ECONOMIC SURVEY OF LATIN AMERICA AND THE CARIBBEAN 1997-1998

The Economic Survey of Latin America and the Caribbean is prepared annually by the Economic Development Division with the assistance of the Statistics and Economic Projections Division and the ECLAC regional and national offices, under the overall supervision of Barbara Stallings, Chief of the Economic Development Division. Hubert Escaith was responsible for technical coordination of the present edition of the Survey.

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Notes

The following symbols have been used in the tables in this Survey:

Three dots (...) indicate that data are not available or are not separately reported.
A dash (-) indicates that the amount is nil or negligible.
A full stop (.) is used to indicate decimals.
The word "dollars" refers to United States dollars, unless otherwise specified.

ECONOMIC COMMISSION FOR LATIN AMERICA
AND THE CARIBBEAN

ECONOMIC SURVEY OF LATIN AMERICA AND THE CARIBBEAN 1997-1998

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NOTE

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FOREWORD

The ***Economic Survey of Latin America and the Caribbean, 1997-1998*** is the fiftieth edition in this series. To mark this milestone, a special chapter has been included in this edition of the Survey which traces the history of the publication and outlines the way in which the economic situation in the region has been viewed during each of the periods examined.

Apart from this innovation, the changes made in 1995 in terms of the *Survey's* coverage of regional economic conditions have been maintained in the 1997-1998 edition. Once again, it is published as a single volume consisting of three parts. Part One contains a summary which provides an overview of the economy in 1997 and the first half of 1998. This summary has also been published as a separate document. The other seven chapters of Part One examine the economic performance of the region in 1997 and go on to analyse some aspects of the economic situation during the first half of 1998. Part Two presents reports on the 20 countries of Latin America and on the situation in the countries of the English-speaking Caribbean. The special chapter which reviews the 50 years of the *Economic Survey* is contained in Part Three.

As in the last two editions of the *Survey,* this year's edition includes a statistical appendix on diskettes which provides ready access to data for recent years and permits the preparation of spreadsheets covering a longer time period. The same methodology as the year before has been used for the presentation of this statistical information.

FIRST PART

THE REGION

I. SUMMARY

1. Inti

The year 1997 was a highly successful one for many economies in Latin America and the Caribbean, thanks to both a strong expansion of output and low inflation. As predicted earlier, however, external shocks, combined with the effects of policies designed to deal with incipient disequilibria in several countries, have made it impossible to repeat that performance this year.

The region's average growth rate of 5.3% in 1997 was one of the highest in the past two decades; it is notable that this expansion was led by the robust growth of both investment and exports. At the same time, inflation fell to 10.4%, the second-lowest level in the last half century, and labour markets showed a moderate improvement. Capital inflows reached an all-time high of nearly US$ 80 billion, which was enough to cover the widening current account deficit (US$ 63 billion) and to permit a substantial increase in international reserves. Over two thirds of these flows consisted of direct investment, the most stable kind of foreign capital.

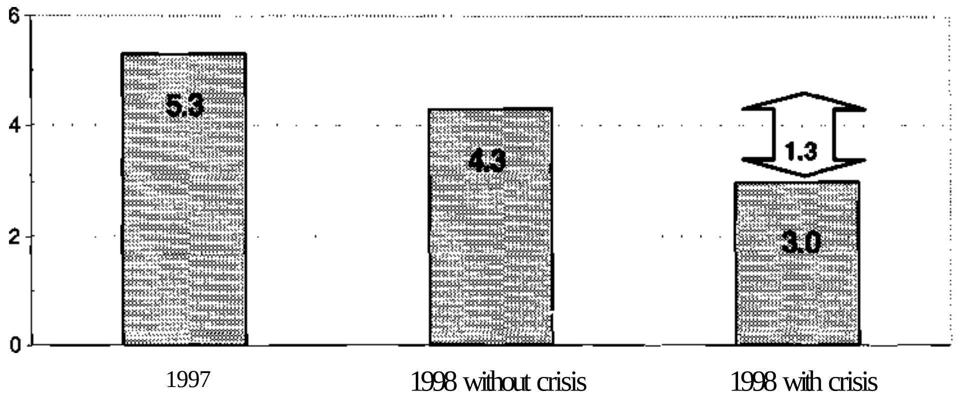
In 1998, by contrast, the region's economies are expected to grow only around 3% on average, which is slightly lower than the norm for the decade. Under these conditions, it is likely that unemployment will again begin to increase. Inflation, which had been falling rapidly until 1997, crept back up to 10.9% in the 12 months to June 1998, although it may recede in the second half of the year, once the food price increases caused by natural disasters have abated. The current account deficit will widen further to around US$ 75 billion (3.7% of GDP, compared to 3.2% the year before), but capital inflows will still be more than enough to cover the gap.

Two types of external shocks have affected the region -and much of the rest of the world as well- in the current biennium. The first has been generated by the climatic phenomenon known as El Niño, which, by warming ocean currents, has caused both severe floods and droughts in different places. In a number of Latin American and Caribbean countries, El Niño has disrupted agricultural production and fishing, wreaked havoc in forestry and ranching activities and destroyed infrastructure and housing stock. The results include depressed growth rates, increased inflation and pressures on the balance of payments owing to both lower exports and higher imports.

The other shock has been the financial crisis that began in Thailand in June 1997 and thereafter expanded to include large devaluations, recessions and inflation in many of the developing countries of East and South-East Asia. The continuing stagnation of the Japanese economy has only exacerbated the problems of its neighbours. As noted in an earlier ECLAC study, the repercussions of the Asian crisis have been transmitted to Latin America through three channels: trade (a decline in the volume of exports to Asia, lower commodity prices, competition from cheap Asian exports, negative spillovers from intraregional effects in Latin America itself); finance (speculative attacks on exchange rates, weakening stock markets, scarce and/or more expensive foreign capital); and policy responses (tighter fiscal and monetary policies).

1 ECLAC, *Impact of the Asian Crisis on Latin A,* (LC/G.2026), May 1998.

Figure 1.1
LATIN AMERICA AND THE CARIBBEAN: OVERALL EFFECTS OF THE ASIAN CRISIS
(In percentage of GDP growth))



Source: ECLAC, on the basis of official figures.

These processes have tended to lower the countries' growth rates and increase their current account deficits, as well as raising the cost of financing those deficits. The ECLAC study tried to separate out the effects of the Asian crisis *per se* from other phenomena, including El Niño, lower oil prices (only partially due to weaker demand in Asia) and the fact that some of the countries in the region had to take steps to prevent their economies from overheating. Thus, a comparison was made between projections for 1998 prepared in September 1997 (before the Asian crisis hit Latin America) and in March 1998 (after serious repercussions had begun to be felt). According to this analysis, growth would have declined by about 1% in 1998 even without the Asian crisis, but the crisis will subtract another 1%-1.5% (see figure 1.1). Given the negative terms-of-trade effect, the rate of increase in gross domestic income will slow even more than GDP growth.

