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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

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UNIDO'S MERCOSUR PROJECT: OVERVIEW REPORT

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MERCOSUR REPORT SERIES D.

Prepared under UNDP-financed TSS-1 facility

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FOREWORD

The UNIDO MERCOSUR project, carried out under the UNDP-financed TSS-1 facility, focused on three main areas within a medium-term outlook:

A. A review of the situation of specific industrial subsectors in order to identify the implications of the MERCOSUR timetable for industrial restructuring and ensuing requirements for technical assistance.

B. An assessment of the past record and prospects of intra-industry MERCOSUR trade as a possible engine for trade creation and efficiency gains.

C. An evaluation of the experience of the European Union from a MERCOSUR perspective in three specific areas:

   (i) Manpower policies, with emphasis on vocational education;

   (ii) Investment incentive regimes;

   (iii) Competition policies.

UNIDO published a first background paper entitled "Trade integration and industrial restructuring: The case of MERCOSUR" (PPD.235(SPEC.)), 28 January 1993. The UNIDO MERCOSUR project included seven additional reports, as follows:

A.1 Medium-term scenarios for industrial restructuring: the pulp and paper subsector;

A.2 Medium-term scenarios for industrial restructuring: the leather and footwear subsector;

B. Intra-industry trade and regional integration between the MERCOSUR countries;

C.1 Training policies in the EU countries;

C.2 Investment incentives, subsidies and related regulations in the EU countries;

C.3 Competition policy in the EU;

D. UNIDO's MERCOSUR project: Overview report.

This overview report on the UNIDO MERCOSUR project summarizes the eight studies and reports made under the project. For further detail of any of the subjects studied, the reader is therefore referred to the full reports. The tables of contents of all the reports are listed in the annex at the end of this document. The overview report contains recommendations concerning the role international cooperation could play in the industrial restructuring that will be entailed by MERCOSUR when it is fully implemented, including recommendations for drawing on the wide technical experience acquired by UNIDO in this field.

CONTENTS

I. TRADE INTEGRATION AND INDUSTRIAL RESTRUCTURING: THE CASE OF MERCOSUR (PPD.235)

1. The objectives of MERCOSUR

The first UNIDO report on the MERCOSUR project was aimed at reviewing some key industrial policy issues raised by the MERCOSUR integration project and at identifying at subsectoral level industrial restructuring and related technical assistance requirements stemming from the timetable for integration specified in the Treaty of Asunción.

Against a backdrop of contradictory current trends towards trade liberalization and the formation of regional blocs, on the one hand, and the growth of subtle forms of protectionism and managed trade practices, on the other, the Presidents of Argentina, Brazil, Paraguay and Uruguay signed on 26 March 1991 the Treaty of Asunción aimed at creating a common market with effect from 1 January 1995.

The Treaty includes a commitment to reduce reciprocal tariffs to 0 per cent by 31 December 1994 with automatic yearly reductions of one fifth. A common external tariff is to be established. Uruguay and Paraguay should have removed their restrictions on trade with the four members of MERCOSUR by 31 December 1995. The parties also agreed to progress gradually towards the free movement of capital, labour and services and to coordinate economic policies to the extent necessary to ensure free trade. The final stage of achieving a full-fledged common market, starting from the establishment of a customs union, will begin on 1 January 1995. The time schedule to arrive at that goal has not been fixed, nor have all the instruments been defined.

On 20 June 1991, the MERCOSUR countries and the United States agreed to establish a joint committee with the task of discussing how trade and investment flows among the five countries could be fostered. After the signing of an inter-agency cooperation agreement between the European Union and the four MERCOSUR countries, a new and more ambitious agreement was envisaged once the customs union is established and MERCOSUR has acquired international legal status. The possibility of an agreement with Japan has also been raised.

The way has been left open for Chile and Bolivia to forge links with MERCOSUR and possibly become full members in the near future. Both countries have already confirmed their intention to negotiate agreements with MERCOSUR, within the framework of the South American free trade area, which MERCOSUR will promote at the instigation of Brazil.

With a total population of 190 million and a GNP of the order of US$ 700 billion, MERCOSUR can be expected to become a sizeable market by international standards.

2. MERCOSUR and intra-industry trade

MERCOSUR is the outcome of a political decision to exploit important latent opportunities for efficiency gains and trade creation and to avoid swimming against the tide of globalization and regional integration in the world economy, which has gained strength from the results obtained in the recent Uruguay Round and the creation of the World Trade Organization.

Important medium-term implications follow from this political decision regarding resource allocation and policies in the interrelated fields of industry, environment, human resources and science and technology. The ensuing economic and institutional adjustments are to be superimposed on those that are already part of the far-reaching economic and social reforms under way at national level in each of the member countries. In the case of the industrial sector, a great potential for reaping economies of specialization and intra-industry trade exists, although a special effort is required to avoid waste of resources and high social costs and to create an environment conducive to private initiative. The urgency with which this effort is required can hardly be overstated.

Although efficiency gains, trade creation and, ultimately, increased social well-being are the expected outcome, unavoidable adjustment costs are entailed. These are related to the execution of the needed industrial restructuring programmes whereby manufacturing enterprises streamline and focus their product lines, reap gains from economies of scale and specialization, and upgrade their international competitiveness. Although some progress along these lines is already observed, the concretion of the common market, starting with the field of free trade and the customs union, will provide a powerful additional incentive within a much broader perspective.

Ambivalent signals stem from current tensions arising from the coexistence of generalized policy changes towards multilateral trade growth, liberalization, deregulation and privatization, on the one hand, and trends towards managed trade, on the other.

At the same time, both on policy and theoretical grounds, trade issues and industrial policy issues are increasingly converging.

International trade friction and conflicts arising from the implementation of subsidy schemes to domestic industry are an almost daily event. In addition, foreign direct investment and other non-market transactions are becoming as powerful a drive towards economic integration as trade itself.

International market structure and conduct are undergoing sharp changes. A clear thrust towards skill-based, more narrowly focused specialization coupled with an intensive strategic partnering activity and cross-border flows of skills and research and development outputs is observed. The frontiers between arm's length and non-arm's length transactions are becoming blurred.

Trade liberalization trends notwithstanding, selective policy interventions are still evasive, albeit under new labels. Their all-out dismissal is being reassessed in the light of concrete, successful historical experiences and new theoretical developments. In both conceptual and practical ways, the blurring of the borderlines between "selective" and "functional" policy interventions does not make the ensuing policy debate any easier.

A new environment for trade and investment is clearly discernible. Most foreign direct investment (FDI), technology and trade flows take place between and within trade blocs (including their peripheries). The share of the three main blocks in world-wide inward FDI rose from 30 per cent in 1980 to 39 per cent in 1988. In 1989, 59 per cent of world trade took place either between (23 per cent) or within (36 per cent) the three main trade blocs. Similarly, out of a total of 4,192 strategic technology alliances undertaken during 1980-1989, 91.3 per cent were either intra- (49 per cent) or inter- (42.3 per cent) alliances by countries members of the three main economic blocs in the world.

Intensive industrial relocation activity is taking place within and between the major trade blocs. Take the South-East Asian region. Many firms from Japan, the Republic of Korea, Taiwan Province of China and Singapore are relocating unskilled labour-intensive activities into low wage-cost economies, giving rise to an emerging intra-firm, inter- and intra-industry network in which high skill, critical component production and assembly segments are retained at home, particularly in Japan, while other segments and subassemblies are relocated within the region.

Subject to the pressures ensuing from the ambivalent context depicted above, the Latin American countries are striving to enhance their capacity to create wealth through an in-depth reassessment of their competitive abilities within ever more open economies. Economic integration schemes such as MERCOSUR, the Central American Common Market, the Caribbean Common Market and the Andean Pact, are one of the avenues being sought, under completely new premises, to facilitate efficiency gains by acceding to larger markets and thus reaping potential economies of scale and advantages from specialization.

The potential for efficiency gains and trade creation in the context of trade integration schemes lies heavily, although by no means exclusively, in the development of two-way trade in manufacturing products (intra-industry trade, IIT). Both global and more specific regional trends point towards the development of IIT as the single fastest growing component of global trade in manufactures and one of the main engines of economic growth. Except for Japan, this kind of trade has become more important than interindustry trade in the industrial world and it is on its way to do so in the developing world as well.

As far as efficiency gains are concerned, the key component of IIT is increasing returns from dynamic economies of scale (particularly those stemming from learning-by-doing and skill upgrading). However, the growth of IIT is by no means a safe indicator of improved resource allocation. It may also mean the opposite.

By emphasizing the IIT and industrial restructuring (IR) dimensions of trade integration, at least two key factors accounting for the failure of past integration attempts (e.g. LAFTA) may be counteracted, i.e. (i) too much focusing on the pure trade approach to integration, and (ii) the uneven distribution of the costs and benefits of regional trade liberalization.

There are a number reasons why the joint approach to trade integration, IIT and IR issues is of particular relevance, not just to leading developed market economies but to industrializing countries as well. These reasons have to do, among other things, with policy definitions relating to the scope and time-frame for an efficient application of infant industry criteria.

3. Industrial restructuring requirements in MERCOSUR

The scope and timing of IR policies are profoundly influenced by broader policy-related issues that arise within a trade area. One of them is: is there a need for a pace setter? A given country may be called forth to play this role if it offers the best combination of competitive strength, economic dynamism, monetary stability and influence on world markets. Such is the case of Germany in the EU, the United States of America in NAFTA and Japan in East Asia.

If a country with a vocation for pace setting falls into disarray (witness Germany today) and is therefore unable to perform as expected, the immediate alternatives are: (i) another country may take its role; (ii) the trade area is weakened and eventually breaks down; and (iii) the weaker countries choose a third (extra-area) country or region or the world market as a whole as an "anchor".

When the differences in specific weight of the countries concerned is substantial, alternative (i) may not be viable; therefore, alternative (iii) becomes the only one viable if the trade area is to subsist. This, however, may weaken considerably the scope for policy convergence and, with it, for trade creation and efficiency gains to stem from the trade area.

