iii) new-generation free trade pacts encompassing such sectors as services, investment, intellectual ownership, and state acquisitions. Chile and Bolivia are successfully engaged in negotiations for broader scope aimed at furthering their association with Mercosur, establishing free trade areas and bringing other sectors and issues into the accords.

With investor confidence returning in Latin America and domestic conditions improving, gross private financial inflows in 2003 increased by 40 percent over 2002. Moreover, interest rate spreads on sovereign bonds over US treasuries reached record lows. Net foreign direct investment (FDI), however, continued its decline from a peak of \$88 billion in 1999 to an estimated \$36 billion in 2003. This is partly explained by the end of the privatization boom and

the profit crisis in Brazil and Argentina. Export growth outpaced import growth for most countries in 2003, leading to surplus positions on trade and a big improvement in the region's current account deficit, down to 0.5 percent of GDP (compared to 4.5 percent in 1998). Tourism revenues and workers' remittances also improved, and commodity prices were generally strong. Consequent upon falling trade and investment barriers and high growth prospects, the countries of Latin America represent attractive alliance prospects for an increasing number of global firms. The typical objective for these strategic alliances is a basic trade-off wherein local firms seek access to technology and capabilities that are critical for their survival in an environment of increased competition and in return, they offer prospective multinational partners' access to a large and growing market. There have been some major factors forming the business environment in most Latin American countries such as:

- Trend of high inflation
- Traditionally closed economies
- Extensive government intervention
- A tradition of family-owned businesses

The region is becoming more attractive to multinationals, as product patent protection is implemented and, more importantly, enforced, in Latin American countries. Mexico, in particular, as a member of NAFTA, is attracting substantial inward investment. This is likely to grow even more rapidly in future, given the recent signing of a trade deal with the European Union. The recent recovery of oil prices has shown a positive sign of growth for a number of countries in the region, particularly Venezuela, Mexico and Colombia.

Corporate networks in Latin America still differ significantly from those in mature countries. Bandwidth usage is symptomatic of this difference. The telecommunication companies in the main markets of the region (Argentina, Brazil, and Mexico, loosely labeled Latin America) enjoy speeds similar to those of developed countries today. Although this may come as no surprise for those familiar with the region, a wide variety of telecom players (ranging from global carriers to Application Service Providers [ASPs]) often disregard this fact and its implications. One of the clearest consequences of the bandwidth lag is that it will constrain the future of applications that can be provided over the Internet. Therefore, ASPs should either adapt their business model or simply wait for better timing (when enough bandwidth is available). While the overall level of development and globalization of Latin American countries can explain these differences to some extent, it is believed that factors directly related to the telecom market also play a key role. In particular, the low level of competition in most countries has kept prices artificially high, thus preventing a faster uptake for many products and services. The Yankee Group is a global leader in technology research and consulting. The customers of the company categorically include technology vendors and users, benefit from our accurate, reliable, and trusted research, consulting, and personalized one-to-one client

interaction covering communications and IT products and services. Now in our fourth decade, the company is headquartered in Boston and maintains offices throughout North America, Europe, Latin America, and the Pacific Rim.

In telecommunications, banking or other sectors that are strictly regulated and where politics plays a role, there's more of a need. Right now in Mexico, which has liberalized many of its rules and regulations and is part of NAFTA, the need for having a local partner has been greatly reduced over the years. Chile may also fall in this category. In other countries, such as Peru, Colombia, Venezuela, Argentina, and Brazil, it is probably more useful to have a strategic partner. The Latin America and Caribbean countries are at a critical juncture that carries risks and challenges but also hopes and motivation. Internationally, they supported the founding of the World Trade Organization (WTO) and hope that the new multilateral regulations will lay the essential ground rules for international trade. The merchandise trade of Latin America performed during 2003 is exhibited in Table 1.5.

Table 1.5 Merchandise Trade of Latin America, 2003
(Value in billion US dollars and annual change in percentage)

Region/Country	Exports				Imports			
	Value	Annual Change			Value	Annual Change		
	2003	2001	2002	2003	2003	2001	2002	2003
Latin America	377	(-4)	0	9	366	(-2)	(-7)	3
Mexico	165	(-5)	1	3	179	(-4)	0	1
Central America (6)	14	(-8)	0	10	28	3	5	6
Caribbean countries (15)	16	(-6)	(-6)	11	28	0	(-2)	0
South America	181	(-2)	(-1)	14	131	(-1)	(-18)	7
Argentina	29	1	(-3)	14	14	(-20)	(-56)	54
Brazil	73	6	4	21	51	0	(-15)	2
Chile	21	(-4)	(-1)	14	19	(-4)	(-4)	13
Venezuela	24	(-14)	(-11)	(-3)	9	11	(-34)	(-21)

Source: World Trade Report- 2004, WTO

An important feature of the region's trade developments was the sluggish growth of Mexican trade in 2003. Mexico is the region's largest trader and recorded a significantly more dynamic trade performance in the 1990s than other countries in the region. The weakness of US import demand for automotive products and the lack of competitiveness of Mexican goods in its major market contributed to this lackluster export performance. Brazil was particularly successful; expanding its merchandise exports by more than 20 per cent, partly due to commodity price

increases and strong demand from China⁹. As imports recovered only marginally, the Brazilian trade surplus rose to a record level of \$25 billion in 2003. Central America and the Caribbean countries continued to record a large merchandise trade deficit, although exports expanded by about 10 per cent, much faster than imports.

⁹ The shipments of Brazil to China rose by 80 percent to US\$ 4.5 billion in 2003.

Chapter 2



Review of Literature

Sustainable development is a prime global concern. It has been emphasized that the business sector will only be more effective if it incorporates social and environmental responsibilities into its policies. Poverty and environmental damages affect the business sector and thus, need to be resolved and prevented to create a good and prosperous business environment. It is also noticed that global competitiveness is the key element to survive in business and it is a task that the business sector along with governments have to confront. Since the latter half of eighties and all through the decade of 90's, issues of reforms have swept the economies of Latin America and Caribbean countries. The development strategy has been based extensively on the policies of import substitution and strong intervention of the state in production of goods, functioning of the marketing and redistribution of income. The economic reforms in a country are complex and multi-dimensional process that involves the development and implementation of many public policies at intermediate levels during the reforms. The economic reforms thus will not have a constant speed and will often be subject to modifications in the policies that bring changes in the performance and structure of economic activities. The economic reforms can be assessed by examining their corresponding policy measures and implications. However, entire economic progress may not be interpreted as an outcome of the reforms. The growth and development may result to be slower in a country or region in a normal process than stirred process of reforms. After years of poor economic management, many Latin American and Caribbean countries are experiencing a process of structural reforms that places them on a path to a superior economic performance (Easterly and Sergio, 1993). Two basic principles identify this process of economic reforms - fiscal and monetary discipline, and reliance on market forces to determine the allocation and distribution of resources.

Macroeconomic Factors

The structural reforms have been initiated in the macro areas including economic activity, international trade, financial markets, generation and use of public resources, governance, and labor markets. It has been observed in the previous studies that the economies that have

advocated for open international trade have gained higher rates of growth influenced by the higher rate of investment and factor productivity (Edwards, 1992, Harrison 1996). Trade leads to specialization, contributes to the total factor productivity (TFP), and offers comparative advantages for the other countries. It also expands potential markets that allow the domestic companies to take advantage of economies of scale and to diffuse technology, innovation and managerial practices through close alliances with the foreign firms. The TFP growth rates in the long run are higher for the countries that exhibit more open and less distorted international trade sector. The TFP growth improves after the reforms on trade liberalization. Chile has been more benefited from trade liberalization as compared to other countries (Mexico) in the region because of faster economic and structural reforms. Chile pioneered the trade liberalization in the 70's and has also led the process all through the 80's and early 90's. Bolivia, Mexico, Venezuela, Brazil (to a lesser extent) experienced the trade reforms considerably during the late 80's and all other countries in the Latin America and the Caribbean (LAC) region began the trade reforms process in early 1990's. Brazil and Venezuela liberalized their tariff- administration and Argentina, Colombia and Peru have also been dynamic in conducting the trade liberalization process. The task of liberalization of international trade has been achieved through a balanced reduction of all trade restrictions, sharp decrease in tariff and para-tariff, and reduction of non-tariff barriers. The non-tariff barriers have been even withdrawn in the Chile and Peru in the process of liberalization.

Although the processes of structural reforms throughout the region have shared the same principles, they have differed in their time of initiation and in the breadth and depth of their specific reforms. Regarding the time of initiation, Chile was the pioneer of market-oriented reforms in the mid-1970s. In the mid-1980s and after a macroeconomic crisis topped by hyperinflation, Bolivia took important steps in ensuring fiscal and monetary stability, and it liberalized its financial system and trade regime. This pattern of crisis followed by economic reforms was repeated in Mexico in the late 1980s, in Argentina, Peru, and Nicaragua in the early 1990s, and, more recently, in Brazil, El Salvador, and Venezuela. Colombia and Costa Rica stand out as cases where structural reforms were not implemented in a crisis environment. The process of structural reforms has also been heterogeneous in other related aspects. While the region as a whole has advanced in certain reforms areas more than in others, the sequencing, depth and

contents of the reforms have differed from country to country. Improving economic integration is only a part of the measures that a government should adopt to improve increases in real GDP per inhabitant and in socio-economic welfare.

The reduction in the average level and dispersion of tariff and para-tariff charges as well as the sharp reduction of non-tariff barriers is where reforms have been the deepest and most generalized in the region. These policy changes have brought about a marked increase in the trade intensity of the reforming economies¹. For the early reformers, among them Bolivia, Chile, Costa Rica, and Mexico, the expansion of international trade as a share of GDP, occurred mostly in the 1986-89 period. In the 1990s, the Argentina, Brazil, Paraguay, and Uruguay constituents of Mercosur experienced very high growth rates of the volume of trade. While the respective trade shares of Colombia, Mexico, and Peru increased rapidly (certainly as result of the liberalization process), the improvement was not as large in the oil-exporting economies of Ecuador and Venezuela despite a liberalization program similar to that of the former countries (especially Colombia). However, the tariff and quantitative restrictions often impede the process of trade liberalization. The higher is the average level of dispersion of tariffs and para-tariffs in terms of custom duties and taxes; more is the distortion of international trade. The measure applied to evaluate the level of tariffs and para-tariffs is the weighted average rate of tariff and para-tariff charges that is used to weigh their respective shares in regional or global imports (Pritchett and Sethi, 1994). The trade reforms in the LAC countries seeded the privatization concept. Consequently Mexico during 1987 and Argentina during 1991-92 had showed *ad hoc* steep rises in the basic economic indicators as a result of the privatization programs. A study on diffusion of technology via international trade from industrial countries to Latin America evaluates the role played by international trade within the region in this process of technology diffusion. The estimates of the study suggest the existence of trade-related technology diffusion from the North. The results are robust for different specifications of the model. Evidence is also found suggesting that trade among the Latin American countries serves as an additional mechanism by which the technology from the industrial countries is indirectly diffused across the region (Blyde 2004).

The most common pattern of economic reforms in Latin America has been, first, radical liberalization, and second, implementation of prudential norms that moderated the initial

liberalization. The policy changes related to the financial system (namely, the removal of interest-rate controls, elimination of mandated credit to “priority” sectors, privatization of state banks, liberalization of the foreign investment regime, and more recently, improvements in the regulatory framework) have improved both the banking system and the stock market. The traditional view about fiscal and monetary policies in developing countries (and particularly in LAC) is that they are pro-cyclical, contributing to deepen business cycles (e.g., Hausmann and Stein, 1996; Gavin and Perotti, 1997; Gavin and Hausmann, 1996; Talvi and Végh, 2000). It has been argued that governments relax their policies during booms and restrict them during busts, due to weak institutions, unfavorable political-economic equilibrium, and volatile access to international capital markets. The most common pattern of financial reforms in the LAC countries has been towards radical liberalization and implementation of prudential norms that moderated the initial process of liberalization. However, growth has been inadequate in the post-reforms period not because of the failure of reforms to yield the expected growth payoff on the basis of international experience, but because of the combination of an unfavorable external environment with the insufficient depth and breadth of reforms.

The performance of the LAC countries since the reforms were initiated in the mid-eighties had shown mixed results. Their annual growth rate for the referred period was 3.9 percent though the performance widely differed. During 1950-1980 the region witnessed relatively higher growth rates of 5.0 percent per annum on an average. The decennial growth of GDP among the Latin American countries is exhibited in Table 2.1.

Table 2.1: Growth of GDP in Latin American Countries

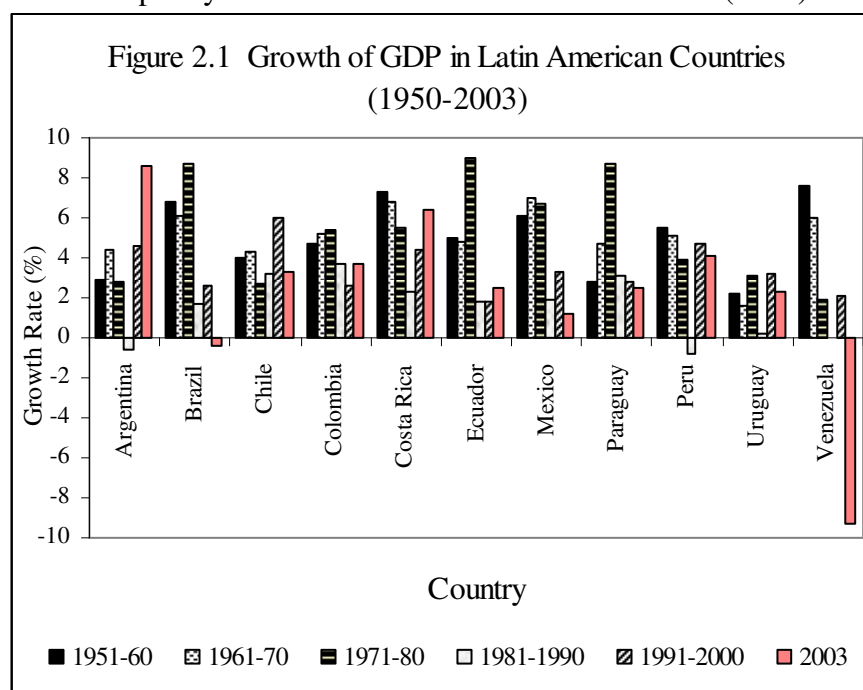
Countries/Period	1951-60	1961-70	1971-80	1981-1990	1991-2000	2003
Argentina	2.9	4.4	2.8	-0.6	4.6	8.6
Brazil	6.8	6.1	8.7	1.7	2.6	-0.4
Chile	4.0	4.3	2.7	3.2	6.0	3.3
Colombia	4.7	5.2	5.4	3.7	2.6	3.7
Costa Rica	7.3	6.8	5.5	2.3	4.4	6.4
Ecuador	5.0	4.8	9.0	1.8	1.8	2.5
Mexico	6.1	7.0	6.7	1.9	3.3	1.2
Paraguay	2.8	4.7	8.7	3.1	2.8	2.5
Peru	5.5	5.1	3.9	-0.8	4.7	4.1
Uruguay	2.2	1.6	3.1	0.2	3.2	2.3
Venezuela	7.6	6.0	1.9	-0.5	2.1	-9.3

Source: Economic Commission for Latin America and Caribbean (ECLAC)

There has been a steep decline in the growth rates to the extent of 1.4 percent per annum in the LAC countries during the decade of 1980. The growth resumed in 1990's, that was lower than the growth rate of 3.4 percent per annum achieved during 1951-81 period.

Among the reforms leaders, Argentina, Bolivia, Chile and Uruguay emerged as star performers with an average growth rate of 4.4 percent per annum during 1991-2000 as against the average annual growth rate of 3.2 percent achieved during 1951-1980 period. These countries also stood above the average growth of the LAC region that accounted for 3.4 percent during 1991-2000. The other countries of the region including Brazil, Columbia, Ecuador, Jamaica, Mexico, Paraguay and Venezuela have shown a declining trend in the referred period. The growth rate for this group of countries has fallen from 5.7 percent in 1951-1980 to 2.0 percent per annum during 1991-2000, which was even below the average growth rate of the LAC region. Costa Rica has been growing at the pace of 6.5 percent per annum during the base period but had shown only 4.4 percent growth rate during the latter period. The decline in the growth rate was caused largely due to the instable political conditions and lower contribution of factors of production to GDP. The trend of the GDP during the above referred period is exhibited in Figure 2.1

The trade policy in Latin America and the Caribbean (LAC) had involved very high levels of



protection and of government intervention in the pre-reforms period. The active pursuit of import substitution policies reduced the openness and efficiency of the regional economies. It also increased their external vulnerability, as they became dependent on a narrow range of export

products, with little ability to absorb external shocks. This state of affairs changed markedly in the 1980s and 1990s, when most countries of the region moved to liberalize their trade regime. Trade policy reform in LAC in the 1990s has been both widespread and extensive, and the region now shows a fairly open trade regime. Such a sharp policy reversal clearly had an impact on trade flows, and those effectively underwent significant changes in the past decade (Loser and Guerguil, 1999). The Latin American countries have not had much experience with competition policies in the past. Combined with restrictive trade policies, the absence of competition policies has often led to monopolized domestic markets.

The strong trade liberalizations in Latin America during the 1980s and the 1990s have introduced a good measure of import competition, but trade policies alone are not sufficient to create a competitive environment in an economy. The presence of non-traded goods, vertical integration, monopolized distribution systems, the limited use of trade policies to foster competition, and sometimes the use of anti-dumping measures, countervailing duties, and safeguards as protective devices have constrained the effectiveness of trade policy as an instrument of competition policy. Competition policies, such as anti-trust, merger controls, and other regulatory means, can prevent the abuse of market power, dominance, exclusionary practices, and complicity among competitors. Domestic competition is further enhanced by foreign ownership and liberalized investment regimes. These latter provisions provide a market presence that enhances competition. A study discusses that trade and competition policies are essential complements and when used together they can lead to higher levels of welfare. There are of course tensions between these two policies that arise from globalization, regional policies, technical barriers, certain forms of industrial policies, and macroeconomic exigencies (Rajapatirana, 1994).

A study examines individual trade policy preferences across 17 countries in Latin America with the focus on whether skilled or unskilled workers are more likely to support liberalized trade and the country characteristics, such as factor endowments, alter the preferences of skilled and unskilled workers. Based on the standard Heckscher-Ohlin model and the Stolper-Samuelson theorem, wage inequality in developing countries will decrease under free trade and unskilled workers will benefit. The findings of the study discusses that on average skilled workers are more likely than unskilled workers to support free trade in Latin American countries. Separate country

regressions reveal that this pattern is only statistically significant in 8 out of 17 Latin American countries. However, there are no countries in our sample in which unskilled workers are statistically more likely to support free trade than skilled workers, not even in the lowest skill-endowed country in the sample. The analysis of the study also reveals that people from Latin American countries with higher GDP, faster growth, more cropland and a longer period of time since reform were more likely on average to support free trade (Beaulieu *et.al.* 2005).

International Economic Environment

The effects of the economic crisis of 90's among the larger countries of Latin America, Brazil appears as the most vulnerable economy. Brazil needs to take further steps to reduce its twin deficits in the current account and the public budget, to make its exchange rate policy flexible and to implement additional structural reforms. Chile, though hit hard by a terms of trade shock, is structurally healthy. Weaker regional demand and the loss of competitiveness associated with the Asian crisis will deteriorate Argentina's external accounts and provoke a significant slowdown. Because of its heavy dependence on the Brazilian market, Argentina will face severe problems if Brazil falls into a crisis. Mexico benefits from its significant export diversification and its close integration to the U.S. economy but faces severe pressures from lower oil prices and, especially, from its weak banking sector. Capital controls, though popular, are no solution at times of crisis. A correction of the fundamental macroeconomic imbalances, on the other hand, is a necessary but not sufficient condition to prevent currency crises (Esquivel and Larrain, 1998). The privatization policies emerging as a driver of globalization in Latin American countries has received much criticism in terms of ineffective management of corporate ventures, lack of proper resources management and political interventions. The success of privatizations is enhanced by two complementary policies: re-regulation or deregulation of industries previously shielded from competitive forces; and an effective corporate governance framework that facilitates privatized firms' access to capital at lower costs. Overall, the empirical record shows that privatization leads to increased profitability and productivity, firm restructuring, fiscal benefits, output growth and even quality improvements. Most cases of privatization failure can be linked to poor contract design, opaque processes with heavy state involvement, lack of re-regulation and a poor corporate governance framework (Lopez and Chong, 2003).

Free Trade Agreements

There have been varying arguments on the impact of trade agreements on the economy and welfare measures. It has been concluded in one of the studies that the preferential trade agreements are mostly welfare reducing since the partner countries might end up with severe welfare losses due to substantial amount of trade diversion (Bhagwati and Panagariya, 1996). Another study finds that Free Trade Areas constitute a potential threat to the world trading system because these types of agreements are, in general, trade diverting and they lead to formation of new interest groups who oppose the multilateral tariff reductions (Krueger, 1995). Interestingly, some researchers present a completely different picture about the implications of bilateral trade agreements. Nordstrom (1995) finds that regional trade agreements might provide trading blocs with stronger incentives to pursue multilateral trade liberalization since establishing these types of agreements allows small countries to deal more effectively with large trading blocs. Perroni and Whalley (1996) indicate that recent regional trade agreements generally take the form of Free Trade Associations in which member countries can choose their external tariff rates freely.

A study focuses on identifying preconditions that will ensure the sustainability of a Free Trade Area of the Americas (FTAA). It argues that the macro, micro, and political conditions advanced in the literature to measure a country's ability to compete internationally, while necessary, are not sufficient to ensure the success and permanence of a free trade agreement. Instead, two additional financial conditions are needed (Rojas-Suarez, 2002). The study discusses that each partner in the free trade area needs to have sustainable public debts as determined by the achievement of credible and sustainable structural fiscal balances and the exchange rate regimes across trading partners should be compatible in the sense that adverse shocks in one country do not generate a policy dilemma in other partners between abandoning their exchange rate system or the free trade area. A preliminary analysis of the evidence in the Latin American and Caribbean region as discussed in the referred study shows the importance of these two preconditions. An analysis of debt sustainability reveals that there are a number of countries in the region that need to deal with potential solvency problems before reaching the status of credible partners in a regional trade arrangement. Argentina is already deemed insolvent, and countries such as Ecuador and

Venezuela rank high on the list of countries where the issue of debt sustainability can become a serious problem. Not resolving this before reaching a regional trade agreement can threaten its long-term stability. The examination of the compatibility of exchange rate systems across trading partners is also very revealing. Part of the success of NAFTA since the late 1990s and the "impasse" of Mercosur during 1999-2001 had to do with the choices of exchange rate regimes. In both trade areas the share of trade among the partners is very high, and in NAFTA, this includes significant financial transactions (Rojas-Suarez, 2002). While Mexico was able to use the flexibility of the exchange rate to improve competitiveness following the sharp decline of portfolio flows from US investors into Mexico following the Asian and Russian crises, Argentina had no mechanisms to deal with an adverse shock from Brazil.