The Latin American and Caribbean Governments have been quick and decisive in their response to these external shocks, and in consequence, their impact so far has been relatively mild. At the same time, it should be pointed out that there has been a clear policy bias towards reducing demand rather than adjusting relative prices, especially the exchange rate. This choice has negative implications for growth rates in the region, at least in the short run, although it also has a positive impact on inflation.

The best-known example is Brazil's reaction when the *real* was attacked in October 1997. Within days, the Government announced a package of measures to defend the currency, which is considered to be the linchpin of the stabilization programme that brought inflation under control. The measures centred around a sharp rise in interest rates and cuts in government expenditure, which led to a slowdown in growth but avoided major financial difficulties of the sort that have undermined a number of Asian economies. It should be pointed out that Brazil was able to undertake these measures because it, like many other Latin American and Caribbean countries, had substantially strengthened its banking system in recent years.

Although sound economic management and other preventive measures have warded off a crisis in the region thus far, a cautious attitude should be maintained for several reasons. First, the recessions in East and South-East Asia now appear likely to last longer than originally foreseen and could worsen. Second, additional problems could emerge, such as a further weakening of the banking sector in Japan, a devaluation in China, or a spread of the contagion to other countries, as ocurred in Russia in August 1998. Third, the crisis may have repercussions on the United States and European economies that have not yet been manifested, which in turn would have a negative affect on Latin American exports. Finally, further weather problems ("La Niña") and the continuation of weak commodity prices could be very damaging to certain countries in the Latin American and Caribbean region.

2. Macroeconomic policy

As in earlier years, the effort to consolidate the ground already won by the stabilization programmes in the Latin American and Caribbean countries has been the objective that has determined the general thrust of macroeconomic policy in 1997 and 1998. Within this general approach, however, it is possible to distinguish two periods characterized by differences in the availability of foreign capital and by policy-makers' responses to the situation. The abrupt change in flows, generated by the deepening of the Asian crisis, marked the separation of the two periods.

For much of 1997, in what constituted the continuation of a trend that had taken shape in the second half of 1996, a plentiful supply of foreign resources was placed at the region's disposal, allowing it to boost domestic growth above the originally projected levels. In response to this sharper-than-expected upswing, and with fiscal deficits starting to show slight increases, the authorities began to modify their monetary targets to bring them into line with the increased demand for money.

The countries' external accounts constituted the dark side of this otherwise bright picture, as the appreciation of the real exchange rate began to accelerate and the situation in the current account of the balance of payments started to deteriorate. Since international reserves were rising, however, these trends were not seen as a major cause of concern by policy-makers, at least until the second half of the year.

When the prospect of having an ample supply of inexpensive external financing vanished in October 1997, the question of the volatility of external credit flows and of the sustainability of the region's growth patterns came to the fore once again. From that point onward, macroeconomic policy returned to a more restrictive stance. At first, the aim of this change was to restore investors' confidence in stabilization programmes and to prevent capital flight. Later on, when the severity of the Asian crisis became apparent, adjustments were directed towards cooling down domestic demand and aligning it with the new external scenario of increasing uncertainty.

The reduction in revenues threatens fiscal equilibria

The fiscal sector is perhaps the area of macroeconomic policy that, from a regional perspective, has undergone the fewest qualitative changes during 1997 and 1998. From early 1997 on, many countries began to have difficulty in meeting their revenue targets; this was mainly because of decreases in non-tax income, whether in the form of capital revenues (especially income from privatizations) or of current receipts (as a consequence of lower sales volumes in State enterprises). All in all, the average decline in public-sector revenue amounted to half a percentage point of GDP. To make up for this loss of income, spending was cut by an average of 0.2 points of GDP, with most of the reduction being made in capital expenditures. Thus, the region's average fiscal deficit rose only slightly (from 1.0% to 1.2% of GDP) and was financed primarily with external resources. Although this deficit was relatively small, the overall figure for the region as a whole masks the existence of fiscal problems in a number of countries, particularly Bolivia, Brazil, Colombia, Ecuador, Guyana and Jamaica.

As of October 1997, with the worsening of the Asian crisis, countries of the region began to adopt measures of fiscal adjustment. These steps were aimed both at reducing expenditure to deal with large fiscal deficits and at counteracting declines in revenue. Brazil was the first country to react to the change in international conditions. While authorities in Brazil had tried earlier to apply fiscal adjustment measures without much success, they took advantage of the new situation to put forward a much more ambitious programme with the aim of reducing the deficit by more than 2% of GDP. As of mid-1998, however, they had not achieved the expected results; indeed, the deficit had widened even further.

Countries that suffered a decline in government revenue because of falling commodity export prices also implemented fiscal adjustment measures. The oil exporters were aprime example, since the price of petroleum on the international market was well below the figures used to prepare government budgets. Thus, Mexico carried out three expenditure cuts in the first half of 1998, achieving a saving of nearly 1% of GDP, while in Venezuela expenditures were reduced and a sales tax was introduced. In Chile, public revenue deteriorated because of the sharp fall in the price of copper in the second half of 1997; this obliged the Government to cut expenditures in 1998.

With the persistence of the Asian crisis, which turned out to be deeper than initially envisaged, other countries also perceived the necessity of implementing austerity measures. The Argentine Government, for example, has recently announced budget cuts to reduce the fiscal deficit and moderate domestic demand so as to keep the external deficit within a range that can be financed.

The overvaluation of local currencies has abated

Given the voluminous inflows of external financing received by the region in 1996 and in the first three quarters of 1997, in the great majority of the countries exchange rate policy focused more on controlling domestic inflation than on fostering external competitiveness. During this period, the use of the exchange rate as a "nominal anchor" to slow price rises had the effect of driving up the rate of real appreciation of Latin American currencies, but that trend has abated in 1998.

Despite a smaller inflation differential with respect to their trading partners outside the region, the countries of Latin America and the Caribbean, taken as a group, registered a real appreciation of their currencies of over 4% in 1997. The appreciation of the currencies of the seven countries with the most active financial markets in the region was particularly marked, reaching an average annualized rate of 8% in the second and third quarters of 1997. The rest of the countries recorded a much more moderate appreciation -an annualized rate of about 2%- during those same months.

As was also true in 1996, the real appreciation of the countries' currencies was primarily caused by financial factors that bore no apparent connection with the fundamentals of the real economy, i.e., growth, productivity and the terms of trade. The risk involved in a delinkage of financial factors from the fundamentals became glaringly evident in the wake of the crisis of October 1997, when international markets began to reassess the external sustainability of the growth and stabilization patterns of, initially, the most heavily exposed economies and, later, all the economies of the region.