One of the main challenges faced by MERCOSUR members is that the domestic content regulations and rules of origin to be set forth do so in such a way as to avoid the trade area becoming an exercise in extended import substitution. This is critical for those countries and subsectors with a low degree of vertical integration and a high relative weight of downstream activities. These countries will naturally favour relying on world market prices as much as possible, thus strengthening the external "anchor" resort, as is the case of Canada within NAFTA.

Progress towards freer intra-MERCOSUR trade will bring about strong adjustment pressures.

There are two types of IR needs pursuant to the removal of barriers to trade to be dealt with. Firstly, there are those having to do with adjustment pressures on existing capacity, and secondly, those related to new industrial opportunities opened by the enlarged market.

It would not be advisable to wait for protectionist lobbying by firms that are in need of restructuring once it is too late to do much about it instead of encouraging them to adjust when there is still time to do so. The rationale behind such a stand, it is sometimes argued, is that adjustment costs are simply the price society has to pay for change. However, those who have to meet such costs directly will find such reasoning hardly persuasive and are more likely to present strong cases for the adoption of protectionist measures.

Faced with the impact of the elimination of trade restraints on prices, firms may respond either by quickly adjusting or by resisting the price change, thus giving rise to an adjustment problem. The acuteness of this problem may be assessed by determining whether trade expansion leads to intra- or inter-industry specialization. Adjustment costs associated with trade integration may be expected to be greater with inter-industry than with the intra-industry specialization. Leaving aside risks stemming from too much exposure to highly price-sensitive and stagnant markets, no matter how efficient the first type of specialization may be in the long run, it is bound to give rise to serious dislocations in both production and employment in the short run. Assuming other factors remain the same, changes in the scope and structure of the input/output mix are likely to be a much less destructive way of gaining efficiency than moving resources across industries. Thus, for instance, transferability of labour may not be possible without complete retraining, or geographical relocation of labour and facilities may be necessary. The impact on income distribution can also be expected to be less dramatic.

As pointed out above, however, interindustry specialization may be inevitable where minimum efficient size is large relative to the total market. Then, significant interindustry adjustments may take place, with large numbers of firms exiting from sectors.

Perhaps the key policy dilemma faced by MERCOSUR countries at the end of 1992 relates to a schism evolving between trade policies on the one hand and the realities of industrial adjustment, on the other.

The Governments have established an overall timetable for reciprocal trade liberalization (in addition to the accelerated schedules under way at the national level) and left it to the private sector to adjust by itself in a context that had at times included wildly diverging exchange rate policies (leading, for instance, to trade frictions stemming from the flow of Brazilian products on to the Argentine market).

Clearly, these situations, like that of sectoral agreements which the private sector itself is negotiating, can only be sorted out in the medium term. Meanwhile, the ground must be prepared so that suitable policy instruments are in place when the time comes to take the most decisive steps towards a genuine common market. Some of the issues that will arise are those dealt with in the series of UNIDO studies on MERCOSUR (relating to such areas as competition, investment incentives, environmental and business management, and skill formation) the main points and conclusions of which are summarized in this overview report).

II. INTRA-INDUSTRY TRADE AND ECONOMIC INTEGRATION IN MERCOSUR (B)

In March 1991, Argentina, Brazil, Paraguay and Uruguay signed the Treaty of Asunción, under which they undertook to establish a common market (MERCOSUR) within a period of five years. This decision created great expectations among people and the press of the four countries; it has also, however, given rise to doubts and uncertainties in the business sectors directly concerned. The questions raised have to do with the economic and social risks likely to accompany the virtual dismantling of barriers to intraregional trade and the subsequent establishment of a common tariff. More concretely, there is a fear that the liberalization of intraregional trade will have substantial negative effects on trade balances, industrial production and employment. It must be noted, however, that these fears may turn out to be premature and are probably unjustified. In fact, the magnitude and thrust of the integration effort depends on economic and institutional factors that transcend trade policy and are capable of adjustment at later stages in the process.

One frequently cited example refers to the persistence of marked asymmetries between the MERCOSUR countries in the area of macroeconomic policy. Sudden fluctuations in currency parities resulting from differences in inflation rates and exchange policies, for example, can seriously distort the movement of relative prices, reversing the results expected from the simple elimination of reciprocal tariffs. These distorting effects blur the rules of competition and tend to perpetuate economic inefficiency, amplifying unnecessarily the magnitude of the industrial adjustment needed in local markets. Under these conditions, the coordination of monetary and exchange rate policy called for in the Treaty of Asunción can introduce a stabilizing element into the economies of the individual countries by making it easier to distribute more fairly the costs of the industrial adjustment.

At the micro-economic level, national differences in productivity, size of companies, costs and quality of production factors, market concentration, and consumer preferences for foreign products all introduce new elements of uncertainty with respect to the results of integration in terms of industrial restructuring. These differences, together with those of an institutional character previously referred to, influence the initial competitiveness of local firms in the enlarged market and thus help determine whether they are likely to grow or shrink. This is particularly true in the case of manufacturing industries with a high requirement for physical and/or human capital and also of those that rely on a greater degree of technological innovation or production standardization. In such industries, in fact, the micro-economic performance achieved in the home market is a key to competitive success in the common market. Nevertheless, the integration of national markets can alter the initial conditions of competitiveness. For example, drastic changes in relative prices as a result of tariff reductions may be offset by reductions in intermediate costs when the enlargement of the market makes it possible either to take advantage of previously untapped economies of scale or coverage or to expand the original scale. In the same way, the opening up of the economies of the associated countries creates new opportunities for mergers, investment and intra-industry specialization that make it possible to recover lost shares of the domestic and regional markets. International experience with economic integration, particularly in Europe, offers numerous examples of effects of this kind that are not contemplated in the traditional theory of international trade and customs unions but are of great importance when evaluating the costs of industrial restructuring. One of the most commonly observed effects is the trend towards an upturn in trading in varieties of the same products. An analysis of this trend in the case of the MERCOSUR countries is the subject of the report.

Since the mid-1980s, the four MERCOSUR countries have been engaged in important reforms of their development policies. The purpose of these reforms is to achieve greater monetary and exchange rate stability, the restructuring and modernization of industry, and the recovery of economic growth. At the same time, major efforts are being made to relaunch the regional integration process and to boost intraregional trade.

The most important results of these efforts have been the following: the further development of the agreements concluded by Argentina and Brazil with Uruguay (CAUCE and PEC), the Argentina-Brazil Economic Integration and Cooperation Programme (PICEAB) and, more recently, the Treaty of Asunción establishing the Southern Cone Common Market (MERCOSUR). These achievements have laid the basis for a genuine integration of national markets, an integration in which the longer-term objective of free movement of goods, capital and labour constitutes the chief driving force for trade and production specialization, as well as the major source of job creation and new investment opportunities.

An important consequence of these developments has been that a number of enterprises located in the region have become better informed regarding the opportunities for specialization that an enlarged market would offer, in addition to acquiring a wealth of experience in coping with the new conditions of competition brought about by the elimination of intraregional trade barriers. Although limited, this accumulation of market knowledge and experience is in itself a factor conducive to integration. However, the existence of other, adverse, factors makes it essential to put into place mechanisms that will permit the dissemination of this experience and its application by all the enterprises in the region.

One of the adverse factors alluded to is the persistence of severe imbalances in the pattern of intra-regional trade in manufactured goods. This situation represents a major obstacle to full integration of the markets by generating protectionist pressures on the part of the sectors affected, which are afraid of losing their share of the market. Pressures of this kind can ultimately lead to official measures being taken that, while helping to check the imbalances, jeopardize achieving the objective of a common market by limiting, as an unintended collateral effect, the growth of intraregional trade.

One way of avoiding this risk is by transforming local enterprises into MERCOSUR enterprises, i.e. enterprises with the ability to produce and compete in an enlarged market. This requires efforts at the official level and elsewhere to spread the perception of this market as an integrated whole, just as accessible and important to the individual enterprise as its own market currently is.

To achieve this, there must be more counselling and information regarding the conditions of competition in the associated markets, the cost relationships and consumption patterns found there, and the nature of any local requirements that may exist with regard to the quality and characteristics of potentially competitive product varieties. An in-depth knowledge of the trends encountered in intraregional trade is an essential source of this kind of information.

Analysis of these trends indicates that the growth of intraregional trade and the application of the integration agreements are taking place against a background of intense intra-industry specialization. In 1990, the level of intra-industry trade between Argentina and Brazil exceeded the 50 per cent mark, approaching the level found in trade between developed countries. During the same year, the intra-industry trade index reached 38 per cent, a figure greater than the average recorded in trade between developing countries. It is generally found that the strength of the intra-industry component in reciprocal trade between MERCOSUR countries is greater than in trade with other countries, and that it is increasing as the markets become more closely integrated.

All of this has important implications for the future of the integration project, primarily with reference to industrial adjustment. The fact is that the trend towards intra-industry specialization encourages this adjustment in that it reduces its costs by making it easier to mobilize production resources and shortening the time frame for its accomplishment. In the second place, it should be pointed out that greater intra-industry specialization usually means a greater variety of available products and more effective use of economies of scale. This in turn means that integration can bring additional benefits in the form of lower costs and also greater volumes and better standards of consumption. In summary, the increasing strength of the intra-industry component in intraregional trade makes the MERCOSUR project more attractive and more advantageous from the point of view of the associated overall costs and benefits.

Growth in intra-industry trade is concentrated mainly in the intermediates and capital goods branches. This suggests that intra-industry specialization as an engine for intraregional trade involves an important element of complementarity in terms of inputs and investments. This is an extremely positive factor as far as industrial development and the more effective use of production resources are concerned. As it happens, the intermediates and capital goods industries are characterized by dynamic economies of scale in the sense that important opportunities for cost reduction can be achieved by focusing technical efforts on a limited number of products. Even in the case of the largest economies in the region, such as those of Argentina and Brazil, it is now illusory to seek the development of industries of this type on a basis of self-sufficiency. Seen as a regional phenomenon, intra-industry specialization makes it possible to take greater advantage of dynamic economies of scale by permitting the decentralization of the production process and, as a consequence, the incorporation of new technologies. Decentralization of this kind is made easier by integration brought about through the dismantling of tariff barriers, the freer movement of capital, and greater facilities for the formation of joint ventures and/or the exploitation of site advantages.