Several emerging market economies have experienced large and persistent trade deficits, following the liberalization reforms of the late 80s and early 90s. The Argentine experience has endorsed the extent to which trade imbalances in the 1990s resulted from income and relative price movements were associated with structural changes from shifts in foreign trade elasticity during the reforms period. New estimates of export and import equations are studied using a broader set of variables than previous studies and distinguishing trade between the member countries of Mercosur and trade with non-Mercosur member countries (Catao and Falcetti, 2002). The results reveal that considerable export sensitivity to world commodity prices, domestic absorption, and economic activity in Brazil, combined with a high income elasticity of imports, are key determinants of Argentina's trade balance. In particular, a study draws attention on the historical context of economic institutions in the region, and on how these institutions have influenced competition policy enforcement (Leon, 2001). The study delineates three conditions necessary for competition policy enforcement in Latin American countries- (a) to achieve efficiency and innovation development goals through the promotion of a pro-market policy agenda (b) institutional incentives placed on competition agencies, and (c) the challenge of adverse anti-market social values where the policy is to be implemented. The discussion in this study is based on the mainstream efficiency-equity economic analysis, and focuses on neo-institutional development concepts of economic process. On the contrary, another study reveals that the Coordination and regional integration of competition policy, both generally and within the context of the various customs unions (MEROSUR, Andes Pact, Caricom, FTAA, and WTO)

remains an unachieved objective. This is a problem because relevant geographic markets in merger and monopoly cases are not, in general, contained in national boundaries and also because benign international mergers are penalized and delayed by the necessity to undergo review in multiple jurisdictions. No Latin American country appears to focus explicitly on the potential for helpful positive and negative incentive effects on economic behavior, and none appears to be engaged in systematic evaluation and measurement of the effects of its policies. Throughout the region, antitrust and other government policies are undercut by the inability of governments and courts to make credible commitments to consistent, transparent decision-making. Still, many Latin American countries are moving in sensible directions by emphasizing well-publicized actions against price fixers, by undertaking competition advocacy programs, and by targeting public sector restraints on competition (Owen, 2003).

In the arena of international trade, coalitions have been traditionally formed within countries, and occasionally, among countries, in order to protect the domestic production of particular goods, services, or sectors of the economy (Rogowski, 1989). However, oil and interest rate shocks in the world economy during the 1980s, coupled with debt crises and the rise of a more market oriented economic philosophy, brought about a dismantling of organized protectionism in many countries, eroding the coalitions which had so tightly resisted trade liberalization (Goldstein, 1998). Alongside regionalism, the world trading order In the last decade has been marked by increased Institutionalization. This has opened up a new, wider set of issues and interests around which future coalitions of countries may well form. Prior to the UR, and during the pre-negotiations of that round, developing countries had formed a coalition of 'the South'. The Group of Ten (G-10), led by a 'Big Five' comprising Argentina, Brazil, Egypt, India and Yugoslavia, formed as soon as the US began its push to launch a new round of trade negotiations. The coalition of developing countries successfully blocked some aspects of the US initiatives. However, the G-10 soon found itself split in trying to formulate negotiating positions on the various aspects trade (Narlikar, 2000; Kumar, 1995)

The change in economy has taken place through the free trade policies in Latin America since 1980's, and most of the region's economies have changed from restrictive to open policies. But unlike trade liberalization in Europe, most trade barriers in Latin America have been reduced

unilaterally. Recently bilateral or multilateral agreements have been considered, especially preferential trade agreements within the region. A Study evaluates the relevance and desirability of multilateral free trade agreements (such as NAFTA) for the Latin American continent and the Caribbean, with an emphasis on how they affect trade flows (Michaely, 1999). Is a preferential trade agreement among some Latin American countries determined as an economic welfare driver? The evidence strongly suggests little likelihood that these agreements will succeed in Latin America. Paradoxically, the intense liberalization in recent years has made it less likely that such agreements would be beneficial except possibly for agreements between some countries and Brazil, Mexico, or (to a lesser extent) Argentina. The trade policy can be used for protection even without high tariffs or quantitative restrictions through anti-dumping measures, countervailing duties, and safeguard measures, which would limit, rather than promote, competition. Caution should be the guiding principle in the use of these measures and they should be GATT compatible in law, and competition promoting in spirit. However, Latin American countries have recently made impressive progress in trade reforms; there has been limited use of competition policies (Rajapatirana, 1994).

The spatial characteristics of a country have significant effects on trade and are generally not correlated with other determinants of income. However, merely examining the correlation between trade and income cannot identify the cause and effect relationship between these two variables. In this context a study constructed the measures of the geographic component of countries' trade and uses those measures to obtain instrumental variables estimates of the effect of trade on income (Frankel and Romer, 1999). The results provide no evidence that ordinary least-squares estimates overstate the effects of trade, though they suggest that trade has a positive effect on income in developing countries.

A significant cross-section of commentators from countries in the weaker half of the Basin, particularly those that make up the Commonwealth Caribbean, have not persuaded that NAFTA and other macro-phenomena offer any hope for countries in the periphery. It is argued that the winners will be among those countries that restructure their political-economic base while rigorously negotiating their terms of entry into the free trade agreement area (Marshall, 1998). Indeed, much of the outcome will be politically determined and cannot be entirely 'read off' from

existing economic structures and relationships. The production sharing practice followed by the multinational companies in the LAC countries as a result of the globalization process also helped in gearing up the export competitiveness. A comparative case study approach has been conducted to explore the inter-organizational dynamics of the Mexican apparel industry's post-NAFTA export dynamism, and it assesses the upgrading prospects that this dynamism entails for exporters in Mexico. The results of fieldwork conducted in three apparel-producing clusters in north, central, and southern Mexico are discussed. The key finding from this commodity chain analysis of linkages between US clients and local producers is that NAFTA-inspired full-package networks provide opportunities for some apparel-manufacturing clusters to upgrade their operations beyond the assembly-export role traditionally associated with Mexico's *maquiladora* plants (Bair, 2002). Evidence of industrial upgrading includes expanded employment opportunities in activities such as textile production, the generation of linkages to local suppliers, and improved working conditions in plants producing for brand-name clients.

Business plays a critical yet poorly understood role in trade policymaking. An analytical framework that focuses on the distribution of business trade preferences, discusses the forces that cause those preferences to change, and the ability of different groups to exert political influence over policy in reference to Mexico in the 1980s and 1990 (Thacker, 2000). Large exporting firms increased their weight due to shifts in the international context, the condition of the domestic economy, and previous government policies. Policymakers granted political access to players whose economic and political leverage had risen, typically those who controlled numerous investment resources and sought out a direct role in policymaking. Many of these players also favored free trade. Business participation in trade policy reflects these patterns. Large, outward-oriented firms played an increasingly important role in Mexico's adoption of free trade policies over the 1980s and early 1990s. Analytical explanations have been developed and tested in reference to the motivations that drove the process of economic integration known as Mercosur (Southern Cone Common Market). The hypotheses tested are those that focus on elite considerations of geo-political, political economic and domestic political factors when deciding to participate in international economic integration (Kaltenthaler and Mora, 2002). The study found that policy elites in Mercosur member states have been primarily driven by domestic political considerations when they have furthered the integration process. This leads to the

conclusion that Mercosur is not likely to develop supranational governance institutions present in the European Union, as policy elites in Mercosur member states desire to maintain a great deal of domestic policy autonomy.

Mercosur member states signed a Protocol for the Defense of Competition in 1996 but congressional approval is pending to make it enforceable. The Protocol provides mechanisms to curb business anti-competitive practices; calls for the convergence of domestic competition laws; and provides an agenda for surveying public policies that limit, restrict, falsify, or distort competition conditions and affect trade among member countries. The Protocol calls upon member countries to undertake preparations to set common standards and mechanisms (Tavares de Araujo, 2003). Argentina's enactment of a new Defense of Competition Law in 1999, which aligns the Argentine competition policy regime with that of Brazil, may help harmonization in this area. Both the Protocol for the Defense of Competition and the mentioned working group could form a basis from which to build regional disciplines on investment incentives. Thus the task of introducing these disciplines should be closely related to the defense of competition, both at the national as well as the regional level, following the experience of the EU.

Trade and Monetary Reforms

The impact of increased global economic integration on national and regional environmental standards has been studied in general by a large number of researchers. However not many studies are available on the institutional reforms in reference to the Latin America. A study reveals the role of market mechanisms in facilitating the dissemination of environmental standards from greener nations to less green ones and the impact of international agreements on trans-border environmental problems (Vogel, 1997). It argues that current regional and international governance mechanisms are adequate to enable nations which have the resources and the commitment to improve environmental quality to do so, either on their own or in cooperation with other nations with similar values and resources. The most common pattern of economic reforms in Latin America has been, first, radical liberalization, and second, implementation of prudential norms that moderated the initial liberalization. The policy changes related to the financial system (namely, the removal of interest-rate controls, elimination of

mandated credit to “priority” sectors, privatization of state banks, liberalization of the foreign investment regime, and more recently, improvements in the regulatory framework) have improved both the banking system and the stock market. The traditional view about fiscal and monetary policies in developing countries (and particularly in LAC) is that they are pro-cyclical, contributing to deepen business cycles (e.g. Djistra, 2000; Mortimore, 1998). It has been argued that governments relax their policies during booms and restrict them during busts, due to weak institutions, unfavorable political-economic equilibrium, and volatile access to international capital markets. The most common pattern of financial reforms in the LAC countries has been towards radical liberalization and implementation of prudential norms that moderated the initial process of liberalization. However, growth has been inadequate in the post-reforms period not because of the failure of reforms to yield the expected growth payoff on the basis of international experience, but because of the combination of an unfavorable external environment with the insufficient depth and breadth of reforms.

The study done by Glick and Moreno (1999) analyzes the role of money, credit, trade and competitiveness variables in signaling currency crises in a sample of East Asian and Latin American countries over the period 1972-1997. The Bivariate tests administered in the study suggest that money and credit, as well as trade and competitiveness variables appear to behave differently around crisis episodes from the periods of tranquility, suggesting that they may help signal currency crises. In multivariate regressions, which allow for the identification of marginal contributions of individual variables, reductions in real domestic credit and in foreign reserves as well as appreciation in the real exchange rate imply increases in the probability of the monetary crisis and lead to the exports decline in the Latin American countries. The study revealed that real exchange rate appreciation appeared to play a greater role in predicting currency crises in East Asia, while foreign reserve losses play a greater role in Latin America due to shrinking exports and low trade competitiveness.

Multiple exchange rates, multiple interest rates, protection of domestic products with licenses, quotas, tariffs in the excess of what would have been necessary for infant industries, and a welter of regulations and bureaucratic obstacles to normal business in general have detrimental effects on economic growth. Mainstream economic theory suggests that economic welfare would be

maximized when distortions are minimized. Accordingly, a removal of distortions of both macroeconomic and microeconomic nature would have beneficial effects on economic activity and the rate of growth (Igor 2000). For the early reformers, among them Bolivia, Chile, Costa Rica, and Mexico, the expansion of international trade as a share of GDP, occurred mostly in the 1986-89 period. In the 1990s, the Argentina, Brazil, Paraguay, and Uruguay constituents of Mercosur experienced very high growth rates of the volume of trade. While the respective trade shares of Colombia, Mexico, and Peru increased rapidly (certainly as a result of the liberalization process), the improvement was not as large in the oil-exporting economies of Ecuador and Venezuela despite a liberalization program similar to that of the former countries (especially Colombia). However, the tariff and quantitative restrictions often impede the process of trade liberalization. The higher is the average level of dispersion of tariffs and para-tariffs in terms of custom duties and taxes; more is the distortion of international trade. The measure applied to evaluate the level of tariffs and para-tariffs is the weighted average rate of tariff and para-tariff charges that is used to weigh their respective shares in regional or global imports (Pritchett, 1996). However, international exchange-rate regimes became less persistent than hard pegs and floats in LAC after the Asian crisis. The choice of exchange-rate regimes and their transitions do matter for inflation and growth (Rajagopal, 2005).

Kamin (1998) describes research comparing the response of inflation to changes in exchange rate competitiveness in various regions of the world with evidence that an empirical relationship between the rate of inflation and the level of the real exchange rate, which was documented for Mexico in previous research contributions, holds for a large set of other countries as well. He argues that such results may pose a dilemma for policy-makers, since it implies that it may not be possible to achieve low inflation and high export competitiveness simultaneously. However, the study demonstrates that the responsiveness of inflation to the real exchange rate has been much higher in Latin America and has distorted the growth of foreign trade despite institutional reforms that were introduced in early 90's by the LAC countries. New empirical work by Hertel and Martin (1999) has shown that a standard tariff cut of 40 per cent in the next round of multilateral trade negotiations would relatively benefit developing more than developed economies. Possible welfare gains would amount to a maximum in the region of 1.5 to 2.0 per cent of total Income for some Asian economies contrasted to 0.1 to 0.2 per cent for most developed economics. Brazil's

income would increase by 0.5 per cent and the rest of Latin America's by 0.2 to 0.3 per cent. This difference between developing and developed countries reflects the fact that tariffs on industrial products in developed economies are much lower than those in developing economies.

Trade Liberalization and Productivity

After decades of weak growth in Latin American countries, the manufacturing sector exports have shown optimistic results in recent years following the international trade agreements. The previous research studies find that the competitive base for export performance in the Latin America and Caribbean (LAC) countries is very narrow and is dominated largely by non-manufactured products like raw materials. However, the countries in the LAC region possess strength in low-end manufacturing and exporting, whereas it is vulnerable to competitive entry and technological change. These processes have meant increasing competition for firms in national and international markets. The LAC countries are urged to increase competitiveness in order to increase employment, production and growth under a context of globalization. The region has been highlighted as an important player in both, as an important source of competitiveness for localized firms and in the reallocation of economic activity. Agglomeration economies and innovations are considered the most important forces in agglomeration leading to increasing competitiveness and to improving living conditions for people living in such regions (Jorge Vera, 2001). The relationship between trade liberalization and manufacturing labor productivity growth for 27 industries in seven Latin American countries from 1970 to 1998 has been studied with the variables export and import growth and a commercial reform index (Paus *et.al.*, 2003). The analysis of the study captures the various channels through which productivity and trade liberalization have been related. The study finds a significant positive correlation between all the three variables and productivity growth.

The factors, which determine the long-run real exchange rate in Argentina, Colombia and Mexico, may be distinguished as real and nominal determinants. Co-integration analysis is utilized to establish that the real exchange rate has an equilibrium relationship with real variables (the terms of trade, capital flows, productivity, and government share of GDP) which excludes nominal variables (nominal exchange rate, money) and central bank intervention. Variance

decompositions reveal that among the real variables that determine the real exchange rate, the terms of trade and productivity explain much of the variation in the real exchange rates. The impulse response functions are broadly consistent with theoretical predictions and shocks to the nominal variables have only transitory effects on the real exchange rate (Joyce and Kamas, 2003). The structural reforms have been initiated in the macro areas including economic activity, international trade, financial markets, generation and use of public resources, governance, and labor markets. Trade leads to specialization, contributes to the total factor productivity (TFP), and offers comparative advantages for the other countries. It also expands potential markets that allow the domestic companies to take advantage of economies of scale and to diffuse technology, innovation and managerial practices through close alliances with the foreign firms (Igor 2000, Rajagopal 2004).

The export competitiveness of a country is also significantly driven by the resources availability in the country and harnessing them. These resources may broadly be classified as natural, monetary, R&D, production and market infrastructure and human resources. The relationship between export competitiveness and investment in machinery, allowing for imperfect substitution between domestically produced and imported machinery has been analyzed in reference to the developing countries by Mody and Yilmaz (2002). A translog export price function is estimated for developed, export-oriented developing, and import-substituting developing countries in a panel data setting. Between 1967 and 1990, imported machinery helped lower export prices for export-oriented developing countries. The study revealed that innovative effort based on imported technologies can be a precursor to the development of domestic innovation capabilities, which may ultimately become the main nexus of a country's innovation efforts to boost the export competitiveness. Changes in comparative advantage should reflect changes in factor endowment, but increasingly, changes in trade policies also affect a region's trade performance. Based on the arguments in Balassa's stages of comparative advantage thesis, this study looks at the performance of manufacture exports in a number of Asian and Latin American economies over the period 1981-1997 and examines the revealed comparative advantage indices between economies in East Asia, Southeast Asia and Latin America. Although the Revealed Comparative Advantages (RCA) measurement may not distinguish between the factor endowments effects from the trade policy effect, we argue that RCA measures provide indication on the movement in

a region's comparative advantage. The evidence strongly suggests that despite the strong export performance experienced by East Asian economies, they are losing their comparative advantage to the lower-tier economies in Southeast Asia and Latin America. Changes in comparative advantage should reflect changes in factor endowment, but increasingly, changes in trade policies also affect a region's trade performance. Based on the arguments in Balassa's stages of comparative advantage thesis, this study looks at the performance of manufacture exports in a number of Asian and Latin American economies over the period 1981-1997 and examines the revealed comparative advantage indices between economies in East Asia, Southeast Asia and Latin America. Although the RCA measurement may not distinguish between the factor endowment effects from the trade policy effect, we argue that RCA measures provide indication on the movement in a region's comparative advantage (Bender and Li, 2002). The evidence strongly suggests that despite the strong export performance experienced by East Asian economies, they are losing their comparative advantage to the lower-tier economies in Southeast Asia and Latin America.

Investment on Trade

The inflow of market-seeking investments is largely determined by the size, growth rate and perspectives of the host market. Natural resources and labor force are relevant in resource-seeking, export-oriented investments. However, multinational corporations (MNCs) seem to be increasingly involved in so-called 'strategic-asset' seeking investments, in which the relevant location based advantages are related to the physical, communications and technological infrastructure, the skills of the labor force, and so on. Economic and political stability and a sound regulatory framework seem to be necessary but not sufficient preconditions to guarantee a steady flow of FDI when the above mentioned location based advantages are lacking (UNCTAD, 1992; Jun and Singh, 1996).

In a 'Cournot duopoly' model of international competition between a domestic and foreign firm, it is shown that when the foreign firm has incomplete information about the marginal cost of the domestic firm then the domestic government can use an export subsidy to signal the competitiveness of its firm. This signaling effect strengthens the usual profit-shifting argument

for an export subsidy. The optimal export subsidy in the signaling equilibrium may be twice as large as the optimal profit-sharing export subsidy under complete information (Collie and Hviid, 1993). The subsidies on physical and financial resources including the fiscal incentives attract the foreign direct investments (FDI), which help in augmenting the export competitiveness of specialized goods and services in the region. The findings of one of the studies conducted on the impact of subsidies in FDI and export competitiveness reveal that linkages between the foreign and domestic sectors need to be improved if FDI is to be a vehicle for improving the competitiveness of domestic firms (Zheng *et. al.*, 2004). The openness-growth connection is still an open question in the empirical literature. Although some studies have found that openness has a positive impact on economic performance, others have seriously questioned the significance of this result. One of the studies on Latin American trade issues emphasizes that openness involves more than just trade liberalization (Cuados *et.al.*, 2004).

The increasing importance of international capital flows and especially foreign direct investment (FDI) seems to be another relevant component of outward oriented policies. Based on the quarterly data from the late seventies to 2000, the study investigates the effects of liberalization in Mexico, Brazil and Argentina by taking into account trade and FDI growth links. The results suggest that it is important to consider both exports and FDI to ascertain the benefits associated to the outward oriented strategies followed by these countries. New growth-trade theories have emphasized the contribution of international trade to economic growth through its effect on capital accumulation. A study with this focus tests the hypothesis that export oriented sectors attain higher rates of investment using panel data techniques and sectoral data from the Mexican manufacturing industry between 1970 and 1990 (Isan, 1998). Despite the substantial variations in export shares across sectors and over time, the study can find no evidence supportive of the hypothesis that exports lead to capital accumulation. There is evidence that common determinants, such as the real exchange rate, may be behind the correlations between exports and investment rates found in cross-country studies. It has been observed in the previous studies that the economies that have advocated for open international trade gained higher rates of growth influenced by the higher rate of investment and factor productivity (Edwards, 1992, Harrison 1996).

A study focused on the relationship between entrepreneurship and successful export marketing performance revealed after testing the hypothesis that entrepreneurship is positively related to such performance (Haar and Buonafina, 2002). The research reveals that entrepreneurial behavior is positively correlated with export marketing behavior, suggesting government actions to boost competitiveness. Contemporary trends in the organization of multinational enterprises (MNEs), developments in regional economic integration, and evidence pertaining to the globalization of innovative activities are suggestive of the need to revisit the question of the contribution of overseas MNE affiliates to the technological capacity of developing countries. The study examining the contribution of European Union (EU) MNEs to the development of technological capacity in Mexico, drawing upon small-scale survey and case study evidence, reaffirms that the main contribution of EU MNEs is that of the long-standing one of MNEs in enhancing aspects of technological know-how in developing countries (Laura and Phelps, 2003). Yet the export orientation and status of EU MNE affiliates in Mexico appears to have been enhanced with regional economic integration and the anecdotal evidence from company case studies hints at possibilities for the future generations of technological know-how.

This study applies an economic approach to empirically investigate differences in inward foreign direct investment (FDI) patterns between East Asia and Latin America and discusses the implication of regional trade arrangements. International production/distribution networks in East Asia effectively utilize the new economic logic of fragmentation, agglomeration, and optimal internalization and seem to greatly contribute to economic development. The study examines statistical data for international trade as well as the activities of Japanese and U.S. multinational enterprises (MNEs) and argues that international production/distribution networks, particularly in machinery industries, are extensively developed in East Asia while remaining immature in Latin America. The impact of regional trade arrangements is substantially different depending on whether international production/distribution networks have already been developed or not. Our findings suggest that the impact of FTAA on FDI in Latin America by East Asian MNEs could be either positive or negative, depending on the content of FTAA and accompanying policies. If differentials between intra-regional tariffs and most favored nations based tariffs are kept large, import-substituting FDI from East Asia may stagnate or even decrease. With a proper policy package to nurture international production/distribution networks, on the other hand, FDI from

East Asia could be accelerated and contributed to deeper integration of Latin America (Kimura and Ando, 2005).

The private investment in developing countries is stimulated by real GDP growth, increases in government investment, improvements in financial intermediation, reductions in credit to the government, and declines in world interest rates. An interesting result of an empirical study relates to the important role played by educational development in stimulating private investment (Ghura and Goodwin, 2000). One of the studies suggests two possible outcomes regarding policy competition for FDI. The first is based on a 'positive-sum game', according to which competition produces net benefits for Investors and host economics alike. The reasoning is that governments know the high priority investors attach to the fundamentals' and thus seek to improve domestic supplies of human capital and Infrastructure as well as to ensure political and macro-economic stability. A corollary to this hypothesis is that intensified competition to attract FDI leads governments to 'do a better job on the fundamentals. Hence, in addition to inducing governments to take actions that enhance growth and Productivity levels (even in the absence of additional FDI), those actions are likely to increase the global supply of FDI (Oman, 1999).