Depending on the policy stance of the country, the currency market's behaviour led either to a nominal devaluation or to a loss of international reserves. In most cases, the nominal devaluation rate began to increase in the fourth quarter of 1997 and the first half of 1998, stopping the real appreciation of local currencies for the region as a whole. This result at the regional level, however, was the average of opposing trends among countries. At the two extremes, Venezuela saw a real appreciation of 14%, while Paraguay registered a real depreciation of nearly 20% (see figure 1.2).

Monetary policy assumes a reactive stance

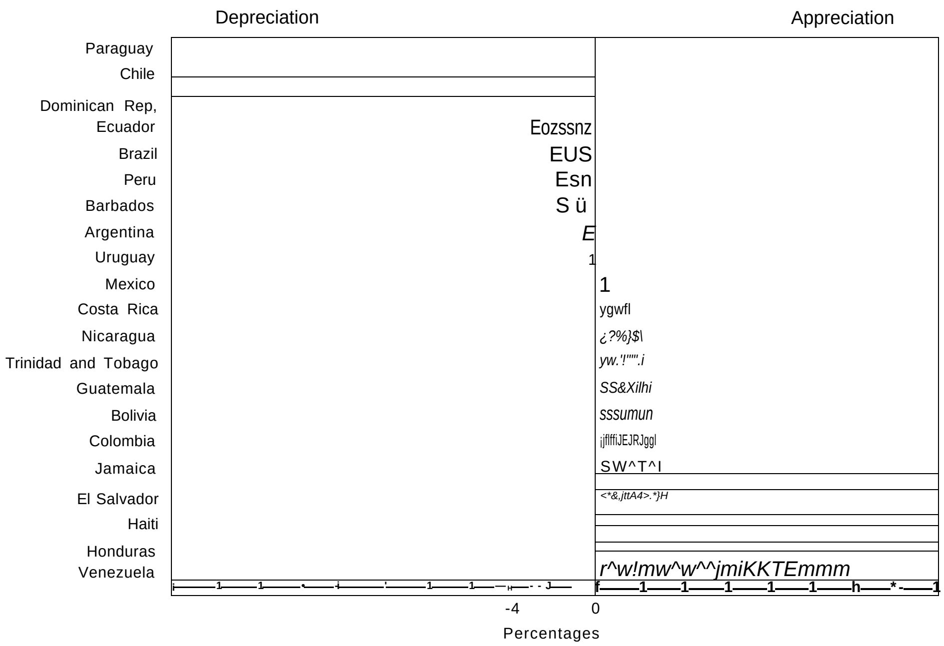
As the growth rates of the Latin American economies outpaced the original projections during the greater part of 1997, monetary authorities adopted a more accomodating stance. Thus, after having grown more slowly than GDP in the previous two years in most of the countries of the region, the supply of base money expanded rapidly during the first three quarters of 1997. This relaxation of monetary policy prompted a reactivation of domestic lending, whose effect on the growth of the money supply was even greater than the impact of the strong build-up of external assets.

It should be pointed out that this increase in the money supply was wholly attributable to stronger demand for local currency on the part of the general public and business as the volume of commercial transactions increased and the

Figure 1.2

LATIN AMERICA AND THE CARIBBEAN: CHANGES IN REAL VALUE OF LOCAL CURRENCIES "

(October 1997to May 1998)



Source: ECLAC, on the basis of figures from the International Monetary Fund.

[0] With respect to the United States dollar.

erosion of purchasing power subsided. Thus, rather than diminishing, as it would have in the presence of excess liquidity, the real interest rate on deposits rose by an average of over one percentage point to an annual rate of around 4%. Moreover, the increase in the money supply did nothing to impede the decline of inflation rates, as the surges that did occur were clearly attributable to supply factors, especially in the case of agricultural products affected by El Niño.

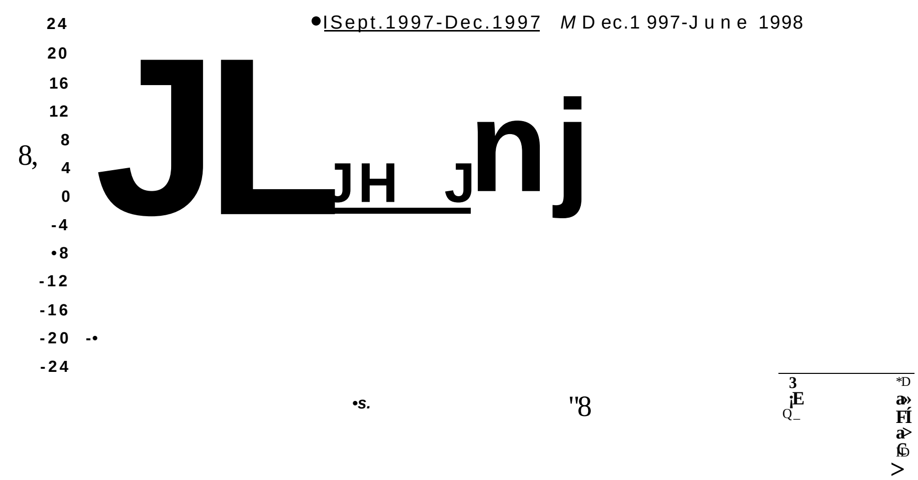
The Asian crisis put an abrupt end to this expansion of the money supply. In the final quarter of 1997, the remonetization of the region's economies slowed sharply, falling from an average annual rate of 15% in real terms to 8% between September and December. Brazil was the first country to tighten its monetary policy in October 1997, but the majority of the region's economies followed suit once the severity of the external shock and of the deterioration in external financial conditions became clear. Interest rates were raised sharply to try to prevent the loss of international reserves, and steps were taken to reduce liquidity on the interbank market (see figure 1.3). It is expected that the resulting reduction in the money supply will, in conjunction with various fiscal adjustments, help check the expansion of domestic demand and thus slow GDP growth in the second half of 1998.

The domestic financial markets saw a continuation of the consolidation process that had begun in the aftermath of the banking crisis that overtook the major economies of Latin America in 1994 and 1995. The main exceptions were Paraguay, where the authorities had to step in and eventually liquidate two banks, and Jamaica, where much of the cost of a severe crisis in that country's banking system had to be

Figure 1.3

LATIN AMERICA AND THE CARIBBEAN: CHANGES IN NOMINAL INTEREST RATES [a]

(Percentage points of variation in different periods))



Source: ECLAC, on the basis of official figures.