The extent of intra-industry trade in such sectors as machinery and chemicals, both of which are technology-intensive and require skilled labour, does not mean that the opportunities for specialization in these sectors have been exhausted. On the contrary, analysis indicates that although there are branches in which the high level of intra-industry specialization has been constant, as, for example, in the case of pumping equipment, electrical goods, inorganic acids and tools, specialization processes are constantly under way in new industries. This points to a great potential for the generation of trade. The extent to which this potential is realized will depend, among other things, on greater progress in the liberalization of intraregional trade, the common tariff level adopted, and the size of the static economies of scale.

For example, in such industries as artificial fibres, pharmaceuticals and office machinery, a simulation postulating a 50 per cent reduction in reciprocal tariffs yielded a marked increase in intra-industry trade indices. In the specific case of artificial fibres, it was found that the effect of a further tariff reduction of up to 100 per cent would be the emergence of intra-industry specialization as the overwhelmingly dominant factor in that industry. This case and others (e.g. office machinery) demonstrate that, even though it considerably increases the level of competition in each company's local market and threatens its share of that market, integration offers new opportunities for specialization and greater participation in the associated markets.

The weak intra-industry component found in intraregional trading in consumer goods is to some extent the result of the tariff and related barriers that continue to exist. Accordingly, the elimination of these barriers could have a strong impact on the size and direction of these trade flows. In certain industries in which intraregional trade will continue to be largely managed, as for example the automotive sector, the degree of intra-industry specialization will depend more on sectoral agreements and corporate decisions; in others, there is a sizeable potential for intra-industry specialization, the realization of which will depend on the ability of business to gain acceptance in the associated markets. Total market integration could facilitate this penetration by bringing lower distribution costs and making imported inputs less expensive. Where this happens, industrial restructuring must be aimed at generating new product lines capable of competing in the enlarged market, and also at achieving greater productivity in lines that already exist.

Following are the conclusions of the study on intra-industry trade in MERCOSUR.

In the last 15 years, intraregional trade in manufactured goods among the MERCOSUR member countries has increased considerably. In general, this growth exceeds that recorded in the other trade flows, which suggests that there has been a greater interpenetration of local markets. This trend started before the entry into force of the quadripartite Asunción agreement and represents a factor that is conducive to the embryonic integration process.

The persistence of severe imbalances in manufactures trade between Argentina and Brazil, imbalances that are favourable to the latter, may impede the achievement of a free trade zone. Bilateral trade between these two countries constitutes the principal integration axis within MERCOSUR. Accordingly, imbalances in this trade have serious consequences for the future of the overall integration project. Against this background, there is an urgent need for greater coordination of exchange rate and monetary policy and for the dismantling of tariff-related barriers and convergence towards a common tariff. This would provide a better framework for the trade liberalization process by reducing the distortions in relative prices and by so facilitating an increase in competitiveness and in intra-industry specialization.

The prospects for this kind of specialization have been assessed in the report on the basis of a retrospective analysis of intra-industry trade. The first general finding of this analysis was that most intraregional trade is concentrated in intermediates and capital goods. Secondly, it was found that the ranking of industries according to the level of intra-industry trading is not greatly affected by changes in the measuring method.

By comparing intra-industry trade indices according to country type and trading partner, it has been possible to check the results against a number of hypotheses that have been advanced in the technical literature. First, it was found that, as maintained by various writers, the two largest economies displayed the highest intra-industry trade indices for trade flows both within and outside MERCOSUR. Second, it was demonstrated that in 1990 there was a sharp increase in the bilateral trade index between Argentina and Brazil, with this index rising to nearly the level found in trade among developed countries. Given that the process of mutual tariff reduction between Argentina and Brazil preceded the MERCOSUR process by several years, this observation is in line with the hypothesis that integration agreements act as a spur to intra-industry trade. This view is also strengthened when one considers Argentine and Uruguayan trade with their Latin American Integration Association partners. The data for Uruguay confirm the notion of high intra-industry content in intraregional trade. In fact, the indices for that country were higher than those for trade among developing countries having a level of industrialization similar to Uruguay's. On the other hand, the clearly interindustry character of Paraguayan trade confirms the theory that this type of trade is linked to lower levels of income and economic development.

The analysis of intra-industry trade trends indicated that, in the case of Argentina and Uruguay, the greater intensity of this trade within the region was a constant for the period in question. It was also found that the direction of the trade alters the pattern of trade by industry, since there are many cases of simultaneous intra- and interindustry specialization, depending on the trade flow in question. Finally, it was established that the increase in intra-industry trade in the MERCOSUR context is associated with the emergence of new specialization processes.

The disaggregated analysis showed that, in the case of intra-industry trade within MERCOSUR, the leading product groups are those that are technology-intensive and rely heavily on human capital. This accords with the theories that link intra-industry trade to product differentiation resulting from technical innovation processes and the existence of economies of scale. However, the findings of other studies indicate that the high intra-industry component observed in the trading in these products requires more precise explanation, since what are involved are intermediate products and capital goods. The fragmentation of the production process and the technological differences among the MERCOSUR countries may be cited as useful explanations in this regard.

The question of the predominant type of product differentiation led to an investigation into trade flows at the highest level of disaggregation possible. The results of this analysis confirmed the importance of intra-industry trade to the MERCOSUR countries, while at the same time indicating that a high proportion of that trade is accounted for by trading in vertically differentiated products, i.e., products differentiated according to quality. The low percentages of trade in horizontally differentiated products and the low proportion of consumer goods in intraregional trade suggest that, contrary to the situation observed in the industrialized countries, demand-side factors still play a minor role in the MERCOSUR intra-industry specialization process.

Using a simulation model that takes into account economies of scale and similar varieties of the same product, it can be shown that integration has differential effects on the intensity of intra-industry trade at the subsectoral level. The magnitude and direction of these effects depend on the economies of scale at the production stage, the degree of tariff protection, and the relative size of pre-existing plant and equipment. For the enlarged market, integration heightens the degree of intra-industry specialization in four of the industries considered, and lowers it in the other three. In bilateral trading, however, it is found that, although integration does lead to a lower share of the local market, it offers new opportunities for specialization through the penetration of the associated markets.

III. MEDIUM-TERM SCENARIOS FOR INDUSTRIAL RESTRUCTURING IN TWO SECTORS

The reports on this subject refer to the pulp and paper sector, and the leather and footwear sector. In both cases, a sectoral assessment of competitiveness was carried out, based on the new scenario created by MERCOSUR and taking a medium-term view. They thus constitute the first contributions to sectoral studies made from the standpoint of the enlarged MERCOSUR market and consider each country's production capability from that perspective.

1. **The pulp and paper subsector** (A.1)

The main points of the study carried out by UNIDO on this subsector are given below.

1.1 **Problems posed by full trade liberalization**

Despite the long-term potential for forestry and the pulp and paper sector in MERCOSUR, there are currently problems in facing full trade liberalization. These problems largely stem from diverse macroeconomic policies in the member countries which impact upon terms of trade. In 1992, Argentina was forced to impose short-term safeguard provisions on certain products to protect the industry against a major increase in paper imports from Brazil, due in part to adjustment problems in exchange policies. Brazil, with its more established pulp and paper subsector, has had a higher degree of exposure to external market forces and is currently more competitive in a range of product lines. The other countries are also moving away from protectionism. However, this subsector in all member countries is comprised primarily of small firms with older facilities that are in need of modernization and improved operating efficiency.

1.2 Subsector-specific adjustment problems and technical assistance requirements

1.2.1 Institutional linkages

Brazil and Argentina have well-established institutional linkages in the subsector. However, the two smaller countries, Uruguay and Paraguay, have some concerns that should not be overlooked. Paraguay must be encouraged to participate in intercountry pulp and paper associations, and in technical exchanges. Uruguay has already established some external relationships in this regard which should be extended. One of the main strengthening interlinkages should come from furthering the technical exchange between all MERCOSUR member countries.

Recommendation: Establish formal interlinkage between pulp and paper subsector research and development organizations in the member countries.

1.2.2 Trade-related issues

Pulpwood (round wood) costs were found to be roughly the same in the various MERCOSUR countries. These countries are all considered to be low-cost pulpwood producers by international standards and it is expected that MERCOSUR fibre production cost advantages will increase over the next one or two decades. Pulp and paper subsector adjustment-related hardships stemming from MERCOSUR integration were found to pose greater challenges to Argentina than to the other partners. No easy solutions were identified. The importance of converging government economic policies was highlighted. In addition, industry trade experts identified the need to establish adequate provisions for resolving trade problems within MERCOSUR, which do not exist at present.

There has recently been a move towards the consensual establishment of a common external tariff.

Recommendation: Government and industry should give priority to developing adequate trade dispute provisions as well as an improved system of trade statistics and the development of a common classification system.

1.2.3 Rationalization and upgrading

The fundamental opportunities for the subsector within MERCOSUR depend upon continued industry rationalization and upgrading. This will help improve the industry's competitive position and increase its scope for intraregional trade. The trend towards greater demand for environment-friendly products and use of recycling will favour the upgrading of equipment and process technology for water-use efficiency, energy efficiency and the reduction of chlorine use in pulp bleaching. By comparison with North America, there are a high number of small pulp and paper mills in MERCOSUR which are typically small family firms with dated facilities. The industry leaders in all of the countries are already implementing improvement programmes, but more work remains to be done, especially among the small to medium-sized companies. Constraints in meeting technical requirements and gaining access to capital severely limit progress.

Certain efficiency gains can be made without significant capital inputs, but almost all improvements will require capital whose availability in MERCOSUR at reasonable interest rates is very limited. In this regard, Argentina might consider setting up a special mid-term revolving "seed capital" fund to initiate small-scale mill improvement programmes at the subsector level. Similar programmes should be considered by the smaller member countries.