Most competition to attract investments occurs within regions, not between them. Thus, any international cooperation among governments to help limit the potential damage caused by competition to attract FDI would probably be best envisaged at the regional level rather than the global level. Nonetheless, this being true for most projects, globalization allows increased mobility of investments; high-tech activities are mostly footloose, as illustrated by the case of the Intel investment in Costa Rica, for which the original 'short-list' included 13 Asian and Latin American countries (Spar, 1998). Mercosur has been remarkably successful at increasing intra-regional trade and attracting FDI. The participation of Mercosur member countries in world FDI inflows increased from 1.4 per cent in 1984-89 to 5.9 per cent in 1997-99. Interest in attracting investment flows has engendered competition mostly at regional or sectoral levels. Controversial cases like the automobile industry have led to arguments in favor of disciplines on incentives. Studies about the Impact of FDI on Argentina and Brazil have raised issues which call for more activists FDI related policies (Chudnovsky and Lopez, 1997, 1998, 2001; Laplane and Sarti, 1997, and Laplane et al., 2001). Specifically, MNCs tend to have huge deficits in their trade

relations with developed countries. The contribution of FDI to the growing merchandise trade deficit in both Argentina and Brazil has thus become a critical Issue. While this situation may change In the future, so far only those MNCs engaged in resource-based investments are clearly net exporters. Second, technological spillovers seem to be minimal. MNCs do not devote significant resources to R&D activities, and have seldom created technological networks with suppliers, customers, competitors or research Institutions.

Nevertheless, statistically significant adverse effects of external debt on private investment found by other studies could not be confirmed by this study. In addition, the results for the full sample of countries are by no means common across the regions. While real GDP growth stimulated private investment in Asia and Latin America, its effect was not significant in Sub-Saharan Africa (SSA). Also, while government investment stimulated private investment in SSA, it had the opposite effect in Asia and Latin America. In addition, private investment was stimulated by increases in private sector credit in Asia and SSA, but not in Latin America. Also, increases in credit to the government had significant adverse effects on private investment in SSA and Latin America. The political economic consensus in Latin America has played significant role in crafting the trade and economy of the region. The splintering of the Mercosur following the Brazilian devaluation in early 1999 has given way to an important re-crafting of the regional vision and a significant expansion of the scope of the regional project. These trends can best be understood as coalescing into a new (and nascent) form of regionalist governance in the countries of the region, in which the Mercosur is reconfigured as a vehicle for a new set of developmentalist and strategic objectives (Phillips, 2001). This emerging form of regionalist governance is both causative and indicative of a new political economy both of the sub-region and of the wider region of the Americas, and reflective of the crystallization of a new political economy of development.

In Argentina, a sort of 'rules-based' competition prevailed during 1991-2001, based on strict legal protection of property rights, predictability, and the adoption of market and investor friendly policies. Incentives based competition only surfaced in an automobile regime established in 1991, which included investment incentives and production resources for local producer and a mining regime adopted in 1993, including a 30-year guarantee of no tax increase for investors.

Privatizations also had some specific features geared to attract foreign investors. FDI showed a strong response to these incentives, but was also attracted by macroeconomic stability and the growth of the domestic and regional market. Sub-national policy competition for investments remained relatively insignificant during the early 1990s. This situation changed by 1996-97, when the 'fiscal war' among the Brazilian states began to raise concerns that the lack of regulations was counter-productive. Buenos Aires, the most affluent Argentine province, announced a reduction in some provincial taxes for new investments in response to Brazilian incentives (De la Guardia, 1997). Though the limited fiscal attributions of the Argentine provinces kept sub-national 'fiscal wars' under relatively low ceilings, there is significant anecdotal evidence showing an increase in the use of investment incentives in the late 1990s. This may be evidenced from the offer that Volkswagen was to make within Mercosur, the best bid for an investment (Chudonvsky and Lopez, 2001). This tendency was reinforced after the Brazilian devaluation in February 1999.

Notes

¹ "Trade intensity" is defined as the quotient of (real) exports plus (real) imports, over (real) GDP

² World Economic Forum : Latin America Agenda, Latin America Business Summit, Rio de Janeiro, Brazil, 20-22 November 2002

Chapter 3

Research Design



The study aims at reviewing the approach to trade policy, economic reforms, role of RTAs and welfare gains in the region in reference to trading blocs in Latin America. The reference period for analysis of spatial and temporal data is 1950-2003. The aspects of trade and growth and problems of Balance of Payments and their relation with macroeconomic policy have also been discussed in the study. Further, this study analyzes economic integration between two economies: one central, with a large local market, and the other peripheral, with a small local market and explore the possibility of building appropriate business partnering models among the Latin American and Asian countries. Each economy has an imperfectly competitive manufacturing sector. It has been observed in the discussion that the trade liberalization creates a strong incentive for the imperfectly competitive industry to concentrate in the central region, near the large market. Additionally, the role of supporting policies to assure the success of trade liberalization is analyzed in the study.

The strategic partnership model has been developed on analyzing the functional gap map in reference to the political, economic, and legal and trade related factors. The analysis concentrates on the evolution of productivity and exports, and it deals with several countries' experiences in the Latin American region. The role of strategic alliances in the trade liberalization and international partnering variables has been analyzed in reference to non-parametric measures and the recent trends towards economic appreciation observed in Latin American countries in the region have been put through the process of appropriate qualitative and quantitative test to support the development of the model.

Sampling and Data Collection

The study is limited to 11 countries of Latin American region selected on the basis of its GDP growth. The principal data sets have been used from the published resources of Economic Commission on Latin America and Caribbean (ECLAC), World Development Reports, World Trade Reports and World Economic Outlook for the reference period 1950-2003. This study will

be based on extensive survey of literature and statistical analysis of the data available from the secondary sources. The data has also been collected for the above reference period on major variables like trade openness, FDI, production portfolios, debt, terms of trade, GNP, foreign reserves, savings, exports share, imports and foreign exchange rates from the published public resources. Data has also been collected from INDSTAT3 released by UNIDO in 2005 which contains statistics about industrial performance of the countries region wise. In the report the data has been arranged according to the international standards industrial classification (ISIC) of all economic activities during 1981-2003.

Theoretical Motivation

The data has been subject to the TFP model discussed in the following sections. The GDP measures constructed by the Nehru and Dareshwar (1993) have been referred in the study to derive calculations for the TFP variables. The data has been analyzed using the dummy variables referring to the period of structural reforms in the region. A similar procedure has been applied by Lefort and Solimano (1994) to measure the economic growth during the recessional period. Similarly, Griliches and Lichtenberg (1984) made an assumption in a study measuring the long-run effects of technology transfer indicators on TFP growth.

The researchers' advocate of endogenous growth theory that claims that physical capital growth alone cannot explain per capita output growth and that the neoclassical model fails to capture a number of crucial variables that explain economic growth. Their main contributions consist of including not only human capital (Romer, 1986, 1990, 1994; Barro, 1991; Lucas, 1988), but also international trade in goods (Eaton and Kortum, 1995, 1996; Rivera Batiz and Romer, 1991a, 1991b; Pissarides, 1997; Grossman and Helpman, 1991). By incorporating technological change, these models consider the diffusion of technology between countries, and the ability of developing countries to adopt and implement foreign technology.

The decomposition of output growth demonstrates that factor growth generally proves much more important than either the improved quality of factors or total factor productivity growth in explaining output growth. The quality of capital positively and significantly affects output growth

in all groups. The quality of labor has a negative and notable effect on the overall economic growth in Latin America. The economic growth thus, associates with the declining quality deployment factors and vice versa. A growth accounting method for productivity and competitiveness has been determined using an integrated production function. The justification to choose this approach is that during low growth period, which might have been contributed by economic recession and the firms, might have been forced to operate on the suboptimal manner with low levels of capacity utilization can be analyzed accurately. The construct of the model is explained below:

The Cobb-Douglas function determines the relative influences of the factors of production. This model has been further interpreted in reference to the impact of factor dynamics resulted out of the structural reforms measures in LAC region, in terms of change in technology, investment, productivity and international trade. These factors, when considered with specific industrial sectors say, manufacturing industry determining the productivity in terms of income will generate competition index that would reveal the industry competitiveness, upon pooling. The model may be described as:

$$Y_t = \hat{Z}_t [K_t^\alpha L_t^{(1-\alpha)}] \hat{Q}_t^\infty [I_t^\beta R_t^{1+\beta}]$$

where, Y is the generated income out of factor productivity (pooled), \hat{Z} is an index of TFP, K and L are the indicators of capital and labor availability and Q^∞ is the projected output as a function of innovation (I) and change in technology (R). Dividing both sides by the intensity of change in factor “Yield” (y), taking Logs and first differentiating the rates of change per LAC countries, resulting into TFP (\hat{Q}) the equation may be constructed as:

$$\ln \left[\frac{y_t}{y_{t-1}} \right] = \ln \left[\frac{\hat{Z}_t}{\hat{Z}_{t-1}} \right] + \alpha \ln \left[\frac{K_t}{K_{t-1}} \right]$$

It is assumed that the rate of growth of TFP can be expressed as a constant (λ) with a random error (ε). In the process of estimating the change in TFP that is reflected in the competitiveness in the manufacturing industry in LAC region, it is also assumed that (λ) suffers a break during the structural reforms and the process of economic integration. This leads to the following equation for estimation:

$$\ln\left[\frac{y_t}{y_{t-1}}\right] = \lambda + \alpha \ln\left[\frac{K_t}{K_{t-1}}\right] + D_{x(r_1+r_2)} + \varepsilon_t$$

Where D_{xr} is the dummy variable activated in the years of structural reforms and economic integration. This variable has been calculated for recession period of reforms D_{xr1} and during reforms when the productivity contribution went negative D_{xr2} . In all the equations, the demand function is assumed to have constant elasticities. The equation may be constructed as :

$$\ln x_t = \hat{p} \ln(rp)_t + \hat{y} \ln(m)_t + \varepsilon_t$$

Where x denotes the exports from LAC region during the reforms period, rp is relative prices, m is foreign real expenditure on manufactured good, \hat{p} is price elasticity, \hat{y} is income elasticity and ε is the error term in the referred period.

Trade Competitiveness

It is assumed that the rate of growth of TFP can be expressed as a constant (λ) with a random error (ε). In the process of estimating the change in TFP that is reflected in the competitiveness in the international trade in LAC region, it is also assumed that (λ) suffers a break during the structural reforms and the process of economic integration. The trade competitiveness in the study has been analyzed with reference to the variables openness, FDI, Portfolio, debt, Terms of Trade and export. The variability of (λ) may be explained in reference to the equation (ii).

This leads to the following equation for estimation:

$$\ln\left[\frac{y_t}{y_{t-1}}\right] = \lambda + \alpha \ln\left[\frac{K_t}{K_{t-1}}\right] + D_{x(r_1+r_2)} + \varepsilon_t \quad (\text{iii})$$

Where $D_{x(r_1+r_2)}$ is the dummy variable activated in the years of structural reforms and economic integration. This variable has been calculated for recession period of reforms D_{xr1} and during reforms when the productivity contribution went negative D_{xr2} . In all the equations, the demand function is assumed to have constant elasticities. The equation may be constructed as :

$$\ln x_t = \hat{p} \ln(rp)_t + \hat{y} \ln(m)_t + \varepsilon_t \quad (\text{iv})$$

Where x denotes the exports from LAC region during the reforms period, rp is relative prices, m is foreign real expenditure on manufactured good, \hat{p} is price elasticity, \hat{y} is income elasticity and ε is the error term in the referred period.

Interplay of Trade Blocs

It has been established through previous research studies (Riezman, 1999; Iscan, 1998; Phillips, 2001) that trade agreements play significant role in developing a favorable environment for trade and economy among the participating countries. In the model it is assumed that there are ‘N’ trading blocs, where in the countries freely trade with each other (*e.g.* NAFTA, CAFTA, MERCASUR). They could be a part of Free Trade Agreement (FTA), Customs Union (CU) or a simple N trading bloc condition. Assuming that there exist N Trading blocs in the LAC region and each bloc is endowed with a fixed amount of each commodity.

Let B_j^i be the trading bloc i in the region with an endowment of the commodity j , chosen for transaction under the bi-lateral trade agreement.¹⁰ The Cobb-Douglas performances exist in each trading blocs and the utility function, which can be derived out of the preferential trade agreements between the countries of trading bloc, may be described as

$$U^i = \sum_{j=1}^M \alpha_j^i \ln \hat{A}_j^i \quad (\text{V})$$

Where U^i is the utility of the trading bloc i , α_j^i is the weight that trading bloc i put on the commodity j , \hat{A}_j^i is the aggregate consumption of j commodity in trading bloc i and M denotes different commodities that have the trade potential in the trading bloc. The volume of trade V_j^i is described as $V_j^i = \hat{A}_j^i - B_j^i$, of which the positive values indicate imports from the point of view of

¹⁰ If $B_j^i = 0.4$ it means trading bloc i is endowed with 40% of the regions endowment of commodity j .

trade competitiveness whereas the negative values represent exports in the trading bloc. The trading blocs impose a fixed value tariff t which may be defined as *advalorem duty* charged in each trading bloc i on import of j commodity (t_j^i). Under such circumstances, the prevailing international price for j commodity may be described as P_{rj} . Accordingly the domestic price for the j commodity in trading bloc i would be $P_{rj} = (1 + t_j^i)P_{rj}$. Hence the equation may be derived as below:

$$\sum_{j=1}^M P_{rj} (1 + t_j^i) \hat{A}_j^i = Y_{j...n}^i = \sum_{j=1}^M (1 + t_j^i) B_j^i + [(P_{rj})(t_j^i)(V_j^i)] \quad (\text{vi})$$

Where in Y_j^i is the revenue granted in the trading bloc i for the commodity j up to 'n' potential commodities to be brought under trading. The equilibrium of the trade blocs within the given trade conditions, may be derived through the equations (v) and (vi), we get:

$$\sum_{j=1}^M P_{rj} \hat{A}_j^i = \sum_{j=1}^M P_{rj} \hat{B}_j^i = 1 \quad (\text{vii})$$

And, towards the demand and supply, the equilibrium among the trading blocs may be achieved as described in the following equation.

$$\sum_{i=1}^N \hat{A}_j^i = \sum_{i=1}^N \hat{B}_j^i = 1 \quad (\text{viii})$$

At the equilibrium, the trade blocs would have aggregate expenditure equal to aggregate revenue, which may also be desired as endowment vector. Endowment may be explained as the sum of values of unilateral trade and consumption.

The measure of the economic welfare in reference to trade agreement has been computed using calibrated fraction δ which expresses the relationship between the fiscal allocation including taxes and gross revenue and trade equilibrium among the countries under study. Such equilibrium

relationship is largely affected by the tariff regions of the participating countries. The welfare cost is derived using the following equation:-

$$B^t(x_1, x_2, x_3) = B^{ft}[(1-\delta)x_1, (1-\delta)x_2, (1-\delta)x_3] \quad (\text{ix})$$

Where B^t denotes the benefits derived under an equilibrium with positive tariffs and B^{ft} represents benefits derived in the given trade equilibrium emerged out of free trade agreements, common market structure or bilateral trade agreements.

Trade Competitiveness

The principal variables used in the analysis are defined as below:

Gross national product (V)

Imports of goods and services (M)

Consumption of goods and services (C)

Savings (S)

Exports of goods and services (E)

Capital inflow [$F \equiv (M - E)$]

Gross domestic investment (I)

Reserves of foreign assets (R)

Growth rate of GNP (r)

In the analysis imports and exports are measured as net flows of returns on investments. The study postulates that a constant capital-output ratio (k') for directly productive net investment and a constant share (z) of current gross income, oriented to replacement and social overhead investment. Hence, gross investment in a given period may be represented by the equation:

$$I_t = k' \Delta V + zV_t \quad (\text{x})$$

Where, $\Delta V = V_{t+1} - V_t$. Since the traditional incremental capital-output ratio (k_t) is defined as $I_t / \Delta V$ and since the growth rate of the following year (r_{t+1}) is represented as $\Delta V / V_t$, dividing equation (x) by (ΔV) yields an equation for (k_t) as a decreasing function of (r_{t+1}):

$$k_t = k' + \left(\frac{z}{r_{t+1}} \right) \quad (\text{xi})$$

In the above equation (k') is the marginal capital-output ratio that is relevant to increase in the level of investment in a given period. The required imports of a country in a given time may be expressed as:

$$M_t = (M)_{t-1} + \mu \Delta V + \chi \Delta C + \phi \Delta \left(\frac{E}{V} \right) + \pi \Delta \left(\frac{R}{V} \right) \quad (\text{xii})$$

Where, Δ refers to changes between the previous and the current period. In the above equation μ, χ, ϕ, ω and π are the constants indicating propensity to import, additional consumption, additional basic investment, export shares and ratio of reserves respectively in reference to imports during the pre- and post-reforms periods in the selected countries. Either the pair of parameter χ and ϕ or the parameter μ is zero in any given application of the above equation.

The model used for the projections of export growth (2015) has been conceived as largely exogenous. An export sector responsive to the trade situation of the country is assumed for “high performance”. The exogenous growth rate of exports has been derived through the following equation:

$$E_t = E_0 (1 + \varepsilon'')^t \quad (\text{xiii})$$

Where in, (ε'') represents exogenous growth rate of exports (E), E_t denotes the exports of goods and services in the reforms period and E_0 exhibits the historical performance of the exports of the countries in the region. The equation for potential savings (S) is hence derived as:

$$(S)_t = (S)_{t-1} + \alpha\Delta V + \gamma\Delta\left(\frac{E}{V}\right) \quad (\text{xiv})$$

Where, Δ refers to the change between the pre-reforms period ($t-1$) and the reforms period (t). In the equation α represents propensity to save from additional GNP and γ denotes the effect of changes in export share on savings.

Revealed Comparative Advantages

The analysis of the data has been carried out on the aggregate by computing four trade performance indices for the East Asia and Latin America regions instead of looking at individual trade policies adopted by individual countries. The two indices used to measure the structural change in the study are the Lawrence Index and the Beneficial Index. The Lawrence Index gives an index value that ranges from 0 to 1, and the index indicates a complete upheaval if it is close to unity, otherwise indicates little change if it is close to 0. This index has been computed using the following equation:

$$L = \left(\frac{1}{2}\right) \sum_{i=1}^n |S_{ij} - S_{i,t-1}| \quad (\text{xv})$$

$$\text{Wherein, } S_{i,t} = \left[\frac{X_{i,t}}{\sum_i X_{i,t}} \right] \quad (\text{xvi})$$

In the above equation $S_{i,t}$ denotes the share of industrial sector i 's export in the total exports of the country in a year t (Sapir, 1996).

The Beneficial Index is used to measure whether a given structural change in export pattern is oriented to the most dynamic products demanded by the world. The beneficial structure change index (BSCI) has been computed using the formula as stated below:

$$\text{BSCI} = \sum_{i=1}^n \left\{ \left[\frac{X_{i,t} / \sum_i X_{i,t}}{X_{i,t-1} / \sum_i X_{i,t-1}} \right] \cdot \left[\frac{(M_{i,t} / M_{i,t-1})}{M_{i,t} / M_{i,t-1}} - 1 \right] \cdot \left(\frac{X_{i,t}}{\sum_i X_{i,t}} \right) \right\} \quad (\text{xvii})$$

A positive value indicates a beneficial orientation, and that the structural change in exports favored the dynamic sectors. The higher the value of this index, the stronger is the beneficial change in export pattern. The other two indices relate to trade specialization (Amable 2000). The Michaely Index is the more traditional index, whose value ranges from 0 to unity with a value closer to 1 indicating a greater degree of trade specialization.

$$\text{This index is defines as: } I = \left(\frac{1}{2} \right) \sum_{i=1}^n \left| \frac{X_i}{\sum_i X_i} - \frac{M_i}{\sum_i M_i} \right|, \quad (\text{xviii})$$

Where X_i and M_i are respectively, exports and imports of sector “i” in a given year (Amable, 2000).

The Trade Specialization Index gives an improved version of the Michaely Index. In this case, the degree of specialization in each sector is weighted by its relative importance in the country's total trade. This index also ranges between zero and one, and the value of one implies a complete specialization in trade.

For the given sector I, its degree of specialization is unambiguously given by the following ratio:

$$\frac{|X_i - M_i|}{X_i + M_i}.$$

The value of 1 for this ratio indicates a complete specialization (to export or to import). Therefore, the aggregate measure of trade specialization can be obtained first by weighting all the individual sectors' measures and then summing over all sectors. So, the trade specialization index (TSI) is defined as (for details, see Bender, 2001).

$$\text{TSI} = \sum_{i=1}^n \left\{ \left(\frac{(X_i + M_i)}{\sum_i (X_i + M_i)} \right) \frac{|X_i - M_i|}{(X_i + M_i)} \right\} = \sum_{i=1}^n \left\{ \frac{|X_i - M_i|}{\sum_i (X_i + M_i)} \right\}, \quad (\text{xix})$$

Where the weights are =
$$\frac{(X_i + M_i)}{\sum_i (X_i + M_i)}$$

Both the Michaely Index and Trade Specialization Index are inversely related to conventional Grubel-Lloyd (GL) intra-industry trade index (Bender and Li, 2002). The industry variable “i” is defined in the GL index as below:

Defined for industry “i” as
$$GL_i = \left\{ 1 - \left[\frac{|X_i - M_i|}{(X_i + M_i)} \right] \right\} \quad (xx)$$

The GL indices for different periods convey some information on the structure of trade in each of these time periods, but it does not allow conclusions on the structure of the *change* in trade flows (Brulhart and Hine, 1999). A generalized rise or fall of average GL indices in one or several countries may be due to *multilateral dimensions*, because it suggests trends towards more intra- or more inter-industry trade and specialization and it may thus indicate the importance of *aggregate* adjustment costs.

Hypotheses

The economic reforms in a country is a complex and multi-dimensional process that involves the development and implementation of many public policies at intermediate levels during the reforms. The economic reforms thus will not have a constant speed and will often be subject to modifications in the policies that bring changes in the performance and structure of economic activities. The economic reforms can be assessed by examining their corresponding policy measures and implications. However, entire economic progress may not be interpreted as an outcome of the reforms. The growth and development may result to be slower in a country or region in a normal process than stirred process of reforms. After years of poor economic management, many Latin American and Caribbean countries are experiencing a process of structural reforms that places them on a path to a superior economic performance (Easterly 1993). Hence, it may be hypothesized that:

H1: Trade reforms process has proceeded at a faster pace, tariff barriers have been reduced significantly and there has been a significant transition in the international relations and business partnering of Latin American countries with rest of the world during 90's.

After the Uruguay Round, all signatories have agreed to incorporate antidumping laws into their trade policy. Both the Uruguay Round and the North American Free Trade Agreement (NAFTA) abolished or reduced tariffs and quotas, which have traditionally been the protectionist tools of choice. Now that these tools have been scaled back, antidumping laws have risen in importance, and are likely to become the most powerful and most often utilized tools of protectionism as domestic producers in more countries feel the pressure of international competition (McGee, 1998). It is shown that in the last few years the Latin American countries have gone from having one of the most distorted external sectors, to having very low degrees of protectionism (Edwards, 1993). Hence it has been hypothesized as:

H2: The trade liberalization policies of the Latin American countries have substantially put off the protectionist policies and opened avenues for foreign direct investment and joint ventures in the public and private sector industries.

The free trade areas for Americas (FTAA) on FDI in Latin America by East Asian multinational enterprises could be either positive or negative, depending on the content of FTAA and accompanying policies. If differentials between intra-regional tariffs and most favored nations based tariffs are kept large, import-substituting FDI from East Asia may stagnate or even decrease. With a proper policy package to nurture international production/distribution networks, on the other hand, FDI from East Asia could be accelerated and contributed to deeper integration of Latin America (Kimura and Ando, 2005). The new economic model in Latin America radically altered foreign direct investment inflows to the region. Previously restrictive national policies became ones that facilitated FDI in the context of new business opportunities. Transnational corporations (TNCs) took a new look at the region in the context of their evolving corporate strategies, examples being efficiency-seeking corporate strategies in the automotive (Mexico) and the apparel industry (Caribbean Basin) and the market access strategy for services in the telecommunications and electrical energy industries (Brazil). Two interrelated problems

were observed in the process - (a) the objectives of TNCs were often attained but those linked to national development goals often were not, and (b) national policies did not channel FDI to priority development activities (Mortimore, 2000). Hence it has been hypothesized as:

H3: The interplay between economic freedom, Foreign Direct Investment (FDI) and growth has shown positive impact on the overall trade and economy status in the Latin American countries.