[a] Short-term annualized rates.

absorbed into the government budget. Banking reforms moved ahead in most of the countries, however, as regulatory systems were strengthened in order to improve the prudential regulation and supervision of financial activities. The consolidation of Latin America's banking system was reflected in a reduction in the number of banking institutions in many countries as well as in the increasingly important role of foreign banks as stockholders and managers of domestic banking institutions. This trend was particularly notable in Argentina, Brazil, Colombia, Mexico and Venezuela, but is in evidence in a majority of the countries of the region.

3. Economic performance

A significant slowdown is expected in GDP growth

The recovery in the level of economic activity that had begun in 1996 in Latin America and the Caribbean gathered speed in 1997, but in 1998 it has slackened considerably. Consequently, the 5.3% growth rate posted in 1997 -one of the highest to be recorded since the late 1970s- is expected to drop to about 3% in 1998, thereby returning to the more modest trend that prevailed at the start of the decade. Per capita GDP is expected to rise by only around 1%.

This uneven performance on the part of the region's economies has in large part been a reflection of the behaviour of capital flows. The huge volume of such inflows in 1997 no doubt contributed to the buoyancy exhibited that year by the Latin American and Caribbean economies. The sudden contraction of those flows in October when the Asian crisis worsened had a dampening effect on economic activity, and a number of Governments were forced to implement harsh adjustment measures, since this new situation came at a time when they had large deficits on their external accounts. The severe deterioration in the terms of trade, especially for oil- and copper-exporting countries, is also playing a role in the poor performance of some countries in 1998.

Almost all the countries of the region shared in the expansion of economic activity seen in 1997; Jamaica was the only country to experience a setback in this regard. Five countries (Argentina, Chile, the Dominican Republic, Mexico and Peru) posted GDP growth of over 6%, and another six economies had rates of between 4% and 6%. In the rest, GDP expanded by between 1 % and 4% (see figure 1.4).

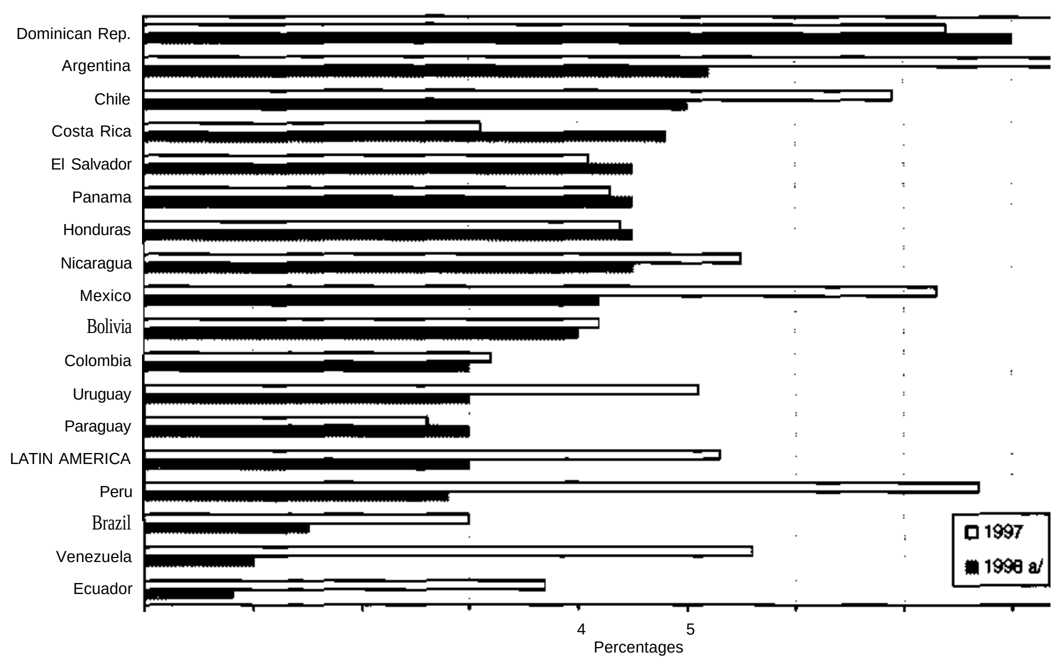
The rapid growth of the Latin American and Caribbean economies in 1997 was largely attributable to investment and exports, which grew much faster than GDP. Gross capital formation expanded particularly sharply in Argentina, Bolivia, the Dominican Republic and Mexico, while exports were an important element in promoting growth in the Dominican Republic, El Salvador, Guatemala, Mexico, Peru, Uruguay and Venezuela. Consumption rose more slowly, in most cases by less than GDP growth. Nevertheless, as a consequence of the liberalization policies of recent years and, above all, the steady real appreciation in most countries' currencies, a considerable portion of domestic demand was diverted to imports. Although this undermined economic dynamism, it also served to alleviate pressure on prices in a context where high growth was leading to full use of productive capacity.

GDP growth is expected to decrease significantly in most of the region in 1998. Some of the Central American and Caribbean countries may be an exception, however, since the Asian crisis has had less of an impact on them and the decline in oil prices has provided some relief in terms of their external accounts. Because of its

Figure **1.4**

LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT

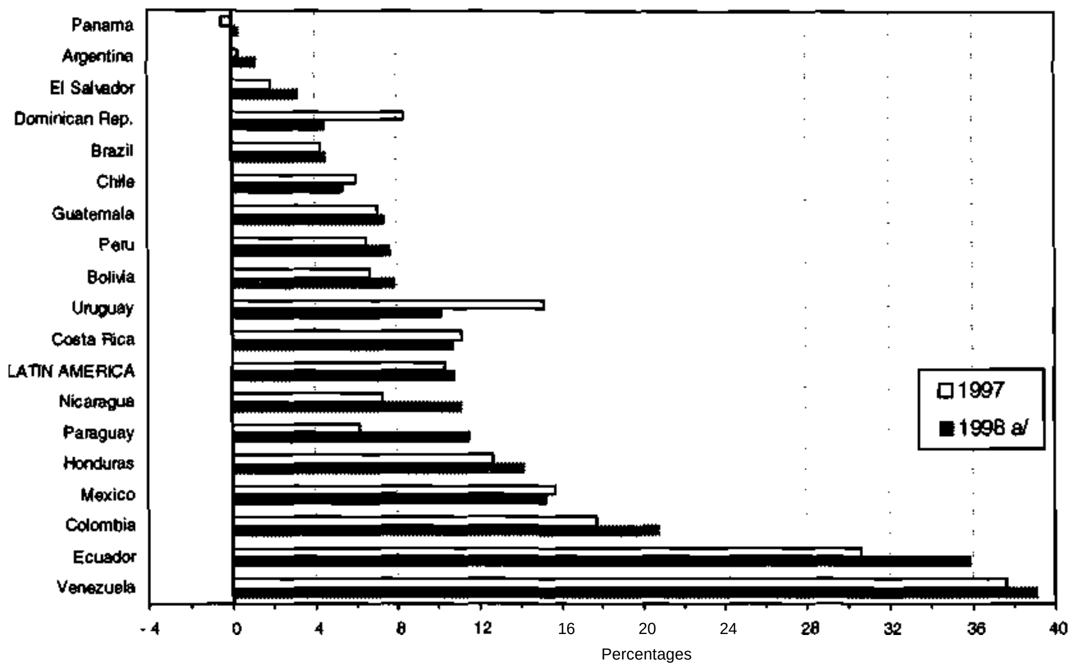
(Annual growth rates)



Source: ECLAC, on the basis of official figures.