Recommendation: Establish special funding programmes in Argentina, Uruguay and Paraguay for subsector facility upgrading. Modernization must focus on the rationalization of company structures and the introduction of quality improvements.

1.2.4 Training and support services

There is also a need for technical assistance, often prior to any capital infusion. This assistance should start with the requirements for training, professional management development, and cultural change in adopting a more international pulp and paper outlook. It would involve training the trainers, training for managers, and training for cultural change, drawing in part on European Union experience. It should include information systems support. With regard to technical assistance, UNIDO has a good reputation in MERCOSUR and could play a role in initiating such programmes, as well as other forms of technical help.

Recommendation: UNIDO should initiate a technical assistance programme for the subsector with appropriate MERCOSUR support.

The issues outlined above present serious challenges and require urgent attention before the MERCOSUR momentum carried by the industry at large is dissipated.

2. **The leather and footwear subsector** (A.2)

The main findings of the study carried out by UNIDO on this subsector are given below.

MERCOSUR provides a new scenario for improving the internal and external competitiveness of companies, in the light of their comparative advantages, medium-term trends and inter-company agreements. Its success will depend on its ability to adapt to a series of internal and external constraints that are identified in the report on the subsector.

The dominant trends in the subsector are towards:

- More inter-firm linkages between suppliers, consumers and marketing firms, as well as between competitors;
- More vertical integration, from tanning through finishing to manufacture;
- More pressure in favour of environmental control;
- The adoption of less polluting tanning processes;
- Improvement in quality of leather from Brazil and Paraguay;
- Adjustment of tannery production capacity through plant closures and relocations;
- Cost reductions associated with moving a step higher in the international footwear market;
- Capture of the domestic markets for cheaper footwear by Brazilian producers, with Argentine and Uruguayan producers supplying the upper ranges of the market;
- Decentralization of the footwear industry, by means of relocations or subcontracting to other regions or abroad;
- The introduction of up-to-date technologies such as computer-aided design (CAD), computer-aided manufacturing (CAM) and micro-electronics;
- The introduction of new organizational methods such as total quality control, just-in-time, kanban or group technology;
- Greater activity by Argentine and Brazilian suppliers of parts and inputs, compared with suppliers from outside the area;

- Strengthening of industrial engineering, research and development, and consulting capacities;

- The establishment of economic subregions on the basis of resources, geography, culture, communications etc.;

- Fewer government incentives and greater curbs on external financing of enterprises.

The free circulation of goods will encourage the conclusion of agreements between firms, putting comparative advantage and production capacity to better use and improving the region's overall competitiveness. Other likely developments that will affect strategy formulation for both regional and export markets are as follows:

- The dominance of marketing channels leading into the region will help strengthen the position of firms that have a greater presence on the combined market; this may lead them to take certain parts of the market away from local small and medium-sized enterprises or craftsmen;

- Intermediate-sized firms may prosper in national, regional or international markets, selling quality leather/leather shoes or occupying profitable market niches, and using regional capacity and raw materials;

- If properly managed, smaller firms may be able to thrive locally, either meeting the demand for craft goods or protecting their products by means of differentiation, fashion, brand names, advertising etc.;

- Firms may convert to subcontracting manufacture of parts (uppers or pre-finished bottoms) with finished-product manufacturers, thus achieving economies of scale and saving on costs;

- Surplus tanning capacity is likely to fall, with more efficient use of installed capacity, better quality and lower costs. It is to be hoped, however, that the effort to obtain high quality raw materials will be maintained;

- Tanneries will seek vertical integration, adopting new tanning, finishing and management methods and improving pollution control. Bigger firms, having the advantage of economies of scale and access to raw material supplies, will tend to squeeze out smaller tanneries, which will decline in number and size;

- Small and medium-sized tanneries will specialize more and more in "wet blue" or semi-finished leathers, or in supplying lower grade leather goods markets; their scope for high-grade production will be limited by the raw materials used and their capacity for investment. They may find openings in small but profitable niches such as leather goods, upholstery or non-bovine leathers.

The needs and interests of each subsector of the industry vary from one MERCOSUR country to another; the experience gained by institutions in assisting industry also varies, as do the activities of employers' associations at national or regional level. Cooperation is provided by organizations from the industrialized countries (e.g. GTZ from Germany, JICA from Japan), specialized agencies such as UNIDO and regional entities such as the European Union.

Expressing the requirements of MERCOSUR in terms of technical assistance needed by the actors involved is a complex task. The problem lies partly in the fact that mature, long-established industries with the latest in automation and management exist side by side with firms using obsolete technology. In such conditions, advice on design, sewing, equipment or new organizational methods has to be adapted to very different audiences.

Environmental control, which concerns practically all the industries in the region, poses the problem of finding the right balance between keeping production costs down and protecting the environment, which means that little is done until such time as outside pressure compels action.

International cooperation has been active in the case of footwear, with new manufacturing techniques being introduced and employees trained. Although the majority of firms in the subsector are not in a position to conduct international business, advisory services can be provided to improve management methods and bring them up to the level required by the enlarged markets. Attending international fairs or trade seminars with businessmen from other parts of the world can provide the incentive to make the necessary changes and possibly lead to agreements based on labour cost advantages and raw material availability. Similar considerations apply to the leather goods and clothing sectors.

UNIDO has provided experts to carry out studies and make recommendations on the footwear industry, tanning and effluent treatment, CAD/CAM applications, prefabrication of footwear parts, and training courses for trainers in the four countries.

IV. EUROPEAN EXPERIENCE IN COMPETITION POLICY, VOCATIONAL EDUCATION AND INVESTMENT INCENTIVES, AND ITS APPLICABILITY TO MERCOSUR

The UNIDO MERCOSUR project included the preparation of three reports on those aspects of the European Union's experience that were considered to be most relevant to MERCOSUR at its present stage.

The salient points of these reports are given below.

1. **Competition policy in the European Union** (C.3)

The report in question examines the trends that have predominated in the European Union, in the structure and international competitivity of European manufacturing industry since the beginning of the 1980s. It then analyses the main dimensions of European Union competition policy, including the areas of friction with other community policies and national jurisdictions. In conclusion, it shows the lessons that can be drawn for MERCOSUR.

A summary of the report's main findings is given below.

A major trend in world trade in recent years has been the formation of regional free trade zones. The United States, Canada and Mexico signed the North American Free Trade Agreement (NAFTA), the newly industrializing countries of South-East Asia have also taken steps in this direction, and in 1991 Argentina, Brazil, Paraguay and Uruguay signed the MERCOSUR Treaty, aimed at creating a common market between these countries by 1995.

In the light of this emerging trend, it is important to try to analyse the implications of a free trade agreement, both to the countries participating in the agreement and to countries outside it. It is also important to learn as much as possible from the experience of other free trade regions in order to identify the factors that contribute to success and to try to apply them, whenever possible, to new treaties such as MERCOSUR. In this respect, it is useful to try to learn from the experience of the European Union, which is the longest standing economic integration area, although the removal of some trade barriers has only occurred recently and there are still measures to be implemented before a completely free trade zone can be achieved among the member countries.

The goals underlying the formation of the European Union, whose roots go back to the two world wars, encompass unification on both economic and political levels. The ultimate aim of the Union's founders was to create an economic and political interdependence that would elevate the economic well-being of its peoples, as well as avoid the occurrence of another war.

It is important to distinguish between the political goal of interdependence and the economic goal of increasing the economic well-being of the member countries. The study on this subject concentrates on the latter goal, although it should be stressed that it is difficult at times to distinguish between the two, since some of the economically significant decisions of the EU were also taken for political reasons. Consequently, the report focuses on EU competition policy and its development. It examines the changes in EU competition policy during the 36 years of its existence, its effectiveness, its interaction with other community policies, and the areas of friction within the Union and with the Union's major trading partners in regard to the implementation, or lack of implementation, of competition policy. This last point is of particular importance because of the interest in new approaches to industrial policy, both within Europe and elsewhere, and to changes in foreign trade flows resulting from regional trade agreements.

1.1 Inferences that can be drawn from EU experience on the function of a competition policy in an area of free trade and economic integration

The three main lessons in regard to competition policy that can be drawn from EU experience relevant to other free trade zones are summarized below.

A free trade agreement, in order to have its full economic effect, should be complemented by a common competition policy. This is a somewhat general assertion. The GATT rounds towards freer trade, for example, need to be complemented by a set of global competition rules. Otherwise, the benefits of free trade might well accrue to the large global firms rather than to the consumers. The need for economic integration to be accompanied by a made-to-measure industrial and competition policy has far-reaching implications because the harmonization of existing industrial and competition policies at national level demands a high level of economic and political cooperation.

This leads to the second inference, that greater cooperation on industrial and competition policy requires a political commitment based on trust, since it depends upon relinquishing important domestic economic tools and shifting decision-making in these matters from the national to the economic community level. The fact that a high degree of cooperation has been achieved in the European Union is encouraging. Although it has taken a long time to reach that level of cooperation, it must be remembered that the European Union was established in a region with a history of less than 50 years of political stability. Trade agreements could perhaps be reached more easily in more stable regions.

The third inference is that, once begun, the economic integration process must go right on to the end. It is difficult to stop at a certain point, because integration is a holistic process that affects all major economic activities. From this perspective, integration is very much a cumulative, path-dependent process.

1.2 Prerequisites for a successful trade agreement

A basic prerequisite for the formation of a trade area is a minimum threshold level of macroeconomic stability. This is needed both to ensure a stable climate for trade and for industrial development and to reduce the need for national Governments to maintain industrial policies establishing non-tariff restraints to trade. Stable exchange rates are one of the key variables for a regional free trade zone. Macroeconomic stability is also needed in order to develop capital markets and encourage long-term investment. The aim of a trade agreement is to accelerate economic growth in the participating countries. This is why the factors affecting growth cannot be separated from the question of the trade agreement.

Apart from trade liberalization and macroeconomic stability, a common industrial policy is also needed. Industrial policy at supranational level must be more effective than at national level.