H4: The foreign direct investment policies and strategic alliances of the host countries significantly affect the trade movements in establishing the business relations with Asian counterparts.

In the past decade enormous change has taken place in trade policies in Latin America: within a few years, most of the region's economies have changed from restrictive to open policies. But unlike trade liberalization in Europe, most trade barriers in Latin America have been reduced unilaterally. Recently bilateral or multilateral agreements have been considered, especially preferential trade agreements within the region. Michaely evaluates the relevance and desirability of multilateral free trade agreements (such as NAFTA) for the Latin American continent and the Caribbean, with an emphasis on how they affect trade flows. Is a preferential trade agreement among some Latin American countries more or less likely to be meaningful than others in reference to their intensity of impact, or benefits, or both (Michaely, 1999)? The evidence strongly suggests little likelihood that these agreements will succeed in Latin America. Paradoxically, the intense liberalization in recent years has made it less likely that such agreements would be beneficial except possibly for agreements between some countries and Brazil, Mexico, or Argentina. When the level of tariffs and non-tariff barriers is already low, a preferential agreement is more likely to have an adverse impact than a beneficial one (although in any case only a slight impact). The hypotheses hence, may be framed as:

H5: The regional trade agreements have not been effective due to economic policies of the member countries of Latin American region and the results were not found encouraging towards international trade and partnering.

Some studies discuss that the Latin American economies are predominantly private with functioning financial systems, substantial purchasing power and widespread understanding of how markets work (Shirley, 1994). Nevertheless, transitional and Latin American privatizers share similar problems: poor performing state firms, varied commitment to privatization, technical difficulties and adverse macroeconomic conditions. Five lessons from Latin America are particularly relevant for transitional economies: (a) privatization can help foster competition; (b) governments can build competent institutions for privatization despite weak capacity; (c) labor can benefit without majority control; (d) transparency and share distributions help win public support; and (e) selling profitable, efficient firms can benefit the economy.

On the contrary research studies have also attempted to establish that the privatization policy faces increasing popular opposition in Latin America. A study uses the results of *Latinobarometro* (2002), a survey of a representative sample of 18522 individuals in 17 countries as our dependent variable of perception, and a privatization dataset on the same countries, including sectoral disaggregation of divestitures, time profiles, proceeds, and other variables for each country (Carrera, Checchi and Florio, 2005) . The main findings of the study reveal that disagreement with privatization is more likely when the respondent is poor, privatization was large and quick, involved a high proportion of public services as water and electricity, the country suffered adverse macroeconomic shocks, and there is high inequality of incomes. It has been observed that more the respondent is educated, the more adverse to privatization he or she is. The research suggests that these results depict a broadly consistent picture of privatization discontent that points to distributional issues, probably because of tariff rebalancing not adequately addressed by policy makers and regulators, as suggested by earlier empirical studies.

However, there are studies that indicate liberalization policies in the post-reforms period of economic growth in the Latin America have induced privatization. The dynamic efficiency effects from trade liberalization do not come automatically. Hence, the hypothesis has been framed as:

H6: Privatization policy of the Latin American countries would offer favorable internationalization platform for developing effective business partnerships with the rest of the world.

The openness-growth connection is still an open question in the empirical literature. Although some studies have found that openness has a positive impact on economic performance, others have seriously questioned the significance of this result. The main point that we try to emphasize in this study is that openness involves more than just trade liberalization. The increasing importance of international capital flows and especially foreign direct investment seems to be another relevant component of outward oriented policies. Therefore, by using quarterly data from the late seventies to 2000, we investigate the effects of liberalization in Mexico, Brazil and Argentina by taking into account trade and FDI growth links (Cuadros *et.al*, 2004). The results of the study suggest that it is important to consider both exports and FDI to ascertain the benefits associated to the outward oriented strategies followed by these countries.

Chapter 4



Results and Discussion

At the beginning of the 1980s, the private sector in Latin America faced a very uncomfortable economic environment. Inflation was high; there were sharp currency fluctuations which, in turn, led to acute price volatility; investment was low and import substitution prompted low production, state interventionism, large foreign debt and severe balance of payment deficits. The whole region suffered a strong macroeconomic state of imbalance, which required strong remedies. The subsequent stabilization and structural adjustment programs aimed to reduce fiscal deficits, open up economies, privatize state enterprises, reduce foreign debt, introduce flexible exchange rates and modernize the financial system.

The decomposition results for the pre- and post-reforms period in the selected countries of the LAC region show that Brazil, Mexico and Uruguay had shown slower growth rate of GDP during the period of reforms.

Table 4.1: Growth Decomposition in Periods of Reforms and No-Reforms of the Economy in Latin American Countries, 1950-2003

(In percent)

Country/ Status	GPD growth		Productivity		Contribution of Productivity in GDP	
	Pre- Reforms	Reforms	Pre-Reforms	Reforms	Pre- Reforms	Reforms
Argentina	1.6	4.7	-0.5	4.1	-31.25	87.23
Brazil	5.2	2.5	0.9	0.2	17.31	8.00
Chile	2.3	5.2	-0.3	2.3	-13.04	44.23
Colombia	4.7	4.7	0.9	1.8	19.15	38.30
Costa Rica	4.3	5.9	-0.1	0.8	-2.33	13.56
Ecuador	1.8	5.5	-0.9	1.6	-50.00	29.09
Mexico	5.7	1.4	1.1	-1.9	19.30	-135.71
Paraguay	4.9	3.5	-0.4	-0.2	-8.16	-5.71
Peru	1.6	5.3	-1.2	2.9	-75.00	54.72
Uruguay	1.6	3.1	0.7	2.1	43.75	67.74
Venezuela	2.3	5.2	-1.2	1.9	-52.17	36.54

Source: Based on the data computation done by the author.

The data presented in the Table 4.1 shows that these countries experienced average rate of output growth to the extent of 4 percent as compared to the 2.8 percent of the pre-reforms period. The contribution of productivity as a fraction of GDP growth has a steep decline in Mexico, and a slow rate of decline in Paraguay during the post-reforms period. Out of the countries selected for the study the contributions of productivity in Brazil and Mexico went down when corresponding economies were reformed. During the pre-reforms period 7 out of 11 countries had showed negative contributions of TFP to output growth, while such trend was found only in the Paraguay and Mexico during the stage of economic reforms.

The long-run effect of reforms would prevail if sustained during the process and may be influenced by the sum of the contemporaneous and the delayed impacts. If the latter is negative, some of the achievements of growth would be lost in the future. If positive, additional growth would occur effortlessly. The results including lagged reforms variables in the basic equation are reported in the coefficients that hold negative signs as compared to those of the corresponding contemporaneous variables. However, the lagged coefficients are quite small in absolute value, leaving substantial positive long-run effects for each of the reforms variables. None of the delayed effects has a clear statistical significance individually, but they have strong significance jointly. This dynamic specification marginally improves upon the static one according to standard statistical measures, as well as with regards to the qualitative features of the results. As measured by the adjusted R-square, the fit of this dynamic specification is slightly better than that of its static counterpart. Moreover, in the dynamic specification, education is statistically significant. The evidence thus suggests the presence of a minor partial offset to the beneficial growth effect of stabilization during the post -reforms years.

The coefficients of the constants and the dummy variables D_{xr1} and D_{xr2} derived from the ordinary least squares for each country and the average of rate of growth for total factor productivity during the periods of reforms have been exhibited in Table 4.2. The regression results show that there is upward growth in the total factor productivity for the six countries with and without the introduction of dummy variables. However, the economic reforms had a positive effect on the rate of growth of TFP that also reflected through the policy of trade liberalization in the Latin American countries.

Table 4.2: Total Factor Productivity Growth: Average in 1950-2003 and Change during Periods of Reforms, OLS Regressions (Percent)

Recession Dummy	None		D_{xr1}		D_{xr2}	
	1950-2003	δ_x	1950-2003	δ_x	1950-2003	δ_x
Argentina	-1.9 (0.161)	6.7 (0.008)	2.5 (0.001)	3.9 (.005)	2.8 (0.001)	4.0 (0.005)
Brazil	-1.3 (0.245)	1.9 (0.392)	0.4 (0.651)	1.4 (0.350)	2.0 (0.010)	0.7 (0.614)
Chile	-1.3 (0.229)	2.9 (0.047)	2.9 (0.059)	1.8 (0.079)	3.4 (0.483)	0.6 (0.927)
Colombia	0.7 (0.465)	0.4 (0.503)	0.8 (0.485)	0.4 (0.593)	2.3 (0.000)	-0.5 (0.271)
Costa Rica	-1.7 (0.201)	1.3 (0.469)	0.3 (0.786)	1.6 (0.174)	0.8 (0.316)	0.9 (0.217)
Ecuador	-1.2 (.570)	3.1 (0.159)	1.3 (0.469)	0.7 (0.740)	1.5 (0.449)	2.9 (0.227)
México	-3.7 (0.004)	1.1 (0.372)	-0.7 (0.415)	1.4 (0.556)	1.2 (0.569)	4.2 (0.899)
Paraguay	-1.3 (0.099)	0.4 (0.784)	0.2 (0.990)	-0.7 (0.536)	1.5 (0.020)	1.1 (0.248)
Peru	-1.9 (0.132)	2.9 (0.16)	0.8 (0.327)	2.6 (0.152)	2.5 (0.224)	0.8 (0.947)
Uruguay	1.4 (0.223)	1.4 (0.537)	2.8 (0.000)	0.4 (0.785)	3.3 (0.000)	-0.2 (0.822)
Venezuela	-1.2 (0.18)	3.3 (0.072)	0.4 (0.458)	2.8 (0.395)	3.6 (0.022)	1.0 (0.440)

δ_x = change during the reforms period

Source: Based on the data computation done by the author.

p values are presented in parentheses, D_{xr1} is activated when the GDP growth is negative while D_{xr2} is activated when the growth rate of TFP is negative.

Assuming low variation in the regional economic growth and taking the estimates at their face values, the income effect is immediate, the short term effect from relative prices is lagged, and the estimated short run price elasticity (-)0.3 is lower in absolute value than the long run elasticity (-)1.3. These results are common in the analysis of time-series data of foreign trade. The estimated long run coefficient of foreign imports is found to be 0.8 that implies a trend of increasing market share for Latin American countries on the basis of the pooled data at constant relative prices. Intra-regional trade is relatively small in general terms and it is negligible for Costa Rica. Mexico has traditionally absorbed only a tiny fraction of Central America's exports. In sum, regional trade flows are not very big - on an average, no more than 18% of the region's exports have gone to the region itself and Mexico. On an average 40% of all imports come from the USA.

Table 4.3: Industry Competitiveness in the Latin American Countries (1970-2000)

Country	Regression Analysis ^a					
	Openness	FDI	Portfolio	Debt	Terms of Trade	Exports
Argentina	0.72988**	0.61124**	0.54371**	0.84319**	0.30104**	0.44134
Brazil	0.30145	0.79216**	0.61112	0.82243	0.12769	0.37621**
Chile	0.53661	0.20073	0.59721	0.88301	0.44166**	0.39823
Colombia	0.19972**	0.14217	0.39012	0.69931**	0.37164	0.47159
Costa Rica	0.55374	0.49214	0.39822**	0.47644	0.79331**	0.61842**
Ecuador	0.11498	-0.11767	0.17632	0.53319	0.03467	0.15620
México	0.19833	0.57622**	0.89831	0.73012**	0.59217**	0.48542
Paraguay	0.77971	0.39872	0.52761	0.61320	0.27643	0.29811
Peru	0.49321**	-0.0352	0.21984**	0.71097	0.48711**	0.30102
Uruguay	0.59136	-0.0349	-0.0127	0.29371	0.30891**	0.20956
Venezuela	0.0234	0.35612	0.52019	0.76653**	0.46522	0.71131**

a : Dependent variable GDP ** Statistical significance at 5 percent level

Source: Based on the data computation done by the author

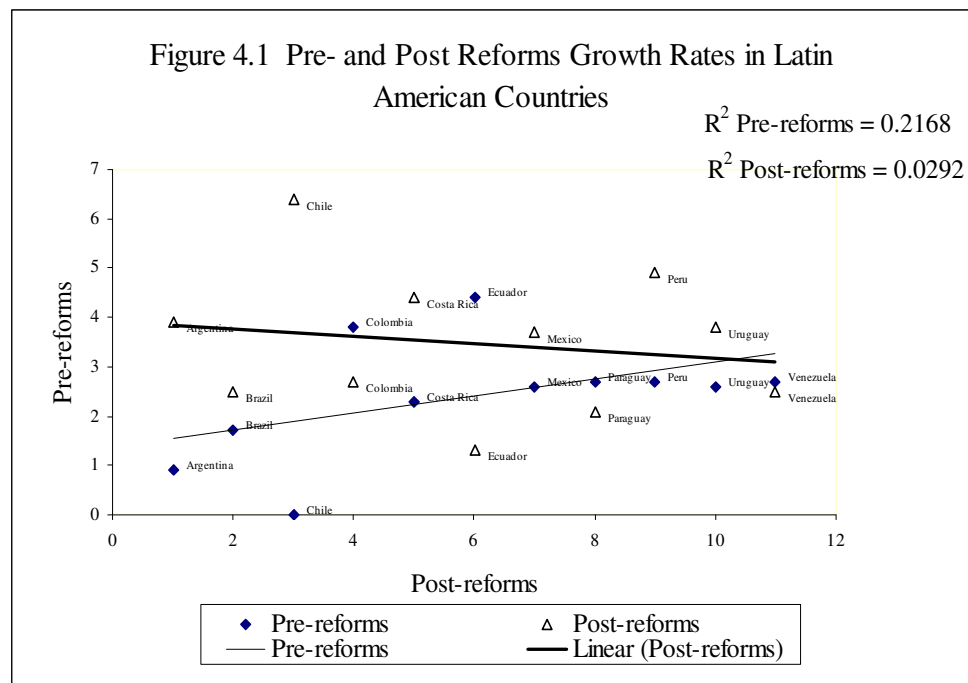
The Table 4.3 shows that the trend of exports in the selected countries is positive but with a slower rate of growth, as compared to the country debt and foreign direct investment (FDI). It may be observed that except 3 countries, others have shown a positive trend in the FDI. Manufacturing in LAC region faces severe competitive stresses as it integrates into the global economy. Though it was the first region in the developing world - in the post-war era to liberalize on international trade and investment flows and had the most advanced industrial base, it failed to fully realize the opportunities offered. The growth of economy in the countries of Latin America during 1950-2003 is exhibited in Table 4.4 in reference to long-run stability and its impact on structural reforms.

Table 4.4: Pre-and Post Reforms Economic Growth in the Latin American Countries
(5 years average basis)

Countries	Pre-reform period			Post-reform period		
	Inflation	Fiscal Surplus	Overall Growth	Inflation	Fiscal Surplus	Overall Growth
Argentina	1376.8	-1.1	0.9	4.7	-0.6	3.9
Brazil	1329.7	-2.1	1.7	9.3	-6.1	2.5
Chile	21.5	0.3	0.0	12.9	1.5	6.4
Colombia	25.6	0.5	3.8	20.8	-1.3	2.7
Costa Rica	17.9	-1.9	2.3	16.2	-2.7	4.4
Ecuador	59.7	1.3	4.4	29.4	-1.5	1.3
Mexico	87.9	-9.6	2.6	20.9	-0.4	3.7
Paraguay	24.9	0.5	2.7	16.9	0.3	2.1
Peru	2454.8	-5.3	2.7	35.7	-0.8	4.9
Uruguay	85.2	-0.9	2.6	34.9	-1.2	3.8
Venezuela	35.7	-1.3	2.7	49.3	-1.1	2.5
Simple Country Average						

Source: For basic data- Economic Commission for Latin America and Caribbean (ECLAC), IMF, 2001
Growth rates are based on the data computation done by the author.

It may be observed from the above Table that In Argentina, Chile, Costa Rica and Peru, the post-reform growth is substantially higher than the one in the five years prior to reform. Also, in Chile in the five pre-reform years there was no growth at all; while in Argentina it was very slow. In



Brazil, Mexico and Uruguay, the post-reform growth is somewhat higher than in the five pre-reform years, while in the cases of Colombia, Ecuador, Paraguay and Venezuela, the post-reform growth is slower than in the five years prior to

reforms. Perhaps even more important than the slowdown in growth was the magnitude of a macroeconomic imbalance and in some cases a virtual economic chaos in the pre-reform period. In many countries inflation rates evolved into hyperinflations during the 1980s, while fiscal deficits continued to burst¹¹. The trend line for the growth of pre- and post-reforms for the Latin American countries has been exhibited in Figure 4.1.

It may be seen from the data presented in the Table 4.4 that in many countries fiscal deficits were uncontrollable during the pre-reform period, which has been severe in Argentina, Brazil and Peru. However, among all, Brazil managed to lower inflation and improve the fiscal situation in the post-reform period and less severe, but still serious was cases of Mexico (both fiscal situation and inflation) and Uruguay (Inflation). The success of the East Asian countries with the export-oriented model of development, as well as the dynamic growth of Chile in the second part of the 1980s, contrasted sharply with the apparent inability of many countries in the region to put their house in order.

¹¹ Results of data analysis exhibited in the Tables 4.1 to 4.4 supports the hypotheses H1, H2, H3 and H4.

Reviewing the impact of the structural reforms in the LAC region it may be stated that manufacturing is no longer the driver of growth in Latin America; a significant concentration has taken place in the industrial sector with a small number of large conglomerates controlling industrial production; small and medium enterprises are experiencing particular difficulty in adjustment; capital-intensive resource-based sectors are growing; and extensive reorganization of work on the shop-floor is taking place. It is also noted that the decline of vertically integrated firms in the region opens up new possibilities for smaller firms as sub-contractors, provided that appropriate infrastructure and markets are operating. The over-emphasis on political instability and ineffective governance issues has led policy makers to overlook key market failures that stand on the way to sustained productivity growth, increasing technological capability and greater competitiveness.

The historical parameters for the pre- and post-reforms period in the selected countries of the LAC region show that the change in growth rate of GNP (r) had been higher during the period of reforms for Mexico, Brazil and Venezuela. The data presented in the Table 4.5 show that the growth rates vary from 2.8 for Argentina to 6.9 for Venezuela. However the study revealed that capital requirements were also highest for Argentina (14.3) followed by Columbia (10.5), Ecuador (7.4) and Mexico (5.7). The capital requirement for Venezuela has been found to be the slowest (0.5). The export growth rate for Peru has emerged as the highest (5.5) while it has been held back for Argentina (3.6). The export growth rate for Mexico during the period of study was found to be above average (4.9). Other studies have also arrived at similar results. Mexico, a prominent liberalizer, failed to attain stellar gross domestic product (GDP) growth in the 1990s, and since 2001 its GDP and exports have stagnated (Tornell, *et.al*, 2004). Brazil, Mexico and Uruguay experienced average rate of output growth to the extent of 4 percent as compared to the 2.8 percent of the pre-reforms period. The contribution of productivity as a fraction of GDP growth has a steep decline in Mexico and a slow rate of decline in Paraguay during the post-reforms period.

Table 4.5: Historical Parameters and Growth Rates during of Reforms and Non-Reforms periods of the Economy in Latin American Countries, 1950-2003

Country	Imports					Exports	Capital Requirement		GNP Growth
Status	ΔV (μ)	ΔC (χ)	ΔI (ϕ)	$\frac{\Delta E}{V}$ (ω)	$\frac{\Delta R}{V}$ (π)	(ε'')	Intercept (k')	(r_{t+1})	(r)
Argentina	0.016	0.025	0.264	228	119	0.036	2.13	0.149	0.028
Brazil	0.054	0.003	0.392	751	26040	0.047	2.19	0.055	0.059
Chile	0.051	0.141	0.412	2299	4423	0.041	2.04	0.041	0.033
Colombia	0.028	0.109	0.556	2196	1753	0.106	2.32	0.105	0.049
Costa Rica	0.035	0.265	0.468	433	77	0.067	2.41	0.066	0.054
Ecuador	0.036	0.054	0.763	489	337	0.074	2.00	0.072	0.039
Mexico	0.310	0.097	0.145	3642	8144	0.049	2.05	0.055	0.061
Paraguay	0.032	0.174	0.339	193	124	0.014	2.96	0.046	0.031
Peru	0.045	0.162	0.597	260	265	0.051	2.29	0.067	0.042
Uruguay	0.040	0.028	0.377	1103	542	0.016	2.58	0.047	0.054
Venezuela	0.250	0.194	0.482	1875	986	0.025	3.24	0.005	0.069

Source: Based on the data computation done by the author.

The relationship between domestic savings (S) assumed to be the function of GNP (V), the inflow of foreign capital (F) and the share of exports in GNP (E/V) have been tested by fitting the regression equation. The Table 4.6 reveals that the impact of additional foreign capital on savings was found to be negative for all the countries in the study except Venezuela but the impact of export share was positive. In reference to the period of study, the inflow of foreign capital has increased for almost all countries covered in the study.

Table 4.6: Economic Competitiveness in the Latin American Countries (1980-2003)

Country	Savings		Export Growth (ε'')	GNP Growth r
	α ($\delta S / \delta V$)	γ ($\delta S / \delta E / V$)		
Argentina	0.354	6624	0.036	0.054
Brazil	0.295	6541	0.047	0.067
Chile	0.247	1120	0.039	0.058
Colombia	0.286	2610	0.106	0.064
Costa Rica	0.255	966	0.057	0.066
Ecuador	0.266	139	0.074	0.057
México	0.284	9442	0.049	0.061
Paraguay	0.245	254	0.009	0.054
Peru	0.237	1233	0.041	0.066
Uruguay	0.311	536	0.019	0.061
Venezuela	0.310	995	0.025	0.077

Source: Based on the data computation done by the author

The trend in export share rose during the post-reforms period (1980-2000) in all the selected countries. However, these results are not conclusive that the trade competition has been the dominant factor for most of the Latin American countries towards augmenting their export share. The long-run effect of reforms would prevail if sustained during the process and may be influenced by the sum of the contemporaneous and the delayed impacts. If the latter is negative, some of the achievements of growth would be lost in the future. If positive, additional growth would occur effortlessly (Rajagopal, 2005).

The Central American countries have shown good growth results during the reforms period, though Chile has shown extraordinary growth during the referred period. Mexico, Argentina and Brazil also show an increasing trend in the economic growth which is largely influenced by the increasing exports share during the reforms period. The countries which experienced decline in the export share include Venezuela, Colombia and Paraguay. The model used for the projections of export growth (2015) has been conceived as largely exogenous. The regression results for the factors of economic growth have been exhibited in Table 4.7.