[a] Preliminary estimates.

Figure 1.5
LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES
(12-month variations)



Source: ECLAC, on the basis of official figures.
[a] Twelve months to June 1998.

size, the drop in Brazil's growth rate to just 1.5% will drive down the region's overall rate considerably, but reductions are also expected in Argentina, Mexico, Peru and Venezuela, all of whose economies flourished in 1997. The slowdown in GDP growth in 1998 can be traced to a slump in domestic demand (especially for capital goods), which has been hurt by the adjustment plans implemented in response to the adverse impacts of the Asian crisis.

Inflation levels off at an annual rate of slightly above 10%

The slow rate of price increases in recent years has been one of the main economic policy accomplishments of the Latin American and Caribbean countries. The average rate of inflation for the region as a whole fell from 18% in 1996 to slightly over 10% in 1997, the second lowest figure in the last 50 years. A slight increase was seen in the first half of 1998, but this did not imply a reversal of the achievements of recent years. In addition to the reduction in the overall rate, it is notable that low figures were registered by a large number of countries in 1997 and 1998: 10 of the 19 countries for which data are available had single-digit inflation in both of these years, and another seven had rates of between 10% and 20%. The only countries that had higher rates -between 30% and 40%- were Ecuador and Venezuela (see figure 1.5).

These results are especially significant in view of the fact that they coincided with rapid GDP growth in the region in 1997. The inflationary pressures generated by the steep upswing in domestic demand were neutralized, thanks to the existence of idle capacity and a considerable increase in external supply. By the same token, the expansion of the workforce helped to curb the rise in wages prompted by stronger demand for labour.

The small amount of ground lost in the 12 months to June 1998 in terms of inflation control was a reflection of developments in only a few countries. Nicaragua registered a rate of 14%, which was double the 1997 figure, and in Paraguay inflation jumped by over five percentage points to nearly 12%. Colombia's inflation rate for the year is expected to be slightly higher than in 1997, but it is hoped that it will still be below 20%. In contrast, the Dominican Republic and Uruguay succeeded in bringing its inflation rate down sharply, and Chile registered somewhat smaller reductions. In the rest of the countries inflation either leveled off or rose slightly.

The increase in inflation rates in some countries and the failure of others to achieve any further reduction are partially attributable to the effects of El Niño, which heavily damaged many crops, thereby driving up the prices of some widely used staple foods. There were also other specific factors at work in some cases, such as government-regulated rate adjustments for public utilities and the devaluation of a few currencies. On the other hand, lower prices for some imports, especially oil, have contributed to stabilization efforts.

Labour markets are likely to forfeit recent gains

Within the context of the high economic growth rates achieved in 1997, the labour market's performance was fairly good, with significant increases in both employment and labour productivity, a small decline in unemployment and a moderate rise in real wages. All this helped to offset part of the deterioration witnessed in the preceding two years. However, although these improvements were sustained during the first half of 1998, it is likely that they will be reversed in the second half of the year.

The favourable results for 1997 were shared by the great majority of the countries in the region. Improved job opportunities, as reflected in a striking increase in employment, stimulated the growth of the labour supply, and the decrease in open unemployment was therefore only moderate. The main exception to this bright picture was Brazil, where sluggish job creation resulted in higher unemployment even though the labour force participation rate declined.

During the first half of 1998 the situation was much the same. In all the countries for which data are available except Brazil, employment levels were higher than they had been during the first half of 1997, and the regional average, weighted by the size of the working-age population, remained constant (see figure 1.6a). The improvement in the employment situation was also reflected in average real wages, which climbed slightly in most of the few countries that have statistics available on this variable.

As a consequence of the trend in employment levels, the rate of unemployment fell during the first half of the year in most of the countries for which data are available (Argentina, Chile, Mexico, Panama, Uruguay and Venezuela), but rose again in Brazil and Colombia. As had also been true in the second half of 1997, in Colombia this was due to a sizeable increase in the labour supply, but in Brazil it was the result of slack job creation. Because of the steep rise in unemployment in Brazil and that economy's strong influence on weighted regional figures by virtue of its size, the average rate of unemployment for the eight countries for which data are available climbed from 7.5% in the first half of 1997 to 8.1% for the corresponding period of 1998, whereas the simple average for these same countries fell from 10.5% to 10.1% (see figure I.6b).

Hence, as of mid-1998, Brazil's labour market was the only one that had been hurt to any significant degree by the slowdown in growth. Nonetheless, it is expected that during the second half of the year the adjustment measures which many countries began to implement in late 1997 or during 1998 may curb job creation and boost unemployment. Consequently, after two bad years (1995 and 1996) and one year of improvements (1997) in terms of the quantity of jobs and, to a partial extent, job quality, the labour market is in danger of suffering another setback.

Figure I.6a
LATES AMERICA AND THE CARIBBEAN: EMPLOYMENT RATES
(Working population as a percentage of the working-age population, first half of each year)

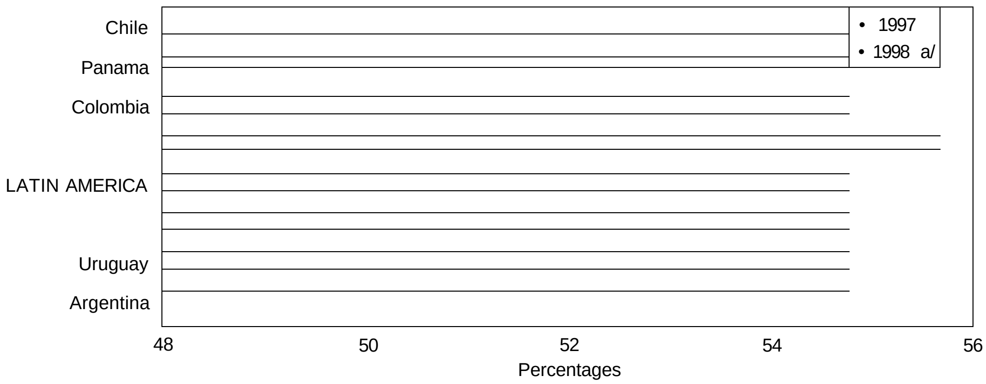
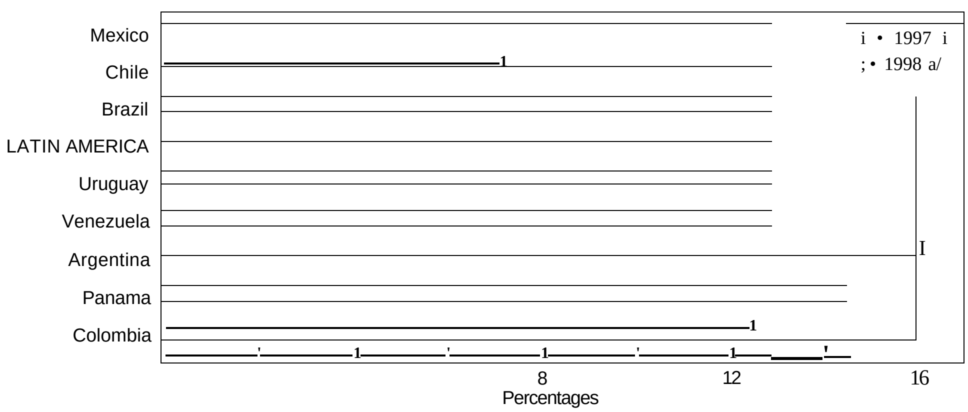