A common competition policy is also of importance to trade agreements for a number of reasons.

First, there is an inherent danger that market control by enterprises at the national level becomes market control at the regional level. This is particularly so when the trade agreement takes place between countries that have a long tradition of supporting national champions.

Second, as world trade moves from multinational trade into trade between trading blocs, problems of unfair trade practices will tend to be solved on the political level. One way to avoid this is to apply strong competition rules to foreign trade.

A competition policy within a trade zone should be articulated with regional industrial policy in order to prevent these policy tools from inhibiting competition within the trading zone and with foreign countries.

It is important to understand the causal connection between the widening of the market and the reduction of market failures. The widening of the market can facilitate the growth of industry and specialization. But it could also damage previously shielded industries which could find that they are unable to compete in a common trade area. This is why competition policy is so essential in order to prevent excessive concentration, which might be encouraged by the opening up of national markets.

Finally, any trade agreement requires a high degree of political commitment on the part of national Governments to give up control of a number of national policy tools and surrender a large share of their economic freedom. The EU experience shows that harmonization of industrial and competition policies requires an awareness of the benefits of such convergence, a process which has taken a long time to materialize and came only after the painful experience of several recessions.

As a result, the importance of complementary measures to trade, such as investment-related issues, local content requirements, export regulations, technology transfer and standard regulations, is enhanced. These all need to be harmonized. Since investment is such an important issue in developing countries, and particularly foreign investment, agreement must be reached on a common policy to prevent distortions and subsequent disagreements that might frustrate integration efforts. The situation might also arise where the scope of the agreement is at odds with the number of members prepared to accept it. This factor must also be taken into account.

The aim of any regional trade agreement is to promote the long-term growth of the participating countries, and this cannot be achieved without improving their competitivity. This is a fact that is still liable to be forgotten in the EU, even though it underlies the Union's new industrial policy. The increases in company profits in a free trade zone should disappear in the long run because of competition both from within and from outside the region.

To conclude, three main lessons can be drawn from the EU experience.

First, in order to be effective, a trade agreement must be complemented by the eradication of domestic non-tariff barriers. This in turn means that cooperation in industrial, regional and competition policies is needed in order to ensure the harmonization of market conditions in the free trade area.

Second, such a level of economic cooperation entails considerable loss of macroeconomic freedom by the States participating in the agreement. It also demands a high level of political cooperation.

Third, economic unification within the EU in areas such as industrial policy has taken a long time to mature and is yet far from complete. Part of the delay can be blamed on the cultural differences between the member States and the inherent rivalry still present within the Union. The greater linguistic homogeneity of the MERCOSUR countries could reduce cultural differences and improve the prospects of reaching the economic agreements needed to build a successful union.

2. **Vocational education in the European Union** (C.1)

The report on the subject examines the experience of the European Union member countries and of the European Commission in matters of vocational and technical education. Attention is focused on the implications of such training for the overall competitiveness of European firms particularly in the light of the new human resources requirements stemming from technological change.

The main points of the report are summarized below.

2.1 The experience of the European Union

There is no single "best practice" education and training model which provides a universal key to economic growth and international competitiveness.

Transferring policies that have been successful in Europe to MERCOSUR countries is desirable. But, the proposed policies need to be evaluated carefully, in the light of the political, cultural, social and economic conditions prevailing in those countries.

The vocational education and training systems can only be effective if people have had a sound basic education.

Other elements of the infrastructure and general attitudes in society need to be appropriate. Reliable electricity supplies, transport systems and telecommunication infrastructures are essential prerequisites for a modern economy.

A coordinated system of research on vocational education and training in each MERCOSUR country could play a key role in helping to develop policies and monitor implementation.

Training levy and apprenticeship tax systems inevitably lead to some waste. Nevertheless, on balance they seem to have made positive contributions to French training. MERCOSUR countries could consider options of introducing training levies.

All EU countries are short of the skills necessary to cope with new technology. All need to increase the educational attainments of their populations. These problems are particularly severe in Mediterranean countries.

EU economies are being subjected to intensifying competitive pressure, especially from Japan and South-East Asia. Product cycles have shortened; new products are constantly being introduced and process technology is being improved continually.

Increasingly, manufacturers are putting into place policies embracing total quality management (TQM), just-in-time (JIT) production and cellular manufacture. These trends lead to the need for supervisors and operators to receive more and broader training.

There are extensive needs for training and retraining in relation to information technology (IT), new materials and the design and operation of processers to minimize the deleterious impacts on the environment.

Since the 1970s, the competitiveness of European industries has depended increasingly on the effective use of IT in both production processes and products. There has been a general shift from manufacturing to service employment, and both have become increasingly dependent on IT-related skills.

A reduction in routine and repetitive tasks has taken place. Unskilled jobs are often being replaced by higher-level jobs based on knowledge and technical skills.

Demand for craft skills is falling. It is often advantageous, however, to train those with craft skills to use new technology, as is common in Germany, rather than to seek to replace craft skills as is more common in the United Kingdom.

The acquisition of many skills is a general trend which applies right across the European economy. Workers require new IT-related skills in addition to traditional skills to enable them to use IT effectively.

The last 25 years have seen the emergence of new structural materials, whose use is likely to permeate the global economy. New industries are taking shape. These trends create needs for new skills.

Increased emphasis on environmental management requires engineers and technicians to design plants to comply with environmental standards. Operators must learn to sample, monitor and regulate waste streams.

Participation by workers in decision-making about the introduction and use of new technology can result in better solutions to the inevitable problems.

It is EU policy that the diversity of education and training systems in member countries should be conserved. It is too early to judge the impact of EU vocational education and training programmes.

Some of the best initial and continuing training systems in Europe are sustained by close cooperation between employers and trade unions.

German vocational and educational training is sustained by values which are strongly held throughout German society. The dual training system, controlled by detailed legislation, provides systematic delivery of carefully considered curricula. College-based teaching covers theoretical aspects and practical training takes place in firms.

Major companies have sharply increased their expenditure on continuing training to cope with skills obsolescence caused by shortening product cycles. Tensions between the dual system and the changing needs of new technology are being coped with well by larger companies and the commercial sector, but less adequately in the small-firm craft sector.

In both Germany and France, there are centrally funded vocational education and training research organizations. National politicians, central government departments, employers' organizations, trade unions and research workers all play important parts in formulating research proposals. This ensures that research findings are translated into action.

Denmark's education and training system played a major role in transforming Denmark from an agricultural country into an industrialized economy supplying advanced manufactured products to niche markets. In 1977, the Education Act established vocational education and training with strong emphasis on the interaction between theory and workshop training. Unlike Germany, Denmark does not rely heavily on apprenticeship.

Emphasis on providing continuing training for semi-skilled workers should help Danish industry to cope with changes in manufacturing organization which are placing more responsibility on operators for quality and output.

In France since 1971, employers of more than 10 workers have been compelled to spend a minimum of 1.2 per cent of their total payroll each year on training. Continuing education and training grew rapidly following this legislation. However, the response has been uneven. Larger firms and the public sector have increased training expenditure substantially, while small firms and industries such as building, civil engineering and agriculture do not exceed the legal minimum.

In the United Kingdom, the National Vocational Qualifications and Training and Enterprise Councils are too new to evaluate. Frequent changes in policy make that country a generally poor example for other countries to follow. However, some individual innovations may provide useful models. For example, Group Training Associations plan and carry out training for small firms which do not have the resources to do so for themselves.

2.2 Implications for MERCOSUR countries

International competition is intensifying. At the same time, rapid technological and organizational change is presenting difficult challenges even for the most advanced vocational education and training systems in Europe, such as those of Germany and Denmark. Even Germany's response to the need to extend and modernize continuing training in small and medium-sized enterprises has not been fully adequate.

Modernizing vocational and educational training is insufficient in itself to meet these challenges. Extensive changes are needed in the organization of manufacturing. The application of information technology to manufacturing, services and construction is expanding rapidly and changing fast. These trends make the education and continuing training of managers and professionals vital to the success of modern and modernizing economies. It is widely recognized that the successful use of new technology requires increasing numbers of people with general scientific and technical qualifications, and Governments in European countries have ensured that the provision of places has tended to reflect this need to a varying extent, but student demand for such places has not always been sufficient to fill them all. In addition to improving vocational education and training, MERCOSUR countries need also to pay attention to these aspects.

The report is concerned with international competition, technological trends and their implications for human resources development policies in Europe. Even in the light of detailed knowledge of the changes in skill needs resulting from new technology use, adapting education and training programmes to meet identified needs is by no means straightforward. Some of the major difficulties are indicated below.

Technological change does not seem likely to result in radical changes to countries' vocational education and training systems. Rather there has been a tendency for new development to be contained within countries' existing systems. The same skill needs can be met by different combinations of educational and training programmes in different countries, and different education and training provision may be used to meet the same skill need even within the same country. Indeed, there are substantial differences between individual firms in a particular area. Extreme examples of this can occur with the introduction into an area of new production methods, forms of work organization and vocational training programmes by inward investors.

Specific skills can be developed by means of alternative patterns of formation. For example, a small Japanese firm is likely to meet the need for someone to operate a computerized-numerical-control machine-tool by recruiting a 19 year old school-leaver with a relatively good education in mathematics and science, and train him on the job. A comparable British small firm will be more likely to seek to employ someone in his twenties or thirties who had previously received training at another firm. The British craftsman is likely to have left school at 16 with less academic mathematics and scientific knowledge than his Japanese counterpart. His apprentice training will have involved initial theoretical elements followed by a period of practical training. A German craftsman is likely to have attained a higher standard of education than his British counterpart and will have undergone a combination of practical work and theoretical (school) training in the dual system.

Nevertheless, relationships between vocational education and training and economic performance can be very important. Effective vocational education and training played a key role in transforming Denmark from a primarily agricultural nation into a modern industrialized State. But these relationships are not simple and straightforward. Designing and implementing effective national policies is particularly difficult because of the many close links and interactions between education, training and other policy areas. The availability of people with particular skills is affected by general education as well as by training. The supply and demand for trainees is affected by pay, which in turn may be affected by collective bargaining, work organization and industrial relations.