Table 4.7: Regression results for factors of economic growth in Latin American countries (1950-2003)

Country	Intercept	V^a	R^2	Intercept	V^a	$(E/V)^a$	F^a	R^2	Correlation with Time (1980-2003) ^b	
									(E/V)	F
Argentina	-998.3	-0.30 (4.01)	0.52	-674.1	0.37 (6.99)	5655.2 (2.02)	-0.54 (3.87)	0.72	-0.04 (-0.12)	-0.09 (0.37)
Brazil	274.3	-0.153 (6.43)	0.29	-203.0	0.241 (4.52)	4721.6 (1.63)	0.644 (1.99)	0.66	0.58 (-0.36)	0.61 (0.14)
Chile	35.4	0.241 (3.72)	0.46	-383.3	0.143 (3.58)	2715.3 (2.15)	0.067 (1.33)	0.48	-0.37 (-0.64)	0.43 (-0.27)
Colombia	443.2	0.094 (3.15)	0.36	-471.2	0.127 (3.96)	2652.5 (3.96)	-0.36 (1.84)	0.73	-0.83 (-0.97)	0.11 (-0.19)
Costa Rica	72.3	-0.024 (1.16)	0.12	16.5	0.052 (1.23)	902.4 (1.44)	-0.27 (1.27)	0.25	-0.14 (-0.36)	0.33 (-0.45)
Ecuador	11.9	-0.163 (9.63)	0.92	-34.6	0.172 (8.77)	-439.7 (1.77)	-0.145 (2.65)	0.73	-0.24 (-0.56)	-0.10 (-0.38)
México	164.6	0.146 (5.63)	0.66	-936.3	0.223 (6.33)	7633.7 (2.07)	-0.76 (3.49)	0.92	0.56 (-0.34)	0.55 (-0.21)
Paraguay	12.4	-0.134 (3.95)	0.48	18.6	0.147 (3.64)	-554.7 (2.57)	0.042 (2.66)	0.39	-0.14 (-0.58)	0.42 (0.14)
Peru	5.9	0.231 (6.94)	0.76	-46.3	0.262 (7.54)	1422.9 (1.90)	-0.051 (3.67)	0.63	-0.39 (-0.44)	-0.49 (-0.59)
Uruguay	34.8	-0.124 (2.34)	0.45	-11.7	0.155 (3.22)	-342.7 (3.92)	-0.345 (2.41)	0.42	-0.63 (-0.74)	0.19 (-0.27)
Venezuela	692.4	0.091 (3.26)	0.37	342.4	0.082 (3.74)	126.0 (1.22)	0.162 (1.14)	0.54	0.22 (-0.32)	0.29 (0.13)

Source: Based on the data computation done by the author.

^a Figures in parentheses are standard deviations

^b Figures in parentheses refer to the period 1950-1979

An export sector responsive to the trade situation of the country is assumed as “high performance”. The exogenous growth rate of exports has been derived through the following equation:

$$E_t = E_0(1 + \varepsilon^n)^t \quad (i)$$

Where, (ε^n) represents exogenous growth rate of exports (E), E_t denotes the exports of goods and services in the reforms period and E_0 exhibits the historical performance of the exports of the countries in the region. The results exhibited in Table 4 reveal that all the countries selected in the study show faster growth in exports though the actual growth may be reflected by the trade policies of these countries implemented through various types of agreements *e.g.* free trade agreement, common market or bilateral trade. As measured by the adjusted R^2 , the fit of this dynamic specification is slightly better than that of its static counterpart. Moreover, in the dynamic specification, education is statistically significant. The evidence thus suggests the presence of a minor partial offset to the beneficial growth effect of stabilization during the post-reforms years¹². Assuming low variation in the regional economic growth and taking the estimates at their face values, the income effect is immediate, the short term effect from relative prices is lagged, and the estimated short run price elasticity (-)0.3 is lower in absolute value than the long run elasticity (-)1.3. These results are common in the analysis of time-series data of foreign trade (Rajagopal, 2005). While using regression results to project savings behavior, it has been assumed that the observed coefficients on GNP and export share describe the coefficient on foreign capital. The equation for potential savings (S) is hence derived as:

$$(S)_t = (S)_{t-1} + \alpha\Delta V + \gamma\Delta\left(\frac{E}{V}\right) \quad (ii)$$

Where, Δ refers to the change between the pre-reforms period ($t-1$) and the reforms period (t). In the equation α represents propensity to save from additional GNP and γ denotes the effect of changes in export share on savings.

¹² The results of the data analysis exhibited in Tables 4.6 to 4.7 and inferences drawn on the results support the hypotheses H2, H3, H4 and H5

Table 4.8: Welfare Equilibrium in Trading Blocs in Latin America

Trade Blocs	NE	FTA	CM	BT
1	2.079	1.235	0.493	0.079
2	1.532	0.928	1.163	1.212
3	1.670	0.946	1.325	1.495
LAC Region	1.752	0.986	1.012	0.929

Trade Blocs 1 = NAFTA (FTA- Free Trade Agreement)

2 = Common Market (CM) - Mercosur

3 = Bilateral Trade (BT) between two countries on mutually convenient agreement

NE = Nash Equilibrium

Since the welfare measure leading to the economic benefit emerging out of foreign trade agreements has been computed in terms of tariff region (taxes) and revenue, it provides an estimate of percentage change in the revenue as an indicator of economic welfare through trade agreements. The economic welfare indicators associated with Nash equilibrium is discussed in the Table 4.7. The results reveal that NAFTA (Trading Bloc 1) has gained over the other two trading blocs in terms of revenue though the trading costs were higher. Each trading bloc approximately gains 1.5% higher in the LAC region, by changing optimal tariff. The trading bloc 2 has gained marginally lesser than the trading bloc 3 which is formed out of bilateral trade agreements. This leads to smaller tariffs and lower economic welfare gains. The analysis of economic welfare gains through Nash equilibrium allows critical examination of the optimal policy in an economy that evolves around take-off state, which is not necessarily efficient¹³.

Revealed Comparative Advantage in East Asia and Latin America

In order to compute the RCA among the east Asian and Latin American countries, the ISCI data of UNIDO (2005) has been used for 11 Latin American countries and 8 East Asian countries. The Asian countries have been categorized into newly industrializing economies, trade partnering economies (ASEAN) and developed economy of the region. The East Asian Newly Industrializing Economics (EANIEs) consisted of Hong Kong, South Korea and Singapore, while the ASEAN4 is composed of the four economies (Indonesia, Malaysia, Philippines and Thailand) of the Association of Southeast Asian Nations (ASEAN). Together with Japan, East

¹³ The data analysis presented in the Table 4.8 and inferences drawn on the results thereof supports the hypotheses H1 and H5

Asia contains a total of eight economies. Although we look specifically at three regions of EANIEs, ASEAN4 and LA, we first take an aggregated view on the export performance of the whole East Asia region. In order to achieve higher significance in the analysis of the ISCI data of UNIDO-2005, the information has been aggregated into the clusters representing the three, five and ten main export clusters (EC) on a 3-digit industry classification, and the sector's corresponding global imports are used as an indicator of global demand. The Tables 4.9 and 4.10 exhibits the export performance of the East Asia and Latin America countries selected for the study, respectively. For the entire period 1981-2003, trade performances are reported on the basis of a triennium ending.

East Asia's share of the 10 main manufacturing export sectors is high, with an average exceeding 82 percent; similarly their share in global total manufacturing imports is significant, with an average of more than 20 percent. Nonetheless, East Asia's manufacturing exports have concentrated in the high-value manufacturing sector groups. While their share of the 3 and 5 main export sectors increased, the 10 main export sectors showed a decrease beginning from the early 1990s. The performance of the exports of manufacturing sector in East Asia is exhibited in Table 4.9.

Table 4.9 Analysis of Exports of Manufacturing Sector in East Asian Countries (1981-2003)
(in US million dollars)

Performance Indicators	1981-83				1990-92				2001-2003 ^a			
	EC-1	EC-2	EC-3	EC-4	EC-1	EC-2	EC-3	EC-4	EC-1	EC-2	EC-3	EC-4
Average annual exports	91.32	108.25	150.95	182.36	238.97	275.75	347.41	426.99	674.33	722.09	582.39	964.82
Ave. annual global imports	300.15	413.02	633.59	973.13	843.37	1089.6	15787.7	237.87	1964.76	2386.99	6329.33	4988.55
Share in total exports	50.7	59.36	82.78	-	55.97	64.58	81.36	-	64.12	73.34	87.92	-
Share in global imports	30.42	26.21	23.83	18.74	28.34	25.31	22.01	17.95	31.04	29.91	24.66	18.20
Growth in main exports (in percent)	1.5	0.74	-3.09	-2.83	27.59	22.39	22.71	26.53	25.31	28.54	27.77	29.52
Growth in global imports (in percent)	0.48	-1.57	-5.10	-4.00	16.09	13.65	12.05	11.99	18.02	15.45	14.86	15.03

EC-1: Export cluster-1 consisting of 3 main export sectors

EC-2: Export cluster-2 consisting of 5 main export sectors next to EC-1

EC-3: Export cluster-3 consisting of 10 main export sectors next to EC-2

EC-4: Total manufacturing exports of the selected countries

^a Projected data by the author

Principal source of information UNIDO statistics 2005

The share of East Asian exports in global manufacturing imports - for the 5 and 10 main and the total manufacture exports showed an increase of up to 4 percent in the 1990s. Therefore, an increase in East Asia's share in global manufacturing imports between 2 and 3 percent can be detected for the entire 1981-1997 periods. These increases are evidences of the successful trade policies that East Asian economies had pursued in the 1980s and 1990s. In term of the growth rates, two distinct periods can be identified. In the 1980s, with the exception of the 1981-1983 sub-period, the global demand (the equivalent global imports) of the 3, 5 and 10 main export sectors showed a higher growth performance than their correspondent main export sectors. In the 1990s, on the contrary, East Asia's manufacturing exports had a much better growth performance than the correspondent global imports. For the whole period 1981-1997, East Asia's manufacturing sector exports growth outperformed the global demand growth for the corresponding manufacturing sectors. The success of East Asia trade exports reflected the suitable trade policies these economies had pursued, and their comparative advantage shows an improvement.

Table 4.10 Analysis of Exports of Manufacturing Sector in Latin American Countries (1981-2003)
(in US million dollars)

Performance Indicators	1981-83				1990-92				2001-2003 ^a			
	EC-1	EC-2	EC-3	EC-4	EC-1	EC-2	EC-3	EC-4	EC-1	EC-2	EC-3	EC-4
Average annual exports	8.35	10.13	17.51	20.97	18.86	231.14	30.08	38.24	32.19	422.84	54.96	66.21
Ave. annual global imports	251.79	423.26	606.82	973.13	578.49	1041.92	1370.34	2378.71	865.33	2311.56	2373.52	3984.66
Share in total exports	39.83	48.32	83.49	-	49.33	60.44	78.65	-	64.42	72.14	84.32	-
Share in global imports	3.32	2.39	2.88	2.15	3.26	2.22	2.19	1.16	2.04	3.69	2.55	1.84
Growth in main exports (in percent)	-7.68	-4.24	17.51	23.04	15.00	12.58	9.28	12.78	18.42	16.81	19.92	15.43
Growth in global imports (in percent)	.3.67	-3.04	-4.34	-4.00	10.72	11.22	8.51	11.99	14.55	16.73	12.60	14.81

EC-1: Export cluster-1 consisting of 3 main export sectors

EC-2: Export cluster-2 consisting of 5 main export sectors next to EC-1

EC-3: Export cluster-3 consisting of 10 main export sectors next to EC-2

EC-4: Total manufacturing exports of the selected countries

^a Projected data by the author

Principal source of information UNIDO statistics 2005

For the Latin American region, although their 10 main export sectors accounted for an average share of about 69 percent for the period 1981-1997, their share showed significant decrease over time. For example, their share of the 10 main exports decreased from 83.49 percent to 58.78 percent during 1981-1983 and 1996-1997 sub-periods, showing a decrease of 24.71 percent

Compared to East Asia, however, Latin America's manufacturing exports are much less concentrated, their values are also much lower, and their share in global total manufacturing imports is only about 2.3 percent on average. The performance of the exports of manufacturing sector in east Asia is exhibited in Table 4.10. Beginning from the second half of the 1980s, however, their share showed a steady increase in global manufacturing imports. Similarly, an increase of the share in global manufacturing imports can also be detected for the 3, 5 and 10 main manufacturing export sectors. Evidences show that the shift of trade policies by Latin American economics in the 1990s had revived their export performance and a gain in export advantage is expected.

The pattern of Latin America's export growth rates, however, is different from East Asia. The percentage growth rates within each of the sub-periods are in general and in particular the 1987-89 and 1996-1997 sub-periods, higher than the global import growth rate for the same sectors. The two exceptions are the 3 and 5 main export sectors for the 1981-1983 and the 1993-1995 sub-periods when global imports performed much better than Latin America's export growth. Table 4.11 shows that the values of the Lawrence Index are very low, though they are constant over the sub-periods, suggesting that there was not an important structural change in the export pattern of East Asia in the whole period. The Beneficial Index did not suggest significant structural change in exports pattern. Both indices indicate that over the period 1981-1997, East Asia's export pattern remained constant. In other words, the same export structure was kept, even though East Asia had been oriented to the most dynamic product sectors in the global markets during this period. The two trade specialization indices show the same pattern. From the beginning of the 1980s to the second half of the 1990s, there was a steady decrease in trade specialization, and there were little movements to "diversify" exports (and imports).

Although there was an increase in intra-industry trade over the period covered by the data, the absolute value of these indices remained low, indicating that the degree of trade specialization

was low since the beginning of the 1980s. This also meant that the extent of intra-industry trade had already reached the "maximum" level. The trade performance indices computed for the Lawrence index, Beneficial index, Michaely index and Trade specialization index for the East Asian and Latin American countries are exhibited in Table 4.11.

Table 4.11 Trade Performance Index

Region	Performance Index	1981-83	1990-92	2001-03
East Asia	Lawrence Index	0.03	0.04	0.03
	Beneficial Index	0.01	0.01	0.03
	Michaely Index	0.31	0.20	0.14
	Trade Specialization Index	0.29	0.24	0.22
Latin America	Lawrence Index	0.11	0.08	0.27
	Beneficial Index	0.03	0.01	0.09
	Michaely Index	0.61	0.43	0.39
	Trade Specialization Index	0.59	0.03	0.34

Data computed by the author based on the statistics of UNIDO, Indstat-2005

An inference may be drawn from the above Table that for the East Asia region there was no significant change in revealed comparative advantage (RCA) of manufacturing sectors, but is affected by inter-country economic differences, as well as inter-industry disparities. The RCA is primarily based on relative export shares that could be biased due to distortions from various trade and non-trade barriers¹⁴.

Based on the statistical data from the UNIDO (1999) source, the empirical study supports the hypothesis of a comparative advantage shift between East Asia and Southeast Asia, and that Latin America also captured the loss in comparative advantage in East Asia. Despite East Asia's strong growth in exports in the 1980s and 1990s, its export pattern is losing its comparative advantage to the lower-tier major ASEAN-4 countries (EC-2) and Latin American countries. Between the 1980s and 1990s, the falling strength in East Asia's trade is captured by the growing strength in the exports of ASEAN-4 and Latin American countries.

¹⁴ The results discussed in Tables 4.9 to 4.11 and inferences drawn accordingly supports the hypotheses H5 and H6 framed for the study.

Applied Inferences of Data Analysis

There are large differences in gross domestic products by sectors among Latin American countries, and majority of these differences are due to the change in the value of industrial and service sectors. The structural reforms Latin American countries have broadly focused in five major areas comprising international trade, financial markets, labor markets, and the generation and use of public resources. Consequently the financial development has improved, especially the depth of financial intermediation, private sector participation in banking, and the size and activity of stock markets. The economic integration and structural reforms in Latin America considered that import substitution in manufacturing sector would be synonymous with industrialization, which in turn was seen as the key to development. As far as the efficient generation and use of public resources are concerned, much has been done to make the value-added tax system efficient and to privatize public enterprises. In response to the liberalization of economies, there has been significant increase in the imports, primarily due to lower inflation, lesser government intervention, and fewer trade barriers. International trade has been the key indicator of the overall economic growth of Latin American countries. The study reviews the approach to trade policy in early reforms period and evolution of thoughts, integrating the economic and structural reforms in Latin America.

The institutional reforms towards trade liberalizations in Latin America during the 1980s and the 1990s have introduced a good measure of import competition, but trade policies alone are not sufficient to create a competitive environment in an economy. The change in economy has taken place through the free trade policies in Latin America since 1980's, and most of the region's economies have changed from restrictive to open policies. But unlike trade liberalization in Europe, most trade barriers in Latin America have been reduced unilaterally. Many Latin American countries favored free trade to improve their economies in terms of savings, export share, foreign reserves and growth of GNP during the reforms period. Business participation in trade policy reflects these patterns in large, outward-oriented firms which played an increasingly important role in Mexico's adoption of free trade policies over the 1980s and early 1990s. After decades of weak growth in Latin American countries, the manufacturing sector exports have shown optimistic results in recent years following the international trade agreements. The

proposed study examines the trends of export dynamism in the Latin American countries and attempts to analyze whether the current pace of growth is sustainable.

During the reforms, progress has been especially remarkable on trade and financial liberalization. However, these reforms proved largely successful in jump-starting economies they have not delivered long-term economic growth on a sustainable basis. Macro-economic reforms must be accompanied by institutional reforms, if they are to have a sustained impact on the economy. There is strong empirical evidence that better governance and higher quality institutions promote higher rates of economic growth. In this context, it is argued that structural and institutional differences between Latin America and South East Asia imply a difference of 2 per cent per annum in growth. It has been observed by the researchers (Cesar and Hebbel 2003) in reference to LAC countries that the monetary and fiscal policies could be counter-cyclical in emerging countries. Their cyclical stance depends on country fundamentals and policy credibility. Fiscal and monetary policies are counter-cyclical in emerging economies with low to moderate country-risk spreads. International exchange-rate regimes became less persistent than hard pegs and floats in LAC after the Asian crisis. The choice of exchange-rate regimes and their transitions do matter for inflation and growth. Inflation in LAC is lower if the regime is less flexible, whereas growth in LAC is higher if the regime is more flexible. The contribution of very successful structural reforms reflected in a massive growth jump in these countries.

Greater trade openness in Latin America would help to improve institutions. The opening up of markets can play an important role in weakening vested interests and reducing economic rents associated with long standing economic and institutional arrangements. Trade can thus spur improvement in domestic institutions that otherwise would not have been possible. In addition, international agreements can be an important external anchor and catalyst for institutional change by breaking through domestic impediments to reforms. Chile and Mexico provide important role models for the region. Institutional strengthening in both the countries has allowed them to establish a successful inflation targeting framework, to lower public debt, to open the trading regime, and to build a strong regulatory and oversight framework for the banking system. Both the countries also provide important lessons of targeted social spending. Chile's example, in particular, of institutional changes that limit the room for inconsistent fiscal behavior by the

regional governance, provides an especially valuable lesson to other countries that have frequently witnessed high fiscal volatility.

Although Latin America has been intensively debating appropriate institutional designs for more than two decades, little progress has been made. One of the key challenges, therefore, will be to provide explanations as to why institutional reforms have succeeded in some policy areas but not in others. Today, most of the Latin American countries are well-respected democracies, with a multi-party political system, the division of powers, a working parliament and regular elections. But at the same time, there is a strong crisis of confidence, not only towards governments, but in the whole political class and representation in general. The increasing lack of confidence in the political elite in Latin America has fostered new forms of opposition in several countries, leading to a significant number of Latin American presidents not being capable of completing their terms of office during the 1990s. Although political shifts are a constant feature of democracy and they generally indicate the strengths of democratic institutions, a more stable political system in the region would have helped to pursue reforms processes in a more effective way. Specifically, a strong macroeconomic stabilization will, after some short-run recessive effects, provide a framework that has less distortion for economic indicators than the pre-reforms period.

The failure of market reforms in Latin America to produce sustained growth and equitable prosperity is demonstrated most clearly by Argentina's most recent economic and political meltdown. But economic difficulties, poverty and searing inequality has continued to plague the Mexican case as well. Latin American policy makers themselves have begun to contribute to the growing discussion of policies necessary to confront the lingering economic and social challenges. Included among the recommended policy prescriptions are: increased social spending supported by tax reforms, assistance to small and medium enterprises, and an end to corruption. Such policy reforms require governments that are autonomous from particular business interests with established institutional channels capable of securing generalized business cooperation and support (Teichman 2002).

Latin American economy has gained substantial competitive advantage in the 1990s. Their improvement in RCA and trade diversification reflected more their government's trade and

liberalization strategy than changes in factor endowment. One reason for the strong RCA improvement certainly is Latin America's initial low share in global export. That is, a relatively small increase in export value accounts for a relatively high increase in the RCA indices of Latin America. Several other factors are also responsible for improvements in Latin America. The North America Free Trade Agreement (NAFTA) concluded in the late 1980s welded together the economies of the United States, Canada and Mexico, thereby forming a solid regional trading block that benefited directly Mexico and indirectly other Latin American economies. Secondly, by the early 1990s, Argentina gained economic stability and an improved export performance emerged. During the 1970s and 1980s, Chile pursued a process of trade liberalization that reorganized and modernized the economy's production structure. All this reflected in a significant improvement in trade performance by the Chilean economy. Peru was also another Latin American country that succeeded in stabilizing the economy in the early 1990s, and improvement in economic conditions was reflected in an improvement in export performance. Argentina, Chile Peru and Mexico are the key Latin American economies in our RCA calculation. For the improvement of RCA to be sustainable, however, Latin American economies should maintain a period of stability and avoid economic or political shocks that devastated her hard-earned comparative advantage.

It is well established that inflation, for example, is costly and that its elimination is beneficial for the long-run growth. The same is true of structural reforms. Multiple exchange rates, multiple interest rates, protection of domestic products with licenses, quotas, tariffs in the excess of what would have been necessary for infant industries, and a welter of regulations and bureaucratic obstacles to normal business in general have detrimental effects on economic growth. Mainstream economic theory suggests that economic welfare would be maximized when distortions are minimized. Accordingly, a removal of distortions of both macroeconomic and microeconomic nature would have beneficial effects on economic activity and the rate of growth (Igor, 2000). Therefore, there might exist a mutual reinforcement of those benefits as the reforms process goes on. In other words, there might be a synergistic relationship between the effects of structural reforms and macroeconomic stabilization.

There is a wide disparity in the growth performance in the 1990s of the seventeen countries studied. There are “leaders” and “laggards” and to understand the effect of structural reforms on

growth, it is necessary to explain the growth performance of both groups. The leading economies had a lower average rate of growth in the base period than in the 1990s, low or negative growth rates immediately before the reforms took place, and huge macroeconomic imbalances. That sparked the reform process and made it much more comprehensive than in other countries. “Laggards”, in contrast, fared much better during the three post-war decades than during the 1990s. Also, their growth rates immediately before the adoption of reforms were not as low as the ones of the “leading” economies, and in most cases they did not experience hyperinflation. As a consequence, the pressure to change was not as strong as in the countries hit harder by the crisis. The economies with stronger growth record during the post-reforms had a much better macroeconomic stabilization record and have adopted deeper and more comprehensive structural reforms (Igor, 2000).