Figure I.6b
LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT
(As a percentage of the economically active population, first half of each year)



Source: ECLAC, on the basis of official figures.
[a] Preliminary data.

The current account deficit continues to widen

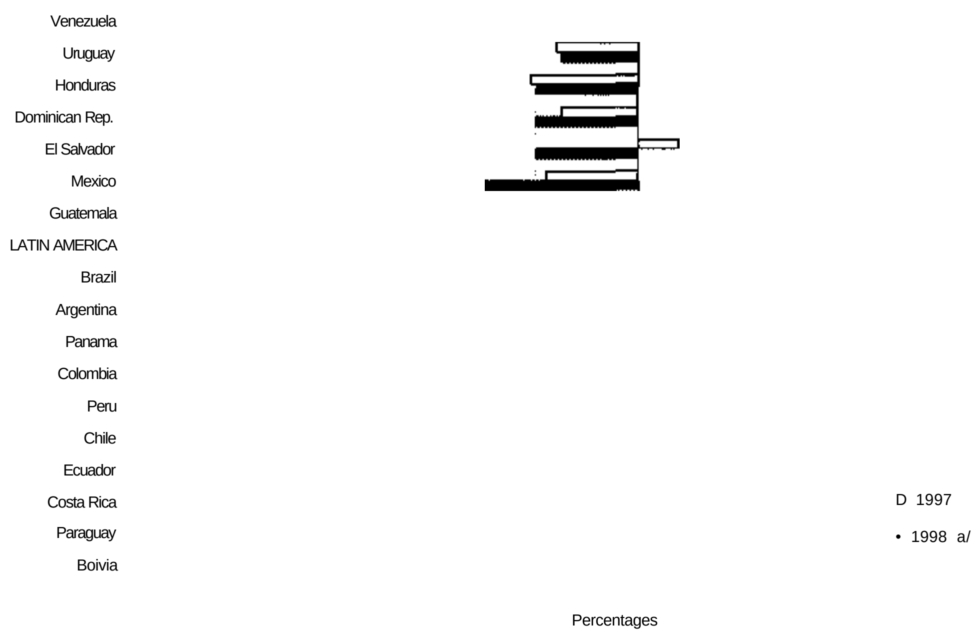
The current account deficit for the Latin American and Caribbean region as a whole has expanded in both 1997 and 1998, as imports continue to rise faster than exports. With the high rate of GDP growth registered in 1997, the gap widened to US$ 63 billion (3.2% of GDP as compared to 2.0% in 1996). In 1998, the deficit is projected at around US$ 75 billion (3.7% of GDP). Plentiful capital inflows continue to provide more than enough funds to cover the deficit (see figure 1.7)).

The expansion of foreign trade in 1997 was one of the largest of the last two decades. Exports climbed by 11% in volume and by 10% in value, while imports rose even more rapidly, by 19% in volume and by 18% in value. The figures for 1998, however, are likely to be much lower.

Figure 1.7

LATIN AMERICA AND THE CARIBBEAN: CURRENT ACCOUNT BALANCE

(As a percentage of GDP)



Source: ECLAC, on the basis of figures from national sources and the International Monetary Fund.
[a] Preliminary estimates.

The growth of trade volume in 1997 was driven by the strength of demand. In the case of imports, this was based on internal demand, which swelled by 7%, thus stimulating GDP, which grew by slightly more than 5%. The significant role played by investment in GDP growth was reflected in the dynamism shown by capital goods imports. Meanwhile, export demand was generated by a world economy that managed to maintain a high growth rate of 4.1% and to boost international trade by 9%; intraregional trade also showed considerable dynamism. In addition to the income effect on the volume of international trade, the real appreciation of regional currencies contributed to an increase in imports while, at the same time, there is no evidence that it hurt exports.

Commodity price trends were mixed in 1997 as the net result of two opposing factors: the positive influence exerted by the buoyancy of the world economy and, in the second half of the year, the negative influence of the Asian crisis. All in all, for most countries, the unit value of exports rose while that of their imports fell, and a widespread improvement was consequently seen in the terms of trade.

Taking into account the above trends, it can be seen that variations in volume were the major factor influencing the value of trade. Nearly all the countries registered increases in their trade deficits, and trade surpluses narrowed in the few countries that had them. As a result, the 1996 trade surplus for the region as a whole gave way to a deficit in 1997.

In the second half of 1997 and the first half of 1998, the Asian crisis has affected trade in three ways:

(i) Lower prices for some commodities (primarily minerals and agricultural raw materials): According to the IMF, the crisis has been the main cause of the downturn in the prices of copper, nickel, natural rubber, wool, leather and rice; it has also been a significant factor in the descent of lead, wood and oil prices. Most of the decrease in copper prices occurred in the second half of 1997, but the slump in oil prices has been concentrated in 1998.