The educational system and the work organization are different in every country, and the same can be said of the industrial relations tradition. This makes it vital to adapt vocational education and training policies and practices to the particular conditions in each country, and to the specific and changing needs of its industries. A coordinated vocational and educational training research system in each MERCOSUR country could play a key role in studying these factors and helping to develop appropriate policies. But it is important to ensure that research findings are taken seriously and translated into policy and action.

In both France and Germany there is widespread interest in ensuring that vocational education and training is carried out properly; and there are mechanisms which ensure that research results are used in policy formulation and the development of practical education and training programmes. The experience of these countries shows that this requires politicians, central government departments, employers' organizations, trade unions and research workers to be involved in formulation of research proposals. The British experience shows that, in the absence of such conditions, the contribution made by research is likely to be far less.

The Greek experience shows that a sound vocational education and training system can only be effective in stimulating economic growth if other elements of the infrastructure and general attitudes in society are also appropriate. If industry, commerce and providers of finance adopt short-term perspectives, this can cripple attempts to promote economic growth. Reliable electricity supplies, transport systems and telecommunication infrastructures are essential prerequisites for a modern economy. Moreover, vocational education and training can only be effective if the population has received sound basic education.

Both the Danish and German vocational education and training systems are characterized by strong State regulation and involvement. A major factor sustaining the excellence of these systems is close cooperation at all levels from local to national between employers and trade unions in relation to both initial and continuing training.

The German dual system has developed steadily since 1969. It is also sustained by very good basic education, and by cultural factors, in particular by respect for the concept of "Beruf" — loosely translatable as "calling" or "vocation" — in relation to occupations from skilled worker to senior professional: belief in the utmost importance of giving everybody the chance to acquire both the education and the practical training necessary to meet the requirements of their "calling". This commitment to "Beruf" is spread throughout all sections of society and is strongly entrenched amongst workers and their trade unions. While there has often been conflict between employers and trade unions about the emphasis which should be placed on particular aspects, the strong consensus about basic values has been encapsulated in highly detailed legislation relating to vocational education and training.

German training is also sustained by the high paid differential between apprentices and skilled workers, helping to reduce the cost of training apprentices incurred by employers (in contrast to the United Kingdom, for example, where these differentials have been relatively low and where apprenticeship is no longer flourishing). Furthermore, the pay differential between "Meisters" (very approximately "foremen" or "supervisors") and skilled workers in Germany is relatively high, giving skilled workers strong incentives to study in their own time to meet the stringent qualification requirements which have to be met to be eligible for high status well-paid positions as "Meisters". There have been several unsuccessful attempts to introduce the "Meister" concept into the United Kingdom. The low pay and status differentials between supervisors and skilled workers has proved to be an insurmountable obstacle to success in such endeavours.

Training levy and tax systems inevitably lead to a certain amount of waste. Some firms may undertake training with the principal objective of avoiding paying levies rather than of enhancing workers' skills. Sometimes such training may contribute little to enhancing workers' skills. Nevertheless, training levies and apprenticeship taxes seem to have made very positive contributions to French training. The British levy/grant system introduced in 1964 (partly in imitation of the French system) was far less successful. Its failure was due to the frequent twists and turns of government industrial training policy rather than to problems inherent in levy systems. The Industrial Training Board (ITB) system was established in 1964, damaged by continuing uncertainty in the period 1970 to 1973, crippled in 1973, and mostly destroyed during the 1980s. It is possible that the British levy/grant system could have been developed and improved, and it might have helped to make needed changes in British training culture. But the system was not left intact long enough to assess its potential. It is therefore suggested that, based on the French experience, MERCOSUR countries could consider options of introducing training levies very seriously.

The British National Vocational Qualifications (NVQ) system was initiated in 1986 and is not yet fully in operation. It has been argued that the NVQ emphasis on performance in work may lead to the neglect of basic education, in contrast to the German dual system which builds vocational competence on a sound educational basis. The establishment of locally based Training and Enterprise Councils was also initiated recently, in 1988. It is too early to assess the potential of these policies.

There is no single "best practice" education and training model which provides a universal key to economic growth and international competitiveness. While, for example, the German and Danish systems are very effective, they are very different from one another and it is impossible to decide which is the more generally effective. Transferring elements of successful policies in EU countries to MERCOSUR countries is desirable. But, before any such transfers are attempted, proposed policies need to be evaluated very carefully in the light of the political, cultural, social and economic conditions prevailing in those countries.

3. Investment incentives in the European Union

The report on this subject examines the national and community experience of the countries members of the European Union in regard to the regional assistance provided to help firms adapt to the new conditions of competition created by the enlarged market. It includes an analysis of the investment incentives and subsidies of the member countries and of the European Union. In both cases, special attention is paid to programmes to promote research and technological development.

The main points of the report are summarized below.

The European Commission is making strenuous efforts to reduce the amounts given each year in subsidies, i.e. grants, loans and tax concessions, to firms by the Governments of the 12 member States.

There are around 700 assistance schemes on offer from national Governments in the Union, as well as from the Union itself, covering almost every aspect of business: starting up a new firm, re-developing a site, research and development, employment, training, exporting, marketing, environmental improvement and energy saving.

Some of this aid is seen by the EU as competition-distorting, especially the support for specific sectors such as coal and steel, and therefore warranting Commission intervention and control. However, many of these schemes concern small quantities and have only small budgets. Other types of subsidy can still be justified, even in a single European market, by the need to help firms in the poorer regions and countries to compete on an equal basis — or, in the words of the Commission, on a "level playing field" — with richer parts of the Union.

The main forms of subsidy used by national Governments to overcome regional inequalities (both within and between countries) are the financial incentives provided under so-called "regional policies". These incentives, usually in the form of grants, loans or tax concessions, promote investment and employment creation in designated "assisted areas". They are intended to compensate firms for some form of regional disadvantage such as peripherality in relation to important markets, skill shortages, an outdated industrial structure or underdeveloped infrastructure.

Almost all the EU countries have various regional policy incentives which may be awarded individually or together as a package. Particularly attractive is the assistance given in the form of non-repayable grants for capital investment, which are often the most valuable incentive. Other types include employment subsidies related to the number of jobs created or saved, soft loans at concessionary rates of interest, and tax allowances. The value of these incentives and incentive packages is limited by EU "ceilings" which restrict the maximum levels of government financial assistance that may be provided to an individual project. (Other limits may be imposed by the administering departments.) In general, the maximum levels are related to the degree of regional disadvantage. Thus, the highest-value regional assistance is given in the Mediterranean countries (Spain, Portugal, Greece and the south of Italy), the Republic of Ireland and Northern Ireland. In contrast, incentive values are significantly lower in parts of Great Britain, Germany, Denmark, France and the Benelux countries.

It should be noted that the value of these incentives is only partly determined by the "maximum" rates of award. The assistance is of course restricted to particular parts of community countries; it is further limited by various "eligibility conditions" which may allow only certain sectors, firms or project types to qualify. In addition, there can be minimum job creation targets which have to be achieved or maximum limits on the amount of investment that qualifies for government aid. The tax treatment of incentives and the phasing of grant payment will also affect incentive values. Finally, the award of an incentive often includes a "clawback" clause, requiring a grant to be repaid if certain investment or employment conditions are not met within a specific time period.

The regional policy assistance provided by the member States was designed to help restructuring or development in poorer or weaker parts of individual countries.

The European Commission, which operates a regional policy of its own, takes a broader perspective: regional disadvantage is seen in a Community context rather than from the national viewpoint. During 1988-1989, the Community's own regional policy was significantly changed. The much-publicized "reform of the Structural Funds" involved a greater concentration of the three funds (European Regional Development Fund (ERDF), European Social Fund and European Agricultural Guidance and Guarantee Fund: Guidance Section) on the poorest regions of the Union, and a progressive doubling of their budgets. In 1992, those funds amounted to ECU 14 billion, some 20 per cent of the total Union budget.

The Commission has defined three categories of Community region on which aid from the three funds will be concentrated to reduce regional disparities:

- Regions which are suffering from significant structural backwardness and underdevelopment (Objective 1);

- Regions experiencing difficulties in adapting to structural change (Objective 2);

- Regions of rural underdevelopment (Objective 5b).

The Structural Funds are supported by other Community financial instruments, primarily the European Investment Bank (EIB), the "New Community Instrument" (NCI) and the European Coal and Steel Community (ECSC). Like the Funds, they are oriented strongly towards regional development and the promotion of Community interests.

Although EIB, NCI and ECSC provide direct loan finance on favourable terms to individual projects, it should be noted that EU regional aid is generally channelled to firms through the regional incentive schemes provided by national Governments. (This is in contrast to many of the Union's "framework" research and development programmes, where firms respond directly to Commission "calls" for applications or proposals.)

V. CONCLUSIONS: INDUSTRIAL RESTRUCTURING IN MERCOSUR AND THE COOPERATION OF UNIDO

1. Main conclusions to be drawn from the first phase of the UNIDO MERCOSUR project

Applying a common perspective to the policies adopted by each member country in order to revamp industry in a climate of macroeconomic stability must be one of the chief tasks of MERCOSUR, once the transition stage of establishing the customs union is over and the stage of building on it and gradually attaining the longer-term objective of a common market has begun.

The policies relate in particular to stimulating investment; incorporating technical advances into production processes and into the distribution of goods and services; technological research and development; the modernization of small and medium-sized enterprises; the development of regional economies, and the adoption of environmental protection measures in line with international standards.

Using the common economic area created by the Treaty of Asunción to facilitate and accelerate the restructuring of production and industry in each member country constitutes one of the major challenges to MERCOSUR in its new phase.

The UNIDO studies show clearly that, in MERCOSUR as a whole, more progress has been made in trade policy — reciprocal tariff reductions, elimination of non-tariff restrictions and negotiation of a common external tariff — than in industrial restructuring.