The countries that adopted far-reaching structural reforms and macroeconomic stabilization did well in the sense that they overcame the credibility problem. They managed to signal that the reform process is irreversible and that the rules of the game have changed for good, both at macroeconomic and microeconomic level. Others that lacked a combination of strong stabilization and strong reforms made things worse with partial reforms since the absence of positive results further undermined the support for reforms. The investment climate did not improve as expected, which further weakened the chances of future reformers. There were also some reinforcing elements that point towards the possibility of synergy between macroeconomic stabilization and structural reforms. Although reforms have had specific and unique characteristics in different countries, there are also some fundamental common threads. Specifically, Argentina, Chile and Peru are the examples of strong macroeconomic stabilization and intense reforms, and the payoff was formidable. On the other side of the spectrum are Ecuador and Venezuela, countries that have changed the course several times during the last fifteen years, increasing the uncertainty for economic agents and reducing the credibility of the policy makers. And for still other economies (Mexico, Paraguay) the reforms did not work as expected, and the payoff has yet to materialize.

The high performance in savings, exports share and reserves of foreign assets would permit accelerated growth to occur with increase in the cumulative capital inflow. Hence, the Latin

American countries may develop policies to identify resources, which would promote the domestic savings and growth of GNP. The increase in inflow of capital would help stimulating improved domestic development performance. The long-run accelerated growth at the cost of external resources may be less than the pre-reforms experience of the countries in resources management. The discussion in the study reveals that growth rates tend to fall only temporarily following a balance-of-payments crisis and then rebound to the pre-crisis levels in some of the Latin American countries. However, a balance-of-payments issue is often associated with a decline of growth rates and may run into the export crisis in the future.

The results of the study determine that international liquidity, financial soundness, real exchange rate depreciation and monetary policy play a critical role in reducing output losses and increasing the economic welfare gains. It has been discussed in the study that while applying the Nash equilibrium, gains from trade liberalization rise through the various types of trade agreements, however, that stem from the impact of foreign economic activity on the domestic marginal cost of production. The trade competitiveness reflects significantly in reference to the welfare losses and gains. The variables that determine the efficacy of the trading blocs include exchange rates, foreign direct investments, total factor productivity and growth in exports. The interest rates in response to domestic inflation need to be adjusted to foreign inflation within the trading blocs in order to optimize the economic welfare gains. The growth impetus associated with the reforms in Latin America has been substantial and the estimated long-run growth effect of the 1990s reform is large for most countries in the region and amounts to almost 2 percentage points of additional annual sustainable growth in the aggregate, enough to double the real income expected in future.

Chapter 5



International Trade Alliance: Developments and Strategies

There are large differences in gross domestic products by sectors among Latin American countries, and the majority of these differences are due to the value of industrial and service sectors. Although the sectoral economic activity has been increased, in per capita terms this value decreased due to the demographic growth that Latin American countries (mainly Mexico and Brazil) had experienced during the last decades. In terms of external trade, it has been found that the outward orientation as the ratio between total exports and GDP increased from 16.1% in 1990 to 32.7% in year 2000. Panama had the highest level in this area (66.5%). Modest growth returned to Latin America and the Caribbean in 2003 and regional GDP advanced by an average 1.3 percent, after a contraction of 0.6 percent in 2002. Argentina continued recovering rapidly after its acute crisis. Brazil, Mexico and Uruguay shared in the broadening of economic recovery during the year. The Andean countries performed well, with Chile, Colombia and Peru recording growth above 3 percent. However, ongoing political uncertainties caused Venezuela's economy to deteriorate further during the first half of the year. Central America grew by an average 3.1 percent and looks set to sustain growth, thanks to the recently signed Central America Free Trade Agreement¹⁵ (CAFTA). The rate of change in the merchandise export in the Latin American countries during 2002 shows that most of the countries in the region except Costa Rica, Ecuador, Peru and St. Kit Islands other have shown a downward trend.

The Central American Free Trade Agreement (CAFTA) negotiated between the U.S. and Central America offers opportunities and challenges for the five countries including El Salvador, Guatemala, Honduras, and Nicaragua that joined in 2003 and Costa Rica that was included in January 2004. Mexico, Nicaragua, Jamaica and Honduras always were over the mean. During the years 1990, 1995 and 2000, Mexico, Cuba, Panama, Argentina, Brazil, Chile and Uruguay reached incomes above 2000 dollars per capita in the service sector (Guisan and Aguayo, 2002). On the other hand, there are some countries like Haiti, Honduras, Nicaragua and Bolivia with incomes below 500 dollars per capita. Latin America's merchandise exports increased slightly as

¹⁵ World Bank : Report on Latin America and Caribbean, Regional Overview, 2003

the decline in intra-regional trade was balanced by increased shipments to other regions. The recovery of commodity prices in the course of the year and the upturn in the US economy contributed to this rise. While most Latin American countries saw a reduction or stagnation in their imports, those of Costa Rica increased by 9 per cent. Mexico benefited from the recovery of the US market while for Costa Rica, the recovery in semi-conductor shipments boosted both imports and exports. Despite the continuation of low prices for a number of primary commodities, exports of many Central American and Caribbean countries recovered strongly. Economic activity in Western Europe remained subdued as Germany, the largest economy, experienced declining domestic demand. Domestic demand growth remained positive in the rest of the region, but was sluggish in several other countries. In the euro zone, public consumption was the most dynamic expenditure category while private consumption slowed down and fixed investment in the enterprise sector fell nearly 3 per cent. In the midst of this poor economic situation, further progress was made in the process of European integration¹⁶.

Starting in the mid-sixties of the 20th century, the European example inspired a number of trade-oriented integration arrangements in the Latin American region such as the Latin American Free Trade Association, which later became the Latin American Integration Association (ALADI), the Central American Common Market (MCCA), the Caribbean Community and Common Market (CARICOM), the Andean Group, later the Andean Community; and more recently, the Southern Common Market (Mercosur), the Group of Three (G3) and the Association of Caribbean States (ACS). There are many bilateral alliances as well. Latin American countries have been living a renaissance since 80's. Most economies are stabilized, living standards are higher, direct foreign investment has surged, democracy has been institutionalized and most countries have demonstrated a desire to integrate themselves into the new global economy by opening their economies to international trade and investment. In the 90's the Latin American countries have liberalized their economies, which has been followed by a significant increase in their imports. This improvement was due primarily to three factors: lower inflation, less government intervention, and fewer trade barriers. International trade has been the key indicator of the overall economic growth of Latin American countries. Several regional free trade agreements signed over the past decade--such as Mercosur, the Central American Common Market, the Andean

¹⁶ World Trade Organization: World Trade Report 2003, pp 30-42

Community, and the Caribbean Common Market-demonstrate the region's understanding of the benefits of free trade. Countries like Chile have gone even further in their trade liberalization efforts, signing bilateral agreements with Mexico and Canada after being unable to sign an agreement with the entire NAFTA bloc. In terms of scope, sectors of interest and coverage, there are three levels of sub-regional arrangements: (i) customs unions currently being finalized, e.g., the Andean Community, Mercosur, MCCA and CARICOM, (ii) first-generation free trade accords with a commercial emphasis, and (iii) new-generation free trade pacts encompassing such sectors as services, investment, intellectual ownership, and state acquisitions. Chile and Bolivia are successfully engaged in negotiations for broader scope aimed at furthering their association with Mercosur, establishing free trade areas and bringing other sectors and issues into the accords.

With investor confidence returning in Latin America and domestic conditions improving, gross private financial inflows in 2003 increased by 40 percent over 2002. Moreover, interest rate spreads on sovereign bonds over US treasuries reached record lows. Net foreign direct investment (FDI), however, continued its decline from a peak of \$88 billion in 1999 to an estimated \$36 billion in 2003. This is partly explained by the end of the privatization boom and the profit crisis in Brazil and Argentina. Export growth outpaced import growth for most countries in 2003, leading to surplus positions on trade and a big improvement in the region's current account deficit, down to 0.5 percent of GDP (compared to 4.5 percent in 1998). Tourism revenues and workers' remittances also improved, and commodity prices were generally strong. Consequent upon falling trade and investment barriers and high growth prospects, the countries of Latin America represent attractive alliance prospects for an increasing number of global firms. The typical objective for these strategic alliances is a basic trade-off wherein local firms seek access to technology and capabilities that are critical for their survival in an environment of increased competition and in return, they offer prospective multinational partners access to a large and growing market.

The region is becoming more attractive to multinationals, as product patent protection is implemented and, more importantly, enforced, in Latin American countries. Mexico, in particular, as a member of NAFTA, is attracting substantial inward investment. This is likely to

grow even more rapidly in future, given the recent signing of a trade deal with the European Union. The recent recovery of oil prices has shown a positive sign of growth for a number of countries in the region, particularly Venezuela, Mexico and Colombia.

Economic environment

In the 1990s macroeconomic policies improved in a majority of developing countries, but the growth dividend from such improvement fell short of expectations, and a policy agenda focused on stability turned out to be associated with a multiplicity of financial crises (Luise and Peter, 2004). The economic advancement of a country may be reviewed in reference to its fiscal, monetary, and exchange rate policies over time, and the effectiveness of the changing policy framework in promoting stability and growth. The contemporary concepts of economic advancement for developed countries include entire range of governmental functions, including sectoral policy reform, economic integration, privatization, public sector enhancement, labor market competitiveness, investment climate enhancement, e-government, soft infrastructures for developing a knowledge economy, macroeconomic management and effective long range planning. The weight of the public sector constitutes a serious impediment to more rapid growth for many countries. Importantly the large expenditure burden it requires does not always translate into an efficient and equitable distribution of services. Such performance is reflected by the public sector efficiency and governance in promoting the economic advancement of a country. The challenges of employment generation, economic growth and societal advancement in changing demographic contexts can only be addressed through productive investment and value building. The climate for investment is therefore critical for the countries which need a strategic direction and an economic concentration on value building rather than value trading, which leads towards the higher degree of economic advancement in a country.

Economic advancement is directly proportional to the educational and training facilities available in the country. Human resources are not only producers of goods and services, which also play a multifold role in economic development. Economic advancement is characterized by the following factors:

- Allocation of labor force to agriculture
- Energy available in large amounts at low cost per unit
- High level of GDP and income
- High levels of per capita consumption
- Relatively low rates of population growth
- Complex modern facilities for transportation, communication, and exchange
- Substantial amount of capital for investment
- Urbanization based on production as well as exchange
- Diversified manufacturing that accounts for an important share of the labor force; and technology that includes ample media and methods for experiment.

These factors may be utilized to examine economic standing of the host country and analysis of a large variety of information on these variables may help to categorize the countries on an economic development scale. Besides, there are many historical, geographic, political, and cultural factors intimately related to the economic well-being of a nation.

Large nominal exchange rate changes affect the behavior of trade flows through their impact on the relative prices of tradable goods in the economy. A change in the nominal exchange rate affects the prices of export and import goods relative to domestically produced goods, which implies changes in the real exchange rate. There is a striking difference, as regards the behavior of the real exchange rate, between the two sets of countries indicated above. In Brazil, Peru, and Argentina home currency goods became more expensive during this episode, due to an even higher domestic inflation rate. For the remaining countries large nominal exchange rate devaluations were transmitted into real exchange rate devaluations. With the notable exception of Brazil and Argentina, all countries had experienced a relative convergence to their initial long-term real exchange rates, with rates of real depreciation much lower than those experienced only two years after the devaluation. In Brazil the five-year period ended just after the large real depreciation resulting from the collapse of the Real Plan in February of 1999 and some of this depreciation was corrected shortly after that. The adjustment of trade flows to their new equilibrium level does not happen immediately. Exporters and importers need to identify new

markets for their products, establish relationships, and develop sales and distribution networks that allow them to find substitutes for their current international partners

The macroeconomic policy refers to the top-down strategy developed and implemented in a country by the government and central banks, usually intended to maximize growth while keeping down inflation and unemployment. The growth factors determining the incentives towards investing in human capital for developing new products include government policies. Countries with broadly free-market policies, in particular free trade and the maintenance of secure property rights typically have higher growth rates. By 1990, most developed countries reckoned to have long-term trend growth rates of 2-2.5% a year. However, during the 1990s, growth rates started to rise, especially in the United States. Some economists said it was the result of the birth of a new economy based on a revolution in productivity, largely because of rapid technological innovation but also (perhaps directly stemming from the spread of new technology) due to increases in the value of human capital. In the end of the 20th century, it has been argued that developments in information technology and globalization leading towards free trade through the regional trade agreements, has given birth to a new economy initiated in United States. These developments have shown a higher rate of productivity and growth than the previous economy it replaced. Open economies have grown much faster on average than closed economies.

The main instruments of macroeconomic policy are deviations in the interest rates and money supply, taxation and public spending, known as fiscal policy. It has been observed that with the rise of rate of unemployment and inflation, the growth rate of the economy declines and the GDP of the country falls¹⁷. This may be an evidence of poorly planned macroeconomic policy and implementation thereof. Higher public spending relative to GDP is generally associated with slower growth. The rise in the rate of inflation is contributed by the high social expenditure and political instability in a country. However, business cycles may simply be an unavoidable fact of economic life that macroeconomic policy, however well conducted, can never be sure of conquering. The long run pattern of growth and recession in the business that may be explained as boom and bust of the economy of a country or a region may be described as business cycle. There are two main versions of the new paradigm that have attracted followers in America lately

¹⁷ The Economist : Insecurities, November 11, 2004

over the reactions of the previous business cycles¹⁸. Of these, one version states that the country's long-term growth rate has shifted upwards while the other reveals that the old pattern of boom and bust has disappeared in the light of the free trade and globalization movement by 2000.

Elsewhere, the reforms did bring lasting benefits. In Chile, an early reformer, fast growth saw poverty halved, to 23%, between 1987 and 1996. Overall, macroeconomic management in the region improved dramatically compared with, say, the 1970s. There was social progress, too (see table 4). Partly because governments pulled back from running steelworks and factories, they spent more on education and health. In some countries, such as Brazil and Mexico, new, targeted, anti-poverty programs were introduced. Where income inequality worsened, it was mainly because of recession, not reform. Privatization was not the blanket failure painted by the critics. There is little argument over the sale of state industries. Public utilities are more controversial. In some countries, their sale was badly handled: either tainted by corruption, or by private monopolies, or because regulation has been poor. But private provision of telephones, electricity and water has vastly increased their coverage and quality. However, that has generally come at a price: as subsidies were withdrawn, tariffs often rose, before later starting to fall¹⁹.

A positive trend in the behavior of trade flows has been observed during the reforms period, resulting from the increased openness of these economies to international markets. There is a striking difference between the behavior of export and import volumes around the devaluation episodes. Exports tend, on average, to increase in the year of the devaluation and the following two years. Only in Argentina, Peru and Venezuela do we observe negative export growth in the second year after the devaluation, and this probably has more to do with the circumstances in world markets at that time, especially in the United States. In all other cases, exports continue to increase. Import volume, in contrast, behaves quite differently. In most of the devaluation episodes import volume contracted; only in the two devaluations by large countries in the mid 1990s (Mexico and Brazil) was there substantial positive import growth. In all other cases, the import contraction was short-lived. Exports increase faster than average to countries in the region, and especially towards countries that are partners in regional trading agreements. Brazil

¹⁸ The Economist : Beyond the business Cycles, October 21, 1999

¹⁹ The Economist: Wanted: A new regional agenda for economic growth, April 24, 2003

and Argentina increased their trading flows with each other significantly, and also with other countries in the region such as Chile and Paraguay. There was also a significant increase in regional trade among Central American countries: Honduras, El Salvador and Guatemala, despite suffering an exchange rate crisis, increased their bilateral trade with one another at a rate significantly above the average of their overall trade growth.

International Competition

Competition may be analyzed in reference to the characteristics of products as breakthrough, competitive, and improved. A *breakthrough product* is a unique innovation that is mainly technical in nature, such as the digital watch, VCR, and personal computer. A *competitive product* is one of many brands currently available in the market and has no special advantage over the competing products. An *improved product* is not unique but is generally superior to many existing brands. For example, let us assume Aubrey Organics is interested in manufacturing shampoo for tender hair in Turkey and seeks entry into the emerging market in the middle-eastern countries. The company finds that in addition to a number of local brands, Johnson & Johnson's baby shampoo and Helene Curtis Industries' Suave Shampoo are the competitive products in the market. Proctor and Gamble has recently entered the market with its Pantene Pro-V brand, which is considered as an improved product. Most of the competition appears to be addressing the existing demand. However, no attempts have been made to satisfy latent demand or incipient demand. After reviewing various considerations, Aubrey Organics may decide to fulfill latent demand with an improved offering through its Camomile Luxurious brand. Based on market information, the company reasons that a hair problem most consumers face in that part of the world is dandruff. No brand has addressed itself to that problem. Even Proctor & Gamble's new entry mainly emphasizes health of hair. Thus, analysis of the competition with reference to product offerings and demand enables Aubrey Organics to determine its entry point into the market of middle-eastern countries. The companies need to analyze some important issues as below while examining the micro-economic environment:

- Who is the competition now, and who will it be in the future?
- What are the key competitors' strategies, objectives and goals?

- How important is a specific market to the competitors, and are they enough to continue to invest?
- What unique strengths do the competitors have?
- Do they have any weaknesses that make them vulnerable?
- What changes are likely in the competitors' future strategies?
- What are the implications of competitors' strategies on the market, the inc. and one's own company?

One of the appropriate ways to examine the competition is to draw up a demographic profile of the industry. Markets dominated by small, single-industry businesses or small regional competitors differ significantly from those dominated by national or multi-industry companies. The competitor strengths may be measured by analyzing various functional indicators in marketing as described below:

- Market share
- Differential advantages
- Cost advantages
- Reputation
- Distribution capabilities
- Core competencies
- Perceptions of target buyers
- Competitors' financial strength, which determines their ability to spend money on advertising and promotions, among other things
- Competitor's ability and speed of innovation for new products and services

It is necessary to list the strengths and weaknesses of the competitors from the customer's viewpoint and analyze how a company can capitalize on their weaknesses and meet the challenges represented by their strengths. The information on the competitor information might be easily obtained by getting a copy of their annual report. It might take analysis of many information sources to understand competitors' strategies and objectives. In an international market, the business takes place in a highly competitive, volatile environment, so it is important

to understand the competition. Some questions as illustrated below can help the marketer to map the micro-economic variables in reference to a competitor:

- Who are your five nearest direct competitors?
- Who are your indirect competitors?
- Is their business growing, steady, or declining?
- What can you learn from their operations or from their advertising?
- What are their strengths and weaknesses?
- How does their product or service differ from yours?

The competition in the photo film products has been increasing with competitive price and promotion strategies among the major international brands like Kodak and Fuji. The consumers have found a bona fide competitor to Kodak in the name of Fujifilm. Clearly, Fujifilm has emerged from a minor player in the early 1980's in American market to take a solid number two position within the US market and has caught the attention, as well as the fury, of Kodak. The success of low priced super stores such as Wal-Mart has taught retailers that diversification, scrambled marketing and "one-stop" shopping are important to consumers. As consolidation in retail industry sweeps in mass marketing, food and drug accounts, retailers realize they must maintain their competitive advantage or close shop. To survive, they are squeezing manufacturers for quality products at competitive prices to capture profit margins for expansion within the industry. This environment has provided an opportunity for Fujifilm to prosper in an otherwise stable and mature photographic industry. Though Kodak and Fuji fight for market share, the real winner and benefactor is the consumer, both the companies officially deny that they are engaging in a price war, but for each move Fuji makes, Kodak counters with a strategic move. Kodak and Fuji traditionally enjoyed healthy margins and treated the market as a mutually profitable duopoly (Finnerty, 2000). Then in the spring of 1996, Fuji cut prices on film by 10 to 15 percent after Costco Wholesalers decided to go exclusively with Kodak. Fuji had excess inventory of 2.5 millions rolls of film. They distributed the heavily discounted film to other retailers to avoid "expiring" film and thus began a correlation between price cutting and market share. Once consumers tried Fuji, they found they liked the product as long as it was priced lower than Kodak. By 1998 the severe pace of competition between Kodak and Fuji seemed to slow down, with the exception of value packs. However, still the companies are on neck-to-neck competition

in the market, though other brands like *Agfa*, *Konica* have made a dent in the global retailing including American markets.

The soundness of the economy of a country largely governs the consumer confidence, which further determines the buying plans of the consumers. A favorable economic environment helps consumers to optimize their buying decisions and augment propensity to spend money. The reverse occurs when economic conditions are unfavorable. The economic environment in Brazil was not encouraging for the various segments of consumers during period 1998-1999 though the inflation was under control. The credit restrictions have had a negative impact on consumption during the above referred period. However, after the country exercised appropriate economic measures to stabilize the economy of the country in the recent past, it has been observed that foreign business corporations consider Brazil to be Latin America's most attractive investment target. International marketers should examine the extent to which their business is vulnerable to economic conditions. For example, in a booming economy, consumers tend to buy durable goods, on the contrary in recession they would avoid spending money. The prevailing economic environment is just an indicator to review the business fit in the given region or country. Even if the short-run economic environment is not conducive to profits, a company may decide to enter an overseas market in anticipation of favorable long-term economic prospects in country such as growing political stability, declining inflation or the low wage rates. However, the long-run perspective is the most critical decision factor, which provides the firm sufficient resources to endure waiting for the future favorable environment. The market attractiveness of Brazil may be described from this point of view.

An accelerating growth and poverty reduction requires governments to reduce the policy risks, costs, and barriers to competition facing firms of all types, from farmers and micro-entrepreneurs to local manufacturing and multinational companies. A vibrant private sector creates jobs, provides the goods and services needed to improve living standards, and contributes taxes necessary for public investment in health, education, and other services. But too often governments stunt the size of those contributions by creating unjustified risks, costs, and barriers to competition²⁰. However, the policy-related risks dominate the concerns of firms in developing

²⁰ World Bank : World Development Report-2005, News Release 2004/89/S, World Bank, Washington DC

countries. Uncertainty about the content and implementation of government policies is the top-rated concern, with other significant risks including macroeconomic instability, arbitrary regulation, and weak protection of property rights. These risks cloud opportunities and chill incentives to invest productively and create jobs.

Political Factors in International Trade Alliances

An accelerating growth and poverty reduction requires governments to reduce the policy risks, costs, and barriers to competition facing firms of all types, from farmers and micro-entrepreneurs to local manufacturing and multinational companies. A vibrant private sector creates jobs, provides the goods and services needed to improve living standards, and contributes taxes necessary for public investment in health, education, and other services. But too often governments stunt the size of those contributions by creating unjustified risks, costs, and barriers to competition²¹. However, the policy-related risks dominate the concerns of firms in developing countries. Uncertainty about the content and implementation of government policies is the top-rated concern, with other significant risks including macroeconomic instability, arbitrary regulation, and weak protection of property rights. These risks cloud opportunities and chill incentives to invest productively and create jobs. Nearly 90 percent of firms in Guatemala, and more than 70 percent of firms in Belarus and Zambia, find the interpretation of regulation unpredictable. It has been highlighted in the World Development Report -2005 that more than 80 percent of firms in Bangladesh, and over 70 percent of firms in Ecuador and Moldova, lack confidence in the courts to uphold their property rights. Improving policy predictability alone can increase the likelihood of new investment by more than 30 percent. Barriers to competition are also pervasive and dull incentives for firms to innovate and increase their productivity - the key to sustainable growth. High risks and costs restrict competition, while governments also limit competition through policy barriers to market entry and exit. Nearly 90 percent of firms in Poland report strong competitive pressure, more than twice the share of firms in Georgia. Stronger competitive pressure can increase the probability of innovation

²¹ World Bank : World Development Report-2005, News Release 2004/89/S, World Bank, Washington DC

The reforms were implemented in a relatively unfavorable external environment. The effect of implementing the reforms during 1991–95, instead of in the previous five-year period, was to associate them with an international context that by itself reduced the average growth rates of the reforming countries by about 1 percent. Latin America has not yet reached the levels of performance achieved in faster-growing regions. The results of the study highlights that only about half of the annual growth gap of about 7 percent between Latin America and East Asia during the reform period can be closed by doing more of the same that is, intensifying the reform effort along the lines already undertaken. This remaining gap suggests that the scope of reform in Latin America will need to be broadened. Improvements in macroeconomic management are simply not sufficient for Latin America to achieve long-run growth rates comparable to those achieved in East Asia. Such results have also been evidenced by other research studies (Fernandez and Monitel, 2001).