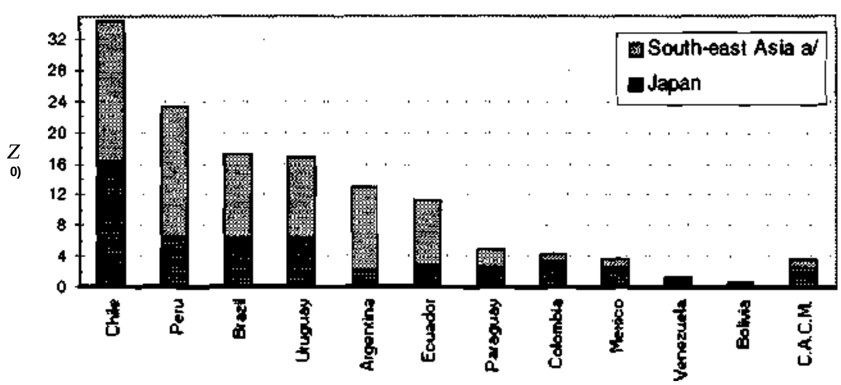
(ii) Lower export value: Given the lower prices of many products exported by the region, it is likely that export value will fall in a number of countries. During the first half of the year, this was the case in Chile, Ecuador, Peru and Venezuela. Part of the contraction will be accounted for by a reduction in exports to Asia, although the impact of such a trend will be mitigated by the fact that Asia buys only a small fraction of the exports of Latin American and Caribbean countries, except in the cases of Chile and Peru (see figure 1.8). A slowing in the growth of intraregional exports, especially within Mercosur, is also expected.

(iii) Reduced import value: Imports may slacken as a consequence of the monetary and fiscal measures implemented in order to slow down spending and support local currencies, especially in Brazil, Chile and Venezuela. The figures that are available so far, however, indicate only that imports were down in Brazil (-2% in the first half of 1998).

The Asian crisis notwithstanding, in 1997 and the first half of 1998 foreign capital continued to flow into Latin America and the Caribbean, providing more than enough funds to cover the countries' mounting current account deficits. What is more, the trend first seen in 1995, whereby the composition of these flows is shifting towards an increasing proportion of medium- and long-term capital, has been strengthening, and the information available as of mid-1998 suggests that this trend will hold firm during the second half of the year.

The past 18 months can be divided into two different phases in terms of the level and cost of the external financing available to the region. During the first phase, which covers the period from January to September 1997, capital inflows were copious and borrowing costs were moving downward. The second phase, from October

Figure 1.8
LATIN AMERICA AND THE CARIBBEAN: EXPORTS TO ASIA
(As a percentage of each country's total exports)



Source: ECLAC, on the basis of official figures.
[a] Includes Australia, Corea, China, Hong Kong, Indonesia, Malaysia, New Zealand, the Philippines, Republic of Korea, Singapore, Taiwan (Province of China) and Thailand.

1997 to mid-1998, can be subdivided into two parts. In the final quarter of 1997, capital flows contracted sharply, while in the first half of 1998, the volume of these flows rebounded but the cost of external financing rose.

The hefty capital inflows seen during the first of these phases -over US$ 90 billion by September 1997- benefitted nearly all countries in the region. The bulk of the flows was made up of long-term capital, particularly foreign direct investment (FDI), which reached an all-time high of nearly US$ 56 billion for the year as a whole. The funds brought into the region in connection with privatization operations in Brazil and Colombia were an important part of the FDI figure. Bond issues (involving significant sums in the cases of Argentina, Brazil and Mexico) also provided medium- and long-term financing; the average maturity of the bonds issued by regional borrowers in 1997 was approximately 15 years. The proportion of short-term credit remained at around 20% of total capital inflows; in most countries these flows consisted mainly of trade finance. Another indicator of the boom characterizing this phase was the rise of 30% in equity values on local stock markets between January and September 1997.

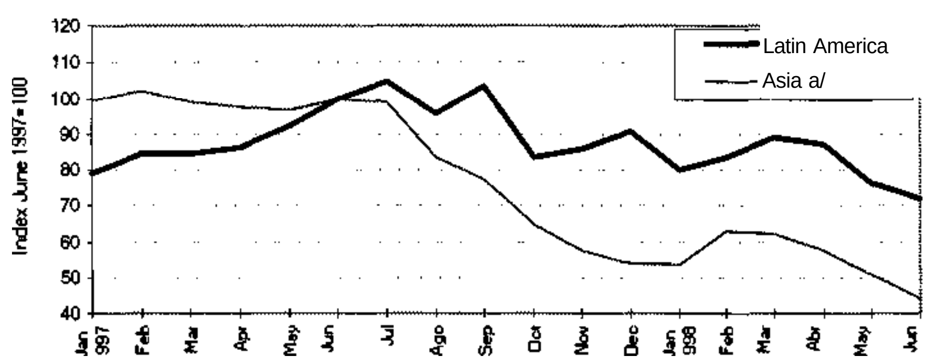
The second phase began when the Asian crisis started to worsen in late October 1997, and equity prices tumbled on stock exchanges in Asia and, to a lesser extent, Latin America (see figure 1.9). The slump in stock prices between the beginning of October 1997 and the end of June 1998 was widespread in the major Latin American economies, and the regional average for this period reversed its earlier gains and fell by 30%. In terms of volume during this second phase, the most severely affected component of capital flows was equity investment. Other types of short-term capital also contracted, especially in Brazil, Chile, Colombia and Venezuela, and much of this reduction was reflected in a decline in international reserves in these countries.

Bond financing was down sharply in the fourth quarter of 1997, but it rebounded during the first half of 1998. The terms of bond issues, however, were less favourable in the first half of 1998 than in the corresponding period of 1997 (see figure 1.10). Average maturities shortened from 15 years to just half that figure, and spreads widened by between 150 and 200 basis points, with issues by non-financial private-sector entities suffering the most. The

Figure 1.9

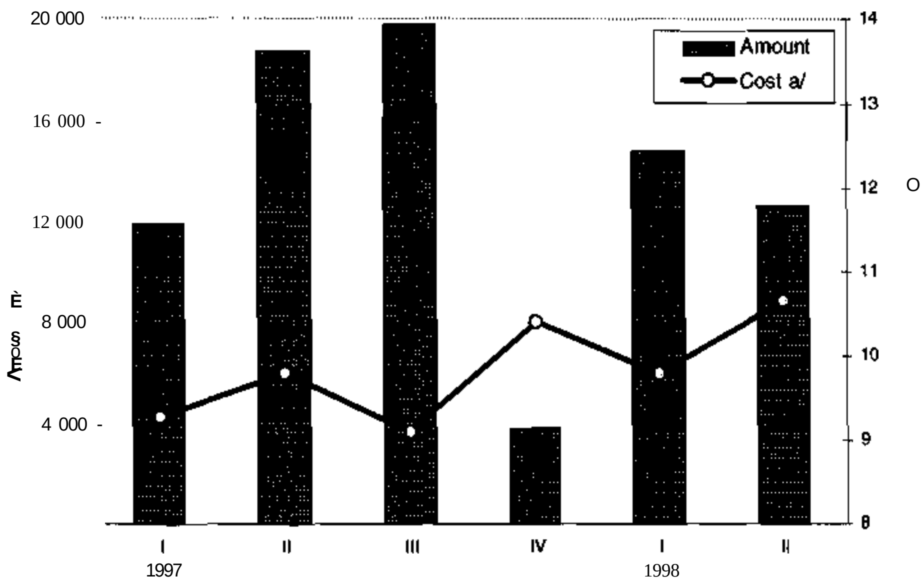
LATIN AMERICA AND THE CARIBBEAN: STOCK MARKET QUOTATIONS

(Index in dollars, June=100)



Source: ECLAC, on the basis of figures from the International Finance Corporation.
[a] Includes China, India, Indonesia, Malaysia, Pakisaán, the Philippines, Republic of Korea, Sri Lanka, Taiwan (Province of China and Thailand.