Within each of the four member countries, however, the economic policies applied in recent years have sent clear signals to the markets that the process of transforming production in a climate of macroeconomic stability is irreversible. These signals were received by many firms which adapted by introducing new production and organization methods, raising productivity, and improving overall competitiveness, often through strategic alliances with other firms, at MERCOSUR level in some cases. In other cases, however, especially in the case of small and medium-sized firms and firms operating in regional economies and in countries where the economy is relatively less developed, companies have had difficulty in reading the signals or lacked the financial means or managerial capacity needed to adapt and change. Many of them have already ceased operations. Others cherish the hope that the processes of adjustment and integration are not irreversible. Many are still at the stage of adapting to the new conditions of competition brought about by the threefold process of overall, regional and domestic economic change. Deciding how to restructure industry within a reasonable period of time, which of necessity must be short, is another of the major tasks that MERCOSUR has ahead of it.

It will call for an overall perception founded on conditions of macroeconomic stability and at the same time a sectoral approach. The objective must be to accentuate the trends already apparent from the UNIDO report towards greater intra-industry specialization, with the benefits that brings for the expansion of cross-investments and reciprocal trade.

This objective implies that sectoral analyses of competitiveness must be made within the broader context of MERCOSUR and not only within the bounds of each member country. It also means that the analysis of the present and future situation must take as its standpoint the broader objective of overall competitiveness of the productive activities in MERCOSUR.

This was the methodological approach used in the two subsectoral studies carried out under the UNIDO MERCOSUR project. It recognizes that MERCOSUR offers a possible new scenario for improving firms' competitiveness on domestic and export markets, on the basis of each firm's relative advantages, medium-term trends and agreements between firms.

In practice, the success of this approach will largely depend on firms' ability to apply strategies of responding and adapting to new conditions of competition, whether overall, regional or domestic.

An appropriate technical cooperation policy in matters of pre-investment and investment financing may in turn make it easier for firms to adapt — especially small and medium-sized firms and those operating in regional economies and in relatively less developed countries — respecting the rules of the market and profiting from the advantages of macroeconomic stability.

The restructuring of firms, the rise of new firms, and the forging of the required networks of strategic alliances, both at domestic and at MERCOSUR level, can best be understood by means of a sound analysis of competition conditions in each sector and subsector, taking a medium-term view at MERCOSUR and at overall level. On the other hand, successions of national studies on competition that do not take due account of the common economic area created by MERCOSUR may give economic operators inadequate or even misleading signals, and lead to inappropriate restructuring and investment decisions.

This type of approach also calls for a considerable joint effort by Governments and firms, both at the analysis stage and in taking action. The active participation of the firms themselves in drawing up the terms of reference for the sectoral studies of competition in MERCOSUR and later in defining and discussing the results will ensure that the studies are realistic and provide sound guidance for restructuring and investment decisions.

The suggestion that firms be involved in the work of Subgroup 7 of the Common Market Group, especially the industrial seminars, is therefore of importance. Also of importance is the action taken by the MERCOSUR Industrial Council, notably to establish sectoral mechanisms for firms from the four countries to work together.

The sectoral studies carried out under the UNIDO project on MERCOSUR illustrate the growing importance of international cooperation channelled through multilateral organizations such as the Inter-American Development Bank, the World Bank, UNDP and UNIDO, as well as through the European Commission, and the technical cooperation programmes conducted on a bilateral basis by OECD countries.

In particular, the studies reveal the crucial importance, in the new phase of MERCOSUR's development, of the positive effects that international cooperation can have on the integration of national efforts in vocational and technical education, and in research and development devoted to new technologies in each sector.

The experience of the European Union can be of value to industrial restructuring in MERCOSUR. The UNIDO studies show clearly its importance in matters of regulating competition, vocational education and investment incentives. In all three cases it can be seen that, while the need in some instances is for common instruments and mechanisms, there is above all a need for efficient coordination of the various national mechanisms and instruments, in a spirit of transparency. Resources which, in the case of MERCOSUR, are particularly scarce could then be used more efficiently and the risk of marked disparities between the three fields giving rise to severe imbalances affecting the relative competitiveness of firms operating in the various member countries could be avoided. While there is no doubt of the importance that common policies may have, implying not only common objectives but also common instruments, the importance of adopting common perspectives in designing and implementing national policies and instruments is also evident.

In particular, the experience in matters of investment incentives, described in one of the UNIDO reports on the MERCOSUR project, will certainly be of value to MERCOSUR countries, despite the very different financial capacity that each has at present to pursue active policies while leaving taxation unchanged. The solution in such a situation, at least according to European experience, would not be to go on subsidizing inefficiency, or "playing the market", or putting off the moment of adjustment for firms, or even less boosting "industrial champions". It would rather be to facilitate the conversion and modernization of existing firms and the creation of new ones, by providing the technical and financial means that will induce them to take advantage of technical innovations and adapt to the new conditions of competition resulting from the enlarged market and overall change. However, the experience of the European Union shows the difficulty in practice of applying stimulative policies in such a way that they do not ultimately disturb the necessary macroeconomic stability or perpetuate inefficiencies in production.

In short, the main conclusions that can be drawn from the reports prepared by UNIDO under the MERCOSUR project are as follows:

(a) One of the main issues that MERCOSUR countries will have to tackle in the future is the widening gap between the progress made in terms of trade policy (e.g. reciprocal opening of markets as a result of the trade liberalization programme) and that made in matters of industrial adjustment policies and achievements, which must themselves be brought about by firms — especially small and medium-sized firms — adapting to the new conditions of competition created by the dual process of trade integration and the opening up of markets;

(b) In order to reap the advantages of intra-industry trade and trade with the rest of the world, solutions to the above problem must be found, promoting efficiency and overall competitiveness in place of unpredictable short-term gains from trade;

(c) This will require sectoral analyses of competitiveness in MERCOSUR as a whole, with firms participating actively in all stages of preparation, finalizing and discussion; the perspective should be a medium-term one referring to MERCOSUR and global scenarios, with the aim of identifying opportunities for inter-firm cooperation and firms' needs in terms of technical cooperation and restructuring;

(d) In the light of experience in the European Union, industrial restructuring in MERCOSUR will entail the adoption by member countries of common approaches to competition policy, vocational education and investment incentives. Common mechanisms and instruments may not be necessary for this, but there must be proper coordination of the activities of each member country, within the context of a common approach and a high degree of transparency;

(e) In the two subsectors that were the subject of individual studies — pulp and paper, and leather and footwear — specific technical cooperation needs were identified in the field of policy formulation for industrial restructuring and the monitoring thereof; human resources training and development; management information and advisory services; technological policies; and environmental policies related to industrial development.

2. Recommendations for future UNIDO action in support of MERCOSUR

2.1 Areas of priority

Thanks to the vast experience UNIDO has acquired in various parts of the world, in industry and technology and in matters of investment and cooperation within industry, and thanks to the services it is able to provide, UNIDO has a significant role to play in the development of MERCOSUR.

To provide effective cooperation, UNIDO should strengthen its own technical resources and experience. It should also collaborate with MERCOSUR Governments and firms so that they can make best use of the technical and financial resources that are currently available, or that may become available in the future, through the activities of other organizations and programmes, whether multilateral or bilateral.

There is a special need for such collaboration in matters of industrial restructuring; sectoral indicators and analyses of competitiveness at regional and overall level; methods of cooperation between firms; human resources development; and technological and environmental policies related to industry.

The reports prepared by UNIDO as part of its MERCOSUR project represent a useful first contribution for those involved in MERCOSUR and its industrial activities. In particular, the methodology, analyses and conclusions of the subsectoral studies that were carried out should be the subject of discussion by entrepreneurs from each subsector.

The various reports on competition, vocational education and investment incentives, presenting the experience of the European Union, also contain information and conclusions that can be of value to decision makers in MERCOSUR. They could be the subject of further attention in the future as part of the technical cooperation programmes carried out by the European Union and some of its member countries with MERCOSUR.

The question of competition policies and rules is one that will be of increasing importance in the development of MERCOSUR, especially as "levelling of the playing field" will be a crucial factor in ensuring that government actions and policies, including those at macroeconomic level, together with business practices, do not artificially distort the relative positions of competitiveness resulting from reciprocal opening of markets for goods and services. With the complete liberalization of trade among member countries at the end of the transition period provided for in the Treaty of Asunción, the question of preserving conditions of competition will acquire special importance.

It will be all the more important, in fact, as there is little chance that macroeconomic policies will be sufficiently coordinated by that time or that the artificial distortions created by government actions and policies (e.g. subsidies and access to government procurement) will be completely eliminated.

UNIDO could make valuable contributions in this field. It could also help prepare for the final stage of MERCOSUR in matters relating to industry, by reporting on the experience of countries in East Asia in industrial restructuring, competitiveness, trade and production networks and technological policies. Countries such as the Republic of Korea could cooperate with UNIDO in these matters, e.g. through the Korean Development Institute.

There is visibly a consensus among MERCOSUR countries on the need to continue vigorous efforts at national level in support of industrial restructuring, especially of small and medium-sized firms, in response to the twin challenges of opening up to world trade and establishing the common market.

It is now accepted that, apart from the necessary action to restore and consolidate macroeconomic balances, strenuous efforts must be made by firms to apply technical innovations and make significant gains in efficiency, productivity and competitiveness, both global and regional.

The four countries are at present taking specific measures to enhance the competitiveness of small and medium-sized firms, both on the MERCOSUR market and in general, by providing advice and information, as well as financing, including pre-investment financing.

These efforts are supported by various projects initiated by multilateral and bilateral international cooperation agencies, such as the World Bank, the Inter-American Development Bank, the Governments of certain OECD member countries, the European Community, and programmes such as the Bolivar Programme sponsored by IDB.

In this connection, UNIDO can provide valuable help by using the methodology it applied in preparing the sectoral studies to identify subsectors and firms that could benefit from the offer of technical and financial assistance, and to draw up technical cooperation projects for subsectors and firms.

One of the priority activities should be to adapt sectoral and local employers' associations so that they can provide interested members with a more efficient support service, including the training of technical staff working with those associations.