Trade and Tariff Structures

The trade among the Latin American and East Asian countries certainly exhibit enormous potential and apart from the trading of physical goods the services trade in terms of consultancy, transfer of technology and managerial training may also be explored bi-regionally. However, there exist differences among both the regions in factor endowment between the generally natural-resource-abundant Latin America and the natural resource-scarce Asia-Pacific Geography (*i.e.* distance) and differences in the availability of capital, knowledge (*e.g.* Japan, South Korea and Taiwan) and labor (China) also have been major drivers of the bilateral trade. It has been observed by many researchers that Latin America is aggressively opened up to world trade and investment in the late 1980s and its mixed results have emerged over two decades in expansion, diversification and upgrading its exports. The Asia-Pacific countries have shown extraordinary success in diversifying their exports and in raising their stakes in the world economy, while at the same time their domestic market is largely protected against import competition. Such trade policies of this region have also alarmed the concerns for global partnering and business expansions. Instruments such as tariff, non-tariff barriers, trade related investment measures (TRIMS) and barriers to domestic distribution still play an import role in these countries, although there are important cross-country differences in their timing, scope and importance.

China has clearly the more protected market, despite the progress made since the WTO accession in 2001, whereas in the other countries protection is particularly high for agriculture. There still exist wide differences in dynamism between these economies. Latin America has yet to resume the high growth rates of the 1950s-60s, whereas most of the Asian Pacific countries, particularly China, have been growing at a breakneck speed, led by exports.

The last several years have witnessed deep changes in trade policy in the Latin American region; this process has generally been accompanied with other far-reaching macroeconomic reforms. Costa Rica stands out as a determined reformer. From an average tariff of 53% in 1985 this country passed to the lowest level in the region: 3.3% in 1999. The overhaul of the tariff structure included the reduction of the average rate as well as the reduction in its dispersion. Though the gains along this dimension are not very notable throughout the nineties, there is a significant reduction relative to the levels observed during the second half of the eighties. Relative to the Chile's structure –which is almost flat- there is still some room to reduce Central America's tariff dispersion. The Table 5.1 exhibits the tariff dispersion structure among the Latin American countries covered under the present study.

Table 5.1: Tariff Dispersion among Latin American Countries

(Standard deviations)

Country	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Argentina	14.5	20.5	20.5	21.5	21.5	8.6	8.6	7.4	5.0	6.7	7.6	7.0	6.8	6.9	8.3
Brazil	36.7	30.0	30.0	26.2	17.2	19.8	17.3	14.2	9.5	8.2	6.9	8.5	7.7	7.3	7.8
Chile	3.2	1.7	1.7	1.0	1.0	0.9	0.9	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Colombia	28.2	16.8	16.8	17.6	17.6	14.2	8.3	6.3	6.3	6.3	4.9	6.3	6.3	6.2	6.2
Costa Rica	27.4	11.2	8.8	8.8	8.8	8.8	8.8	8.1	6.4	6.2	8.5	6.2	5.5	4.6	7.8
Ecuador	-	39.0	39.0	38.6	38.6	20.4	20.4	6.0	6.0	6.3	5.6	6.4	6.4	6.4	6.3
Mexico	15.4	14.3	14.3	7.0	7.0	4.5	4.5	4.5	4.4	4.4	5.4	10.6	10.6	13.5	9.4
Paraguay	-	15.2	15.2	15.2	15.2	13.0	1.4	7.8	6.8	7.7	6.9	7.1	6.7	6.5	7.4
Peru	26.8	25.9	25.9	27.4	27.4	22.6	22.6	4.4	4.4	4.4	4.4	4.4	4.4	2.9	2.5
Uruguay	16.2	18.8	18.8	14.4	14.4	9.7	9.7	5.9	5.9	5.9	7.1	7.3	6.9	7.9	4.3
Venezuela	28.6	30.2	30.2	31.4	31.4	17.1	17.1	11.3	11.3	11.3	4.8	4.8	6.1	6.1	5.9

Source: Computed on the data available with ECLAC, UNCTAD, WTO and IDB for the referred periods.

The involvement of Central America's major trading partner, the USA in a trade agreement benefiting neighboring Mexico could have been a source of disruption in the direction and pattern of trade flows in the region. Despite the implementation of NAFTA in 1994, a number of Central American countries (Costa Rica, Guatemala, Honduras, Nicaragua and the Dominican Republic)

witnessed throughout the decade an unprecedented increase in trade, both in import and export trade, with the US (Leaderman *et.al*, 2002) . This implies that NAFTA preferential treatment, with its potential trade diversion effect, was to some extent effectively counter balanced. It is notable that only Costa Rica experienced a decline in its market share, but this was probably due to export growth in other sectors of the economy of Costa Rica.

Table 5.2: Exports from Latin American Countries to Asia-Pacific (1990-2003)

(US \$ millions)

Country	Japan	Korea Republic	China	Hong Kong	Taiwan	Singapore	ASEAN ^a	Asia-Pacific (A)	World (B)	Percent Share (A/B)
Argentina	344 (395)	434 (51)	2478 (241)	98 (60)	126 (48)	10 (409)	1098 (329)	4588 (1164)	29566 (12352)	15.5 (9.4)
Brazil	2311 (2349)	1223 (543)	4533 (382)	694 (271)	689 (432)	338 (250)	1113 (790)	10900 (5016)	73084 (31412)	14.9 (16.0)
Chile	2243 (1384)	1006 (258)	1817 (34)	0 (41)	583 (279)	39 (33)	254 (132)	5922 (2162)	20077 (8522)	29.5 (25.4)
Colombia	202 (259)	76 (13)	82 (2)	16 (16)	52 (1)	11 (3)	18 (9)	456 (303)	13092 (6765)	3.5 (4.5)
Costa Rica	58 (15)	11 (5)	89 (0)	132 (2)	39 (6)	24 (1)	244 (5)	596 (34)	5800 (1456)	10.3 (2.4)
Ecuador	86 (51)	242 (23)	14 (0)	3 (0)	4 (65)	1 (0)	3 (2)	353 (142)	6038 (2714)	5.8 (5.2)
Mexico	607 (1442)	95 (102)	463 (65)	258 (42)	106 (0)	183 (33)	91 (26)	1803 (1711)	165395 (26345)	1.1 (6.5)
Paraguay	5 (21)	0 (6)	17 (67)	9 (17)	12 (3)	1 (5)	9 (5)	53 (123)	1242 (1708)	4.3 (7.2)
Peru	390 (420)	176 (65)	675 (55)	30 (19)	147 (50)	16 (0)	76 (18)	1511 (628)	8749 (3313)	17.3 (19.0)
Uruguay	12 (21)	6 (6)	95 (67)	14 (17)	5 (3)	2 (5)	63 (5)	197 (123)	2198 (1708)	9.0 (7.2)
Venezuela	135 (505)	15 (6)	165 (6)	11 (34)	37 (57)	201 (125)	9 (44)	571 (777)	24974 (18044)	2.3 (4.3)
LAC	6473 (6958)	3367 (1091)	10470 (866)	1278 (507)	1786 (967)	832 (495)	3029 (1376)	27234 (12261)	363707 (120916)	7.5 (10.1)

Figures in parentheses indicate values for 1990

Source: IDB-INT calculations based on UN/COMTRADE data published in the official document AB-2370, March 21, 2005: "Asia and Latin America and the Caribbean: Economic Links, Cooperation and Development Strategies"

Latin America's total exports grew by an annual average 8.9 percent between 1990 and 2003 raising its share of world exports from 3 to 5.4 percent as exhibited in Table 5.2. Mexico has been the indisputable driver of Latin America's export growth, with its share of the regional total rising from a fifth in the early 1980s to 45 percent in 2003. It may be observed from the exhibited data that four big countries which include Mexico, Brazil, Argentina, and Venezuela-today generate more than three-fourths of Latin America's exports. Imports mirror the export patterns.

Even with Latin America struggling with anemic economic growth, the region's imports rose by more than exports (an annual average of 10.1 percent in 1990-2003), perhaps reflecting the region's rather aggressive opening and episodes of exchange rate appreciation.

The dynamism of trade notwithstanding, the volume of Latin American exports to Asia-Pacific starts from a relatively low base and is well below the region's exports to North America, the European Union, and intra-regional commerce. In fact, while increasing substantially up to 1991, the importance of Asia-Pacific as a market for Latin America has declined over the past decade. Latin American exports to Asia-Pacific stood at \$24 billion in 2003, with the Asia-Pacific accounting for 6.6 percent of Latin America's total exports to the world—a marked drop from Asia-Pacific's share of 9 percent in 1990. Central America did, however, experience slight growth in the share of the Asia-Pacific in total exports in 1990-2003. Of the individual countries, Argentina, Chile, Colombia, Costa Rica, El Salvador, Guatemala, Jamaica, Paraguay, Peru, Uruguay, and Venezuela did experience a rise in the share of Asia-Pacific in their exports between 1990 and 2003.

The importance of the Asia-Pacific is most marked for Chile, which exported 29 percent of its exports to Asia-Pacific, as well as for the Mercosur countries, which sent 15 percent of their exports to the Asia-Pacific basin in 2003. Arguably, the most vulnerable region right now is Latin America, where most countries are trying to cope with an environment of high economic fragility, partly resulting from the current global slowdown but also reflecting internal political trouble and policy mismanagement. The region's problems are of a more long-term nature than merely cyclical and therefore need to be tackled accordingly, taking into account country-specific circumstances. Latin America's large distance from world markets, the region's complicated topography, and the tropical climate pose particularly important challenges²². On the macroeconomic front, the fiscal policy stance has deteriorated significantly in several countries, sending them into a dangerous spiral of increasing debts and deficits despite important efforts to generate primary surpluses in the public budget. However, that encouraging reforms have been implemented in some areas, notably regarding foreign trade and financial liberalization. As a

²² The discussion pertaining to Table 5.1 and 5.2 supports the hypotheses H5 and H6.

result, exports have deepened and become more diversified, which bodes well when the external environment becomes more favorable again.

Architecture of Business Partnering among Asian-LA Countries

The Latin American and Caribbean countries have a long history of bilateral and sub-regional preferential agreements on trade and economic integration. Dating from the 1960s and early 1970s, the Latin American Free Trade Area (LAFTA), the Andean Community (AC), the Caribbean Common Market (Caricom) and the Central American Common Market (CACM) rarely met their goals, because of the inherent clash between integration and import substitution industrialization. However, a new wave of preferential agreements rocked the region in the 1990s, now linked to a re-hauling of trade and development strategies. Traditional arrangements, such as the Latin American Integration Association (LAIA) - LAFTA's successor - and the AC, gained strength and Mercosur broke off as an important sub-regional initiative in South America. Various bilateral agreements (many of them under the Montevideo Treaty that created LAIA in 1981) were struck, generally with the goal of establishing free trade areas. Moreover, Mexico negotiated NAFTA with the US and Canada during the 1990s.

In the process of bi-regional business negotiations among the Latin American and Asian countries, the Free Trade Agreements (FTAs) were up until recently and signed mainly in reference to the geographically proximate countries. Today, however, FTAs are becoming trans-continental, Reflecting this trend are, for example, the US-Australia, US-Singapore, and Mexico-Israel FTAs, as well as the EU's FTAs with Chile, Mexico, and South Africa. Also Latin America and Asia have established trans-continental FTAs. In 2003, Chile and South Korea signed the first comprehensive FTA between an Asian and Latin American country; the agreement went into effect in April 2004. Japan and Mexico have also recently concluded FTA talks. Latin American and East Asian partners have launched negotiations for three further biregional FTAs, including Chile-Singapore-New Zealand, Mexico-South Korea, and Mexico- Singapore FTAs. Chile and Japan have formed a joint study group to explore the feasibility of launching formal FTA negotiations. Latin Arnerica-Asia trans-continentalisrn has spanned the AsiaPacific basin, with Brazil and India negotiating an FTA. Moreover, plans have been expressed for Chile-Japan,

Mexico-New Zealand, Mercosur-India, Mercosur-China, and Chile-China FTAs. The Table 5.3 exhibits the successful trade and economic negotiations since 1980 among the Latin American and Asian countries.

Table 5.3: Concluded Trade and Economic Partnership among the Latin American and Asian Countries (1980-2004)

Trade and Economic Agreements	Year of Entry
Asia-Pacific Economic Cooperation (APEC)	1989
South Korea-Chile	2003
Taiwan-Panama	2004
Japan –Mexico	2004

These agreements often managed to form sub-regional free trade areas; many even explicitly seek to become common markets. For example, Mercosur was created with the intention of gradually evolving towards a common market and the AC has reaffirmed its goal of forming a common market in 2005. Neither has the Caricom abandoned its strategic goal of building a common market, evidenced by member statements in the Protocol of Guatemala in 1993. With ambitious integration goals and modest results, taken together the initiatives present similar trends and prospects, most remain in a free trade, a stage incapable of turning into full-fledged customs unions. Divergent foreign policies, domestic political and economic restraints, and border conflicts plague nearly all. Conflicts flare up from disparities in size, economic structure and patterns of trade, in addition to often contradictory cost-benefit evaluations of undertaking a common external tariff. Moreover, regional agreements risk being drowned out by the deepening of unilateral preferential trade schemes in the US and the EU that benefit the small economies of Central America and the Caribbean.

Prospects

After many years of effort, a global preferential trade agreement was negotiated in the form of the Global System of Trade Preferences (GSTP), which entered into force in 1989. The Preamble of the GSTP Agreement embodies the belief that the system is a major instrument of south-south

cooperation, for the promotion of collective self-reliance as well as for the strengthening of world trade as a whole. Participation in the GSTP is limited to members of the Group of 77 and only those developing countries that have exchanged concessions are eligible for its benefits. Developing countries, as members of the Group of 77, can become parties to the Agreement individually or as a sub-regional, regional or interregional grouping. The Agreement envisages arrangements relating to tariffs; para-tariffs, non-tariff measures, direct trade measures, including medium and long-term contracts, and sectoral agreements. The negotiations can be conducted in accordance with one or any combination of the following modalities:

- Product-by-product negotiations;
- Across-the-board tariff reductions;
- Sectoral negotiations; and
- Direct trade measures.

The GSTP Agreement also contains special benefits for the least developed countries by granting exclusive preferential concessions and by stipulating that they must not be required to make concessions on a reciprocal basis. Concessions have been exchanged among 45 developing countries in the first round of GSTP negotiations, which concluded on 30 April 1988 and involved important trading nations from all regions. Among the countries were Argentina, Brazil, Chile, Colombia, Mexico and Peru from Latin America, and India, Indonesia, Malaysia, Pakistan, Philippines, Republic of Korea, Singapore and Thailand from the Asian and Pacific region. Some main features of the concessions granted in the first round of GSTP negotiations were:

- Concessions were confined to tariffs;
- Use of product-by-product negotiations as the modality;
- Limited coverage of concessions for most participants. For example, Argentina had five tariff lines at the 10-digit level; Chile had 10 tariff lines at the eight object level; Indonesia had one tariff line at the seven-digit level; Malaysia had one tariff line at the seven digit level; Philippines had three tariff lines at the seven-digit level and Thailand had 11 tariff lines at the six-digit level. Somewhat more extensive but still quite modest concessions were given by Brazil, 93 tariff lines at the eight-digit level; India gave 32

tariff lines at the six-digit level and Mexico gave 26 tariff lines at seven-digit level. Only the concession granted by Yugoslavia was quite extensive; and

- Concessions were generally in terms of a margin of preference over a range of 10 to 50 per cent.

The first and by far the most significant is Mercosur, with Argentina, Brazil, Paraguay and Uruguay as members. Mercosur introduced a common external tariff (CET) in 1995, to be phased over a six-year period. The aim is to eventually create a common market with free movement of goods, labor, services and capital. A feature of the Mercosur policy is that it has either formed a free trade area with other countries (such as Chile) or is actively negotiating such an accord (such as with the EU). Colombia, Mexico and Venezuela formed another free-trade area, known as the Group of Three in 1994, to be phased over a 10-year period.

In Asia, the most significant arrangement is among the countries of South-East Asia. ASEAN was formed in 1967 to promote economic, social and cultural cooperation among Indonesia, Malaysia, Philippines, Singapore and Thailand. In 1978, ASEAN put into force a preferential trading arrangement granting a margin of preference to members of 10 to 15 per cent on selected products. In the early 1990s, the arrangement was upgraded into the ASEAN Free Trade Area (AFTA) and in 1994 it was decided to fully implement the arrangement in 2003. ASEAN membership has also expanded to include Brunei Darussalam, Viet Nam, Lao People's Democratic Republic, Myanmar and Cambodia. Another integration arrangement among the developing countries of the region that is potentially significant is the South Asian Association for Regional Cooperation (SAARC), whose membership includes Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. A decision was taken in 1992 to form the SAARC Preferential Trading Arrangement (SAPTA) and in 1995, the group agreed to move towards a free trade area. However, political differences between India and Pakistan have impeded the effectiveness of the arrangement. In the meantime, India and Sri Lanka have moved separately to form a free trade area.

The economic integration arrangements in the Latin American and Asian regions have been established mainly at the sub-regional level. There are initiatives in the Latin American region to

link together some of the Sub-regional arrangements. This leads to the question of what are the possibilities for economic integration arrangements linking the two regions. In the Asian and Latin American regions, some cross-regional free trade areas are almost at the point of being established. The one between Chile and the Republic of Korea is more advanced, but other bilateral initiatives are under way between Japan and Chile, Colombia and Mexico. Preferential arrangements have also been envisaged between Taiwan Province of China and some countries in Central America. Besides the countries of Asia, membership in APEC includes Mexico, Peru and Chile. However, their membership has so far been only a consultation forum and not an integration arrangement. The trade and economic negotiations which are lying under process and newly planned have been exhibited in Table 5.4.

Table 5.4: Trade and Economic Negotiations among the Latin American and Asian Countries: In Process and Newly Proposed

Latin American Country	Asian Countries	
	Negotiations in Process	Newly Planned Proposals
Chile	Singapore-New Zealand	Japan
	China	-
Guatemala	Taiwan	-
Panama	Singapore	-
Peru	Singapore	-
	Thailand	
Mexico	Singapore	New Zealand
	-	South Korea
Mercosur	-	China
	-	India

Source: IDB, Integration and Regional Programs Department

The best opportunity for countries of Asia and Latin America may be to intensify their commercial exchanges by continuing to rely on non-discriminatory trade relations²³. To expand interregional trade, the countries of the two regions should look at barriers to trade for products of interest to them from countries of the other region and negotiate for reduction or elimination on

²³ The discussions in reference to Table 5.3 and 5.4 supports the hypotheses H5 and H6.

the basis of MFN at a future round of multilateral trade negotiations. Apart from this, other cooperative action could be taken to overcome impediments due to such factors as distance, lack of traditional trade relations and even linguistic differences that have inhibited interregional trade exchanges. Consultative forums among governments and among businesses should be set up where they do not exist. Such forums have to be strengthened where they already exist. Periodic consultations have to be coordinated with full use of the internet to disseminate information about production capabilities and the supply needs in the two regions.

Expansion of Latin America-Asia Trade Links

The trade performance of Asian and Pacific countries had been outstanding up to 1997. In 1980, the region exported less than US\$ 280 billion, by 1990 that total had increased to almost US\$ 700 billion and in 1995 more than US\$ 1,230 billion. Results on the export side were matched by an exceptional performance on the import side. Total imports jumped from US\$ 292 billion in 1980 to more than US\$ 700 billion 10 years later and over US\$ 1,300 billion in 1995. These values indicate an average annual growth rate between 1990 and 1995 of about 12 per cent for exports and over 13 per cent for imports. However, the Asian crisis had a negative effect on the region's trade performance. Between 1996 and 1998, the average annual growth of total exports was -0.2 per cent, while on the import side the decrease was more pronounced, at -4.2 per cent. The result for the period 1990-1998 shows that annual growth for exports reached only 7.5 per cent as compared to 11.5 per cent for the period of 1980-1990. Growth of Asian and Pacific exports to the countries belonging to Latin American Integration Association (LAIA) increased 19 per cent a year between 1990 and 1995, growth that was even more pronounced than intra-Asian trade. This was a clear indication that trade liberalization in Latin America offered a special opportunity for Asian and Pacific countries to increase their share in this expanding market. In the following three years, Asian and Pacific exports to Latin America increased over 7 per cent per year²⁴.

Inter-regional cooperation has intensified on the trans-Pacific agenda in recent years. Latin America and Asia-Pacific have created various fora to deal with bilateral economic and political issues. The most comprehensive in terms of bi-regional membership is the Forum for East Asia-

²⁴ World Trade Reports, 1999, 2001, 2003 and 2004, World Trade Organization

Latin America Cooperation (FEALAC) launched at a Ministerial Meeting in March 2001 in Santiago, Chile. Comprising of 17 Latin American and 15 Asia-Pacific economics, FEALAC is an informal mechanism for dialogue and cooperation among the countries of the two regions to meet political, cultural, social, economic and international issues of common concern. Two further major venues of trans-Pacific cooperation are the Pacific Basin Economic Council (PBEC) and the Pacific Economic Cooperation Conference (PECC). The Latin American partners in each are Colombia, Chile, Ecuador, Mexico and Peru. PBEC is an association of senior business leaders from more than 1,100 major corporations in 20 economics around the Pacific Basin Region aimed at expanding trade and investment flows through open markets. In its next International General Meeting (IGM) in June 2005 in Hong Kong, PECC will focus on the Pacific Basin's role in the next stages of globalization, such as the Doha Development Round. Meanwhile, the 25-member PECC promotes trade, investment, financial stability, and development around the Pacific Rim. It comprises senior representatives from business, government, and the academia. PECC has recently focused on the proliferation of regional integration agreements as a potential way for achieving the Bogor Convention Goals of APEC²⁵.

Japan and Latin America have deep-seated cooperation. Japan has alone, contributed to Latin America's development through economic and technical cooperation aimed particularly at economic reform, poverty reduction, and environmental protection. It is one of Latin America's main sources of Official Development Assistance (ODA). Japan was one of the key actors in helping Latin America debt crisis of the early- 1980s, and also involved in the Central American peace processes. More recently, Japan has supported the electoral processes in Latin America, including joining the dispatch of election observers from the Organization of American States (OAS). Japan has also pursued active cooperation with the Caribbean through the Japan-CARICOM Consultation, which centers on fostering bilateral relations, and economic cooperation, cultural exchanges, and collaboration in international fora.

It is interesting to note that this was the highest rate of growth compared to other regions. On the other hand, Asian and Pacific imports from LAIA were the most affected among the regions.