The experience already acquired in this field, especially in European countries, could be shared through joint programmes with the European Union and European business institutions. The European Commission's AL-INVEST Programme provides a suitable framework and instruments for this.

The experience that UNIDO and its experts possess, the services currently on offer from the Organization, and the results of the first series of studies carried out by UNIDO on MERCOSUR, are positive factors that put the Organization in a position to provide very useful services for the next phase of MERCOSUR's development.

Given the dynamic nature of the MERCOSUR process and of the transformation of industry taking place in each of its member countries, the contribution of UNIDO must meet criteria of great proximity and flexibility if it is to be timely and effective.

The trend towards decentralization of UNIDO operations and the possible establishment of subregional offices are factors that may favour an active role for the Organization in MERCOSUR, a role that should be marked by a high degree of operational flexibility and low costs. The subregion could even be a suitable location for a trial period of operational decentralization by UNIDO.

Without underestimating the current and future activities and projects of UNIDO within each member country of MERCOSUR, or in other MERCOSUR bodies, such as Subgroup 8, it is the work of Subgroup 7 of the Common Market Group which would benefit most from collaboration with UNIDO.

UNIDO should therefore participate actively as an observer in the meetings of Subgroup 7. By so doing, it will be able to follow closely and collaborate from the technical point of view in the activities generated by the Subgroup and its committees. UNIDO is already cooperating with MERCOSUR in connection with competitiveness indicators and analyses, as well as science and technology.

With its experience and its resources of experts and services, UNIDO also has considerable scope for action in connection with the work of the Micro-, Small and Medium-sized Enterprise Policies Committee (and the proposed Working Subgroup), the Industrial Promotion and Restructuring Committee, and the MERCOSUR Quality and Productivity Programme.

It would also be useful if UNIDO could attend as an observer the industrial seminars organized by MERCOSUR with active participation from private industry. The seminars provide an excellent source of information on, and appreciation of, the needs of industry in MERCOSUR in matters of competitiveness and restructuring. They would provide an opportunity to present and discuss the sectoral studies already carried out by UNIDO or any studies that may be made in the future. This is a field in which UNIDO could forge practical working relationships with the IDB MERCOSUR project, the Bolivar Programme and the European Commission.

The MERCOSUR Industrial Council, together with sectoral mechanisms in the private sector, are also suitable channels for the flow of experience and technical cooperation from UNIDO to MERCOSUR.

The following are some of the fields in which UNIDO activities related to MERCOSUR could be most fruitful and appreciated:

(a) Sectoral indicators and analyses of competitiveness, together with identification of specific industrial restructuring projects at sectoral, subsectoral and enterprise level.

This includes:

- Devising medium-term subsectoral scenarios, with the aim of identifying challenges and opportunities for efficiency gains and trade creation, including evaluation of the impact on specific countries, along the lines of the studies already made for the pulp and paper, and leather and footwear subsectors;

- Identifying restructuring projects at sectoral and firm level, and the corresponding requirements for technical cooperation and financing; and

- Drawing up specific technical assistance projects at sectoral, subsectoral and firm level.

(b) Support services for inter-firm cooperation networks, especially of medium-sized and small firms.

This includes:

- Providing information and technical support for the conclusion of inter-firm agreements within MERCOSUR, especially by small and medium-sized firms, and assistance in obtaining the necessary financing at the pre-investment and investment stages. Technical assistance may be supplied in key areas such as flexible specialization, productivity and the development of marketing and production networks, with the emphasis on subsectors.

(c) Technological cooperation policies.

This includes:

- Evaluating the regional dimensions of current policy orientations with a view to developing capacities, financing innovative projects and strengthening the science and technology infrastructure;

- Cooperating in efforts to ensure the homogeneity and quality of legal codes, intellectual property, and procedures and institutions in the field of environmental control and quality management;

- Providing the education and training required by the foregoing; and

- Evaluating and devising measures to facilitate technology transfer within the region, as well as transfers from third countries, whether or not they are connected with foreign direct investment.

2.2 **Mechanisms to facilitate international cooperation**

In order to facilitate international cooperation with MERCOSUR in the field of industrial restructuring, an *inter-agency technical task force* and a *MERCOSUR pre-investment programme for private projects* could be promoted, with the collaboration of various international organizations such as UNIDO.

2.2.1 Inter-agency technical task force

To ensure the effectiveness of international cooperation with MERCOSUR, especially in the fields covered by the UNIDO MERCOSUR project, an inter-agency technical task force should be established. The task force would operate in support and under the aegis of Subgroup 7 of the Common Market Group.

Its membership could include an industrial specialist of recognized standing in the region and a specialist in international technical cooperation.

The function of the task force, through the services of its experts, would be to help match the requests for technical cooperation arising out of the activities of Subgroup 7 with the supply of assistance available from UNIDO and other international cooperation agencies or obtainable through specific projects presented by MERCOSUR countries. UNIDO experts themselves could perhaps provide assistance in drawing up technical cooperation projects for submission to various international cooperation sources.

Another priority function should be to help identify, by means of sectoral studies, firms that could benefit from technical and financial cooperation, in order to draw up and validate their restructuring and competitiveness strategies, at MERCOSUR and global levels.

The existence of an inter-agency task force of this nature could contribute to the coordination of UNIDO activities with those being carried out under other present or future projects in the field of industrial restructuring, competitiveness, and inter-firm and technological cooperation; examples of such activities are provided by the IDB-MERCOSUR project, the IDB-Multilateral Investment Fund, the cooperation between the European Union and MERCOSUR, and the Bolivar Programme.

The task force could be set up under the auspices of UNIDO, IDB (including the Bolivar Programme), UNDP and the European Commission. Its relationship with Subgroup 7 would be direct. It is worth noting in this connection that, apart from the contributions made by UNIDO through its MERCOSUR project and its bilateral programmes, the European Commission and IDB are together channelling about $20 million at present into non-reimbursable technical cooperation, which includes studies on industrial restructuring and sectoral analyses of competitiveness. To this must be added the various programmes and projects being carried out with UNDP funding in each member country, as well as those under way at country level under bilateral programmes of technical and industrial cooperation.

It is therefore extremely important to have available an adaptable and practical mechanism that can lend momentum to the various activities under way, with UNIDO contributing its wide international experience and its technical expertise in these matters.

Matching the supply of cooperation available under these and other programmes with the potential demand at subsectoral and firm level should be a priority aim for UNIDO. UNIDO activities in this field, especially its cooperation with sectoral and local business associations, themselves adapted to their members' new needs, could also allow greater advantage to be taken of the activities envisaged by the European Union under its AL-INVEST programme, particularly for the promotion of inter-firm agreements and joint ventures with medium-sized and small European companies.

2.2.2 MERCOSUR pre-investment programme for private projects

In order to meet the growing demand from private business, especially medium-sized and small firms, for support in carrying out pre-investment activities, a MERCOSUR pre-investment programme for private projects should be established.

UNIDO, IDB, UNDP and the European Union could collaborate in drawing up the programme's terms of reference, defining access criteria and designing the financing mechanisms. Examples that could be followed are the European Community Investment Partners (ECIP) facility and, at the domestic level of one MERCOSUR country, the recently established Non-traditional Agricultural Commodity Export Promotion Fund.

The programme could comprise four national windows, one per country, each offering IDB technical cooperation funding reimbursable in local currency and possibly, in the case of Paraguay and Uruguay, non-reimbursable technical cooperation from IDB and the European Union.

These resources could be supplemented by non-reimbursable technical cooperation financing provided by IDB itself, e.g. through its Multilateral Investment Fund, and by funding from OECD countries interested in participating in the MERCOSUR industrial restructuring process by providing technical cooperation. Agreements could be made to this end with the European Union's ECIP facility and with IDB TC-Funds.

Ways of associating specific projects, through the national windows, with the Multilateral Investment Fund set up by IDB could also be agreed upon, in accordance with the Fund's objectives and criteria. The pre-investment operations should be reimbursable, although additional funds provided for specific activities could be non-reimbursable. The firms or employers' associations concerned should in any case cover at least 50 per cent of the cost of pre-investment activities. A network of banks could be one of the channels through which firms would have access to the funds. The experience of ECIP and the Bolivar Programme could be useful in this respect.

A programme of this nature should have links from the very start up to its later operational stage with the private sector and its institutions, e.g. the MERCOSUR Industrial Council, and with the banking systems in MERCOSUR countries.

It should also have links with investment promotion and inter-firm cooperation mechanisms already existing in MERCOSUR member countries, such as, in Argentina, the Investment Office of the Ministry of Economic Affairs, the Invest Foundation and the activities carried out by the Department of Industry in support of small and medium-sized enterprises; and in Brazil, the funding lines opened by the Studies and Projects Financing Facility (FINEP) to promote cooperation between small and medium-sized private enterprises within MERCOSUR, and the Itamaraty Investment Promotion and Technology Transfer System for Enterprises (SIPRI).

With regard to the resources of the pre-investment programme, the countries of MERCOSUR could make arrangements with IDB for a facility similar to that of TC-Funds, which would make available a non-reimbursable technical cooperation component to cover the expenses of visits by local experts, as a supplement to the use of foreign experts.

Specific non-reimbursable technical cooperation projects that might arise out of the collaboration between UNIDO and MERCOSUR could be submitted by MERCOSUR countries for consideration by multilateral and bilateral technical cooperation sources, such as the previously mentioned IDB Multilateral Investment Fund, the European Commission and the Governments of OECD countries.

UNIDO could, in such instances, help draw up the terms of reference of the various technical cooperation projects, either through the proposed inter-agency technical task force or through the services of its own experts (with the support of the IDB TC-Funds facility), arrange the necessary support from the relevant source and perhaps compete for appointment as executive agent for the project.

In the initial phase, UNIDO should concentrate on producing "success stories", especially of small and medium-sized firms which restructure and work together to adapt to MERCOSUR, so as to be more competitive in general, and of business associations that also reorganize so as to provide better support to their members in the necessary endeavour to compete on MERCOSUR and wider markets.