²⁵ Official document Inter-American Development Bank (IDB) # AB-2370, March 21, 2005: "Asia and Latin America and the Caribbean: Economic Links, Cooperation and Development Strategies"

Even before the Asian crisis, Latin America was a minor partner in Asia's export and import flows. In 1998, only 2.2 per cent of total Asian and Pacific exports went to Latin America, and only 1.8 per cent of their imports originated in LAIA countries. It is even more significant that 18 years earlier, the share of LAIA countries in total Asian and Pacific exports and imports was higher. During the first five years of the 1990s, growth of exports from Asia and the Pacific to LAIA was high. Eight countries had annual average growth rates over 20 per cent during this period. Three countries that included China, Indonesia and Thailand had increases of over 40 per cent in their exports to the region.

The average annual growth rate for imports to East Asian countries from LAIA countries actually increased slightly over the rate for 1990-1995. However, New Zealand's imports from the world which had increased on average by 8 per cent between 1990 and 1995 decreased almost 6 per cent between 1996 and 1998. Before the crisis, the most dynamic Asian market for Latin American products was Malaysia, followed closely by Indonesia. The import demand of these two countries declined drastically after the crisis. During this period, Latin America represented more than 2 per cent of total imports for only five Asian and Pacific countries, Latin America absorbed more than 2 per cent of total exports for only three countries. Latin America had the highest average market share of total exports for Japan, while the region's imports were more relevant for the Republic of Korea. South Korea maintains important institutional ties with the countries of Latin America and the Caribbean. It was one of the first Asian countries to join the OAS as a permanent observer, and has made efforts to contribute to Latin America's economic and social development through ODA and technical cooperation. South Korea has recently sought to deepen its economic ties with Latin America. Besides the FTA with Chile, in 2003 South Korea staged with various Latin American countries the South Korea-Latin America and Caribbean Business Forum, which drew a host of government officials and analysts. South Korea and Mexico are joined by the 21st Century Commission, a private-level consultation forum created to explore possibilities for longer-term bilateral collaboration.

China and Latin America have strengthened cooperation ties markedly over the past decade. The Rio Group and China launched political dialogue in 1990, and in 1994 China became the first foreign country to be admitted as an observer to the Latin American Integration Agreement

(LAIA or ALADI). In 1997, China was admitted to the Caribbean Development Bank. China has also held official talks with Mercosur following the establishment of a bilateral dialogue mechanism. Furthermore, much like Japan and South Korea, China collaborates with various Latin American countries in APEC and FEALAC. It also has expressed interest in a non-borrower membership in the Inter-American Development Bank.

Business between East Asia and Latin America is small. East Asia is largely represented by the countries Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam, along with Australia, China, Japan, South Korea and New Zealand. Latin-American countries export only \$23 billion worth of products to East Asia from total annual exports of \$350 billion with an even smaller amount of Asian exports going the other way. Total trade, on the other hand, between the Philippines and Latin America was around \$800 million in 2002. Trade between the Philippines and Mexico paced these economic ties. Our other major export markets are Panama, Brazil, Chile and Costa Rica. The relations between the Philippines and Mexico started with the Galleon Trade. Through the centuries, bilateral trade ties have developed between Manila and Latin-American capitals. There was a time when the Philippines was considered part of the Hispanic community. The potential for bigger trade and investments is great. Latin America with 500 million consumers is a major market for Philippine goods and services. Manila promises to be a big investment partner and regional headquarters for Latin America in Asia. Philippine visibility is strong in most of Latin America, although there is a need to establish full-fledged embassies in many countries to speed up economic and cultural ties. The

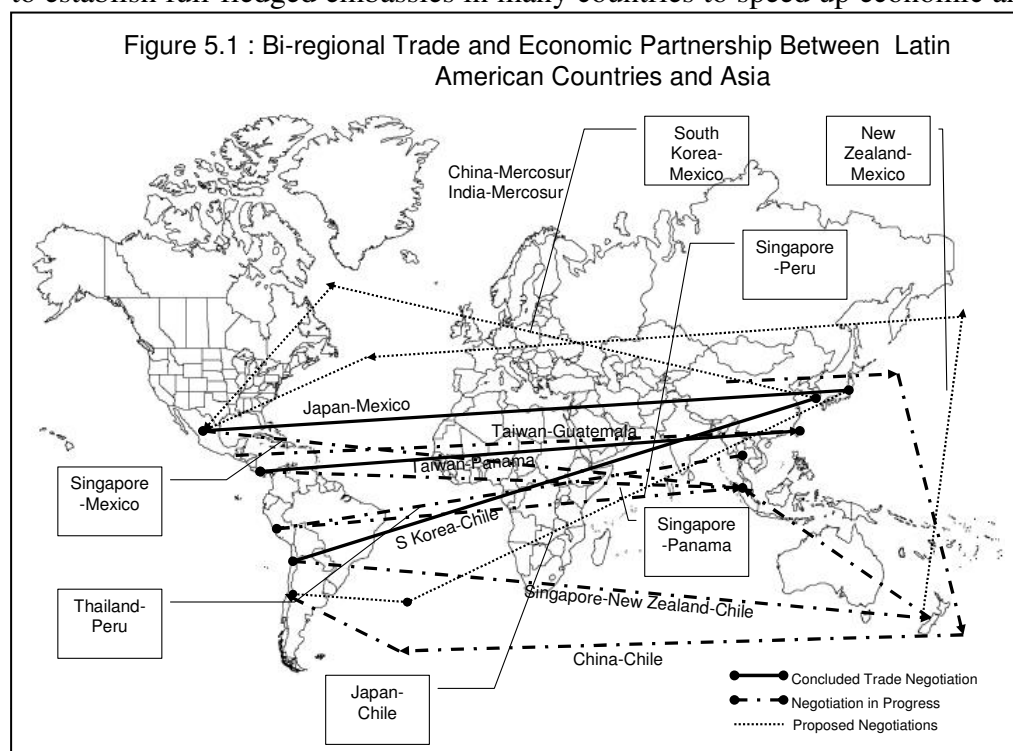


Figure 5.1 exhibits the possible trade agreements among the Latin America and Southeast Asian countries.

In fact, Latin America was the only region that presented positive growth rates for exports from Asia and the Pacific. The solid nature of Latin American import demand has at its roots the process of deep transformation in the region. The depth in the recent crisis in Latin America has not entirely stopped this process. However, Latin American exports to Asia and the Pacific were the most strongly affected by the crisis. This creates a challenge for countries of both regions to find ways to establish solid trade and economic relation that are less vulnerable to fluctuations in the international economic environment. During the 1990s, Latin America improved its trade ties with most regions of the world. From 1990 to 1998, total exports increased from US\$ 113 billion to US\$ 248 billion. Total imports, which stood at US\$ 83 billion in 1990, reached US\$ 282 billion in 1998. These values indicate an average annual increase of almost 17 per cent for imports and 11 per cent for exports. These statistics represent a drastic change from the 1980s when the debt crisis caused a slowdown for Latin America's external trade, particularly in imports. As shown in the tables, LAIA imports stagnated in the period 1980-1990, growing at an average of 4 per cent annually. In the same period, the yearly average increase of world exports was 6 per cent.



Chapter 6

Summary and Recommendations

It may be seen from the international trade arrangements that the trade structure of the Western Hemisphere's intraregional trade is significant but excessively concentrated in bilateral trade between a few countries; the United States with Mexico and Canada, and Argentina with Brazil. In 1999, almost all countries in this region either reported a sharp decline in economic growth or were in full recession, displaying a regional growth rate close to nil for that year. The value of exports from the region fell in 1998 for the first time in over 10 years. While total exports of the region recovered slightly in 1999, intraregional trade in the case of Mercosur and the Andean Community fell markedly in 1999. However, there have been some favorable external factors, such as strong economic growth in the United States; continued economic expansion in Europe; possible recovery of Japan from recession; more favorable prospects for international financial flows to the region; and the recovery of commodity prices. ECLAC forecasts for the region that there will be a significant recovery with an average growth rate of 3.6 per cent for 2000. Latin American exports to Asia and the Pacific, however, accounted for only 2 per cent of Asian and Pacific imports, showing a steady decline from a share of more than 3 per cent of Asian and Pacific imports in 1970. This meant that Asia and the Pacific had become one of the most important trade partners for Latin America as a whole, while the relative importance of LAIA countries for Asia and the Pacific was small, in terms of both their imports and exports.

The import and export markets for both regions have become more diversified a process that is expected to continue in the future. Among the LAIA countries, Argentina, Brazil, Chile and Mexico accounted for more than 80 per cent of the total interregional trade flows. Generally, the economic contraction in 1998 for major trade partners, Japan and the Republic of Korea, had a strong negative effect on the LAIA import demand. The share of LAIA in total imports was highest for Japan, but at only 3.2 per cent; while the Republic of Korea showed the highest LAIA participation in total exports at 3.5 per cent during 1990-2000. In the same period Peru, Mexico and the four Mercosur countries absorbed imports from Asia and the Pacific at a rapid rate, in some cases close to 40 per cent a year.

The exports from Asia and the Pacific to Latin America have achieved a higher degree of diversification. Asia and the Pacific entered the Latin American market with a variety of goods produced by industries operating at great advantages of scale and with advanced technology (automobiles and their components, home appliances and electronic products). Meanwhile, Latin America provides Asia and the Pacific with primary products such as copper, iron, steel, zinc, wood, soybeans, coffee, fish and meat, plus a few semi-manufactured products such as soybean oil, refined copper and fish meal. Sometimes, Latin American producers are able to compete with Asian and Pacific producers in their own markets. In this context, it is clear that manufactured products from LAIA countries have had better access to sub-regional and hemispheric markets than Asian and Pacific products.

The product composition of LAIA exports differs substantially according to its trading partners. Manufactures prevail in LAIA exports to the United States as well as in intraregional trade. In fact, close to 65 per cent of LAIA intraregional trade consists of manufactures. Food products predominate in LAIA exports to the European Union. In contrast, LAIA exports to Asia and the Pacific show a very different product composition. Minerals, metals and food have a large share in LAIA exports to this region. There has been a marked increase in the trade share of food. It is also interesting that manufactured exports to Japan are very limited, while exports to other Asian and Pacific countries and areas have a relatively high share of manufactures and semi-manufactures. Due to the increasing relative importance of food products and metals and minerals, the share of manufactures and fuels in LAIA exports to Asia and the Pacific has declined throughout the 1990s. The principal LAIA export items to Asia and the Pacific are by and large primary commodities, whose depressed prices recently has resulted in much lower values of exports. The major export items include copper; iron ore; iron and steel; aluminum; crude oil; wood, study and pulp; soybeans and soybean products; coffee; fish and its products and meat; and leather. LAIA countries could be expected to play an increasingly important role as bases providing several primary commodities to Asia and the Pacific. The product composition of Asian and Pacific exports is dominated by manufactured goods, regardless of the importing region.

External trade with Asia and the Pacific appears to exhibit the most traditional features of the Latin American export model. The competitiveness of this model continues to depend on natural resources, while it gradually starts to incorporate products with a higher value-added. For instance, in the case of Chile, a decline in exports of the mining sector has been replaced with an increasing share the forest industry and its by-products (pulp and study), fish industry and agro-industry. Brazil has developed a processed food industry and some progress can also be observed in the metal industry, especially steel and tin. Argentina has achieved a better trade position by exporting steel pipes to Asian markets, especially to ASEAN-member countries. Mexico has developed industries in the cement and glass sectors. All these products, which have been called “industrial commodities”, indicate that a slow diversification process of trade between Latin America and Asian economies (Akio, 1999) began to appear in the 1990s and projected to be in the early decade of 2000.

Both regions have made commendable progress in reducing barriers to trade through multilateral trade negotiations, regional efforts, bilateral efforts and unilateral measures. In Asia and the Pacific, average tariffs have declined substantially in recent years. The simple average applied tariff in 1996 was below 15 per cent for 10 of the 12 countries considered, of which eight were below 10 per cent and three below 5 per cent. Liberalization efforts in more recent years have brought the rates even lower. The LAIA countries have also registered remarkable reductions in tariffs and tariff dispersion in recent years, and their average of MFN rates now fall in the range of about 10 to 14 per cent. The majority of the countries in both regions are taking a “Uruguay Round Plus” approach. High tariffs affecting some industries and numerous non-tariff barriers (NTBs) still exist in both regions, despite the benefits of liberalized trade, and this substantially reduces mutual comparative advantages. In fact, although tariffs have gradually been reduced, NTBs are still prevalent, including quotas, import licensing, discriminatory customs procedures, burdensome testing and certification requirements.

The recent proliferation of trade agreements in Latin America and Asia and the Pacific has not only brought realignments in tariff and non-tariff measures, but also dynamic effects on trade and investment flows, the cost structure of production, competition patterns and the creation and diffusion of technology. These agreements have contributed to better articulation of transport,

telecommunications, energy, water and other infrastructure capacities at the regional level. It is expected that they will also lead to a more homogenous system of trade-related services, investment, intellectual property rights, factor mobility, rules of origin, anti-monopoly laws, anti-dumping and safeguards, sanitary and phytosanitary regulations. These efforts to enhance the systemic competitiveness of each region will, in turn, enable each country to more efficiently participate in the world market.

Recommendations

In view of the economic development of the countries involved and in their political, social, legal and administrative systems, and with equal respect for the views of all participating countries, future business partnering and economic cooperation between Latin America and East Asian countries may be guided by the following strategies:

General Trade Negotiations

- The countries of each region should exhibit multidimensionality by giving priority to strengthening their relations with one another, through efforts that carry forward on the political, economic and social dimensions, particularly in areas of trade, investment, social development, science and technology, education, culture and institutional development.
- The business partnership strategies should be developed keeping in view the heterogeneity in economic development, culture and institutional modalities that exist in both regions, while seeking globally balanced relations. The relationship should be based on fundamental shared principles and values, which in turn can be translated into clear political messages and a general sustained process of dialogue and cooperation. Relationships can be deepened at the bi-regional level, regional or bilateral levels, taking advantages of the special circumstances of country groupings. Building relationships should proceed at different levels and speeds among the countries of the region.

- Considering the multiplicity of forums it is necessary to focus the trade partnering negotiations at bilateral and multilateral levels and avoid overlap between distinct dialogues and similar initiatives taken at other forums.
- In order to promote the private and public sectors in both regions to take advantage of trade and investment opportunities, Asia and Pacific and Latin American countries should have a framework for discussing and harmonizing common trade and investment interests.
- Economic issues should be a key part of the cooperation process between the two regions in view of the current low levels of economic exchange and the great potential for expansion. Close and growing economic ties are an important element for recovery and sustained growth in both regions. Both regions should work together to develop priorities, policies and measures in economic cooperation and thus maximize interregional synergy, based on the following principles: (i) closer cooperation and dialogue between government and the private sector, with the latter as the engine of growth; (ii) non-discriminatory liberalization, transparency and open regionalism; and (iii) consistency and compliance with applicable international rules, particularly those of the WTO.
- Increased trade and investment based on open markets and firm adherence to applicable international rules would contribute to early restoration of broad-based economic growth in both regions. The policies should be framed to remove the existing bottlenecks such as information exchange and knowledge sharing to intensify the bi-regional/ bilateral trade and investment flows

Operational Issues in Business Partnering Model

Bilateral negotiations should be strategically pursued in removing/ reducing the non-tariff and investment barriers. The trade related negotiations among the Latin America-East Asian countries should also focus on the technical norms and standards; rules of origin, anti-dumping, subsidies, countervailing measures; other liberalization and deregulation measures (privatization); sub-regional, regional and hemispheric integration processes; and convergence and divergence between regional integration and multilateral trade regimes. The negotiations should also be dealt on simplifying the customs rules and procedures, including non-transparent and inefficient

infrastructures; differing customs; improper application of rules of origin, customs valuation, pre-shipment inspection and import licensing. Customs problems can be especially difficult for small and medium enterprises that have less experience and fewer resources for handling these problems.

Bi-regional multilateral trade need to be encouraged among the Latin America and East Asian countries which would enable them to promote liberalization which is conducive to increasing the traditional trade flows among the participating countries. The bi-regional diplomatic negotiations should be evolved towards developing an action plan aiming at reducing NTBs and transaction costs, as well as promoting trade and investment opportunities between the two regions. Such a plan could provide concrete goals to be achieved in identified priority areas such as: (a) customs procedures, standards, testing, certification and accreditation; (b) public procurement; (c) quarantine and SPS procedures; (d) intellectual property rights; and (e) mobility of business people. The detailed descriptions on the above issues are discussed below:

Customs Procedures

- Accelerated alignment and harmonization of tariff nomenclatures with the World Customs Organization(WCO) standards;
- Accelerated implementation of obligations under the WTO Customs Valuation Agreement;
- Endeavor to start negotiations on customs co-operation and mutual administrative assistance agreements between the Latin American and Asian business partners;
- Promotion of transparency through mutual access to existing databases such as customs duties and nomenclature, tariff quotas, import and export procedures and formalities, rules of origin, customs legislation, etc.;
- Improvement of predictability for the business community through publication, and clarification upon request, of customs regulations and procedures in force taking into account, where appropriate, the relevant international customs Conventions, such as the Kyoto Convention;

- Promotion of standardized and simplified documentation taking into account the existing international standards and the ongoing discussions in various international fora.

Standards, testing, certification, accreditation and technical regulations

In supporting and enhancing the bi-regional trade related cooperation in the areas of standards, testing, certification, and accreditation bodies, the deliverables which may need to be considered during evolving the trade policies or tenure agreements are discussed as below:

- Close consultation, where appropriate, in relation to the work of international bodies dealing with standards such as the International Organization for Standards (ISO) and the International Electrotechnical Commission (IEC) and to the WTO –Technical Barriers to Trade(TBT) discussions;
- Work towards the improvement of mutual understanding of each other’s systems of testing, accreditation and certification of conformity, and the development and dissemination of information materials on national standards, certification and accreditation procedures in SME friendly format;
- Accelerated alignment of national standards to international standards, ensuring that national standards thus aligned are embodied in national laws and regulations, and periodic reporting thereon;
- Identification of sectors of priority interest with a view to the consideration of entering into Mutual Recognition Arrangements (MARS); and
- Establishing cooperation in the promotion of technical and institutional capacity-building in relation to standards, testing, certification, accreditation and technical regulations, including the exchange of information on existing programs, the identification of possible gaps, and the enhancement of cooperation programs as appropriate.

Public Procurement

The governments of Latin America-East Asian countries may develop a Trade Facilitation Action Plan (TFAP) with a focus providing transparency in public procurement, in particular through exchanging information on public procurement procedures, statistics, and opportunities. The plan may include exchange of information on central government procurement procedures and making them available in a format suitable to the business community; sharing inventory of existing database and promoting mutual cooperation on exploring the technical support on public procurement projects.

Quarantine and Sanitary and Phytosanitary (SPS) Measures

The bi-regional trade agreements should also discuss the issues related to promotion of simplification and rationalization in procedures and documentation considering international best practice, and enhancement of transparency on electronic media. This would help enhancing the trade among the partnering countries in plant genetic engineering and value added trade of flora based products. Such negotiations would facilitate enhancement of transparency in key quarantine and SPS areas including inspection and approval procedures, quarantine requirements and normal inspection processing time.

Intellectual Property Rights(IPR)

The TFAP should also focus on cooperation in technical, institutional and human capacity-building in relation to IPR awareness and enforcement including exchange of information on existing programs, the identification of possible gaps in these programs, and their enhancement as appropriate.

Mobility of Business People

With a view to facilitating direct business-to-business contacts between the two regions, the negotiating countries should draw an administrative measures to examine and report

on concerns identified by the business community with respect to formalities for business travel and temporary stay.

Trade in Private Sector

The role of private sector organizations and chambers of commerce can be assumed in the creation of a private sector network linking Asian and Latin American companies. The integration process also involves mutual perceptions that are cultural, with an aim to replace the conventional agreements with contacts among actual business people and the possibility of creating common policies and benefits.

Global Wrap-up

There is a fast change observed in the world markets resulting into the new emerging markets across the countries.. In this century China, India and Latin America and the emerging market based economies in Eastern Europe promise new opportunities for global trade. The Pacific region had shown time-bending leap in the past four decades as significant Asian population participated in the rapid transition in response to the global movement of trade and services. Asia may be portrayed as the fastest growing market for the top brands of western companies and at the same time the Asian companies began penetrating in the western markets at low price-high quality strategy. While the luxury and fashion goods are dominating the Asian and Far-east markets, the specialized product like electronics and automobiles from Asian Markets are trying to capture considerable market share in Europe and North American countries. The emerging markets in the developing countries have shown a strong potential for change in preferences during the late 20th century. In most of the advanced countries the birth rate is declining while it is increasing in the developing countries. It has been observed that the technology has homogenized the world markets for variety of customer and industrial needs. The reduction in the tariff barriers, duties and liberalization process worldwide has further given a stimulus to the international marketing across the regional boundaries.

International companies, in order to be better among the competition involve significantly in assessing, monitoring and responding to the global competition by offering competitive values, developing superior brand image and positioning the product appropriately, keeping broader product line, adjustable price and keeping the quality of the products relatively high. Thus, it may

be stated in brief that for competing globally the international companies should configure their marketing operation as discussed above, coordinate effectively with the domestic and neighboring markets and establish linkage of various marketing activities in different regions in order to sustain growing competition. Networks have made integration systems an essential aspect of doing business. Businesses rely on significant integration of servers to address the business needs of division, partners, distributors, and other affiliated groups to achieve efficient information access, enterprise-wide communication, and business process systems automation. Changing composition of world trade has been accompanied by a shift in production structures and the composition of domestic output. In industrial countries growth in the information technology sector is rapidly changing with technology and services while developing countries are specializing in areas like apparel, metal products and electronics.

The Pacific Rim offers a variety of opportunities for American and European companies for the products and services that range from telecommunication instruments to the aircraft seats and banking services and a host of other products. Although it is a competitive market, the region is growing economically cohesive that attracts production sharing possibilities with the industrial countries. The Asian producers outside Japan have gained more than one fourth of the global market share for personal computers. Japan and the Pacific emerging triad comprising Singapore, Taiwan and South Korea provide most of the capital and expertise for the rest of the countries of the region that have enormous labor and natural resources. Hong Kong also contributes significantly for the development of international trade in the pacific region. Japan is Canada's second largest national trading partner (after the United States), taking 2.1% of total exports, and is the fifth largest source of foreign direct investment (FDI) in Canada. Canada is a leading supplier to Japan of a number of products of key export interest, such as lumber, pulp and study, coal, meat, fish, oilseeds and prefabricated housing. While resource-based exports continue to represent much of our trading relationship, Canada is an increasingly important source of sophisticated, value-added, technology-driven products and services imported by Japan. In 2003, Canada's total merchandise trade with Japan was \$22 billion. Canadian exports to Japan have declined steadily since the mid 1990s, Canadian exports to Japan declined again to \$8.1 billion in 2003 from \$8.4 billion in 2002 while imports from Japan decreased by 10% in 2003 to

\$14 billion. In 2003, Canada exported \$1.4 billion in services and imported \$1.9 billion²⁶. The long-term trend in Japan is toward a growing demand for cost-competitive and innovative imports, which represents a significant market opportunity for Canadian exporters. The Asia Pacific region has been the fastest growing trade block over past three decades though it had experience downturn in 1998 and extended after shocks. East Asia is the principal export market for American goods. The transpacific trade has grown over 50 percent of its transatlantic trade by the end of 20th century.

²⁶ Government of Canada : Report on Canada's International Market Access Priorities- 2004, Department of Foreign Affairs and International Trade, Opening doors to the world, Chapter 6, 2004



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