Figure 1.10
LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISSUES



Source: ECLAC, on the basis of figures from national sources, the World Bank and the International Monetary Fund.
[a] Sum of the average spread for bond issues plus the yield of long-term United States Treasury bonds.

terms and conditions of bank loans deteriorated less than those of bonds.

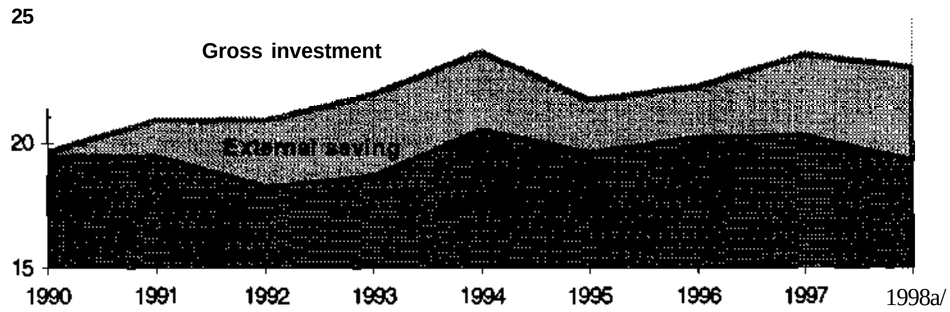
Although foreign direct investment shrank in some countries during the first half of 1998, it is expected to recover in the second half. The privatization of Brazil's telecommunications system (Telebras) in July 1998 was the largest such operation in Latin America's history and constituted a milestone in terms of the level of confidence in the region's biggest economy, which should have positive repercussions on other countries. It is therefore expected that total FDI for the region in 1998 will be within the same range as the exceedingly high figure registered for 1997.

Foreign saving provides the dynamism for investment

The data for 1997 indicate that economic growth and stabilization in the countries of the region were coupled with an extraordinary degree of dynamism in investment and saving (especially external saving). In all the countries except Haiti, the expansion of gross fixed investment outpaced GDP growth, and this was reflected in an across-the-board increase in gross fixed investment coefficients. Thus, gross capital formation reached 23.5% of GDP in current prices, one of the highest levels seen since the early 1980s.

Revenues from this operation amounted to **US$** 19 billion, most of which was foreign capital; 40% of this sum was to be paid in 1998 and the balance was to be disbursed in the course of the following two years.

Figure **1.**11
LATIN AMERICA AND THE CARIBBEAN: SAVING AND INVESTMENT RATIOS
(As a percentage of GDP at current prices)



Source: ECLAC, on the basis of official figures.
[a] Preliminary estimates.

In the closing months of 1997, however, GDP growth began to slow down, and this trend has grown stronger in 1998. An estimate prepared by ECLAC, which is consistent with the fact that investment tends to be more volatile than output, suggests that the growth rate of investment will decrease substantially in 1998 (see figure 1.11).

Although considerable progress has been made in the area of financial liberalization in Latin America and the Caribbean, the region's domestic savings rates have stabilized at around 20% of GDP (in current prices). External saving therefore continues to be the most dynamic component of financing for gross capital formation. In 1997 external saving accounted for about 13% of gross capital formation, or 3.2% of GDP. Foreign direct investment, in turn, is the strongest component of external saving, and in 1997 represented three fourths of the total. External saving is expected to continue to expand in 1998, although at a slower pace than the year before.

4. Policy lessons from the Asian crisis

The problems experienced during the past 12 months, as the Asian crisis began to have an impact on the Latin American and Caribbean region, point to a number of useful lessons that should be borne in mind. In the domestic sphere, these lessons relate to macroeconomic, institutional and competitiveness issues. Internationally, they include the need for greater coordination and regulation.

The main macroeconomic lesson refers to the need to concentrate on managing the economy during boom periods, since policy-makers have much more manoeuvering room before a crisis strikes. In periods of economic expansion, large capital inflows tend to result in increased public and private expenditure and in the build-up of large debts; the reversal of these flows is likely to produce a serious crisis. Since Latin American fiscal policy has tended to be procyclical in recent years, the possibility of using flexible tax and spending instruments that could decrease the volatility of growth should be explored. With respect to monetary policy, greater autonomy can be obtained through the use of mechanisms to discourage excess capital flows; such measures might include reserve requirements (such as those used in Chile and Colombia) or taxes (as in the case of Brazil).

In the institutional sphere, even though a great deal of progress has been made in the last few years, further attention needs to be paid to strengthening the region's banks and improving prudential regulation and supervision. This includes the training of supervisors as well as the formulation of rules and regulations. Given the propensity to volatility exhibited by Latin America and the Caribbean and the high cost of financial crises in developing countries, a capital/asset ratio higher than the 8% required by the Bank for International Settlements would probably be appropriate. Even more important is the proper sequencing of financial liberalization and the establishment of an adequate regulatory framework. If liberalization precedes regulation, serious problems are likely to result.

Since the Asian crisis has not been limited to the financial sector but has instead extended into the real economy, a number of lessons concerning the latter may also be drawn. To judge from the Latin American experience in the last year, it is obvious that over-reliance on a few primary export products is still a dangerous tendency. Thus, in the case of several of the region's economies, copper and oil exports offered a vulnerable flank through which both price and quantity shocks could penetrate. From the vantage point of Asia, a less obvious lesson focuses on more sophisticated "commodities"; even computer chips can suffer from volatility. Looking beyond the measures to be taken in connection with particular types of products, it is evident that monitoring markets to detect situations of oversupply is a high-priority task. Likewise, it is clear that competitiveness should be a constant concern and must not be taken for granted.

The current crisis has also focused attention on the high degree of instability characterizing financial markets at the world level, especially in their fastest growing segments, such as mutual funds and derivatives. There is a lack of coordination among the industrial countries that serve as the base of operations for the world's main financial firms. No international institution exists that has the responsibility for coordinating and supervising these firms. The International Monetary Fund has insufficient resources for this task and no mandate. In the private sphere, credit rating agencies have tended to exacerbate instability rather than diminish it. This would seem to be a good opportunity to rethink international institutional arrangements, but a bad time to consider further liberalization of financial markets.

Of particular concern is the role played by short-term capital flows, since such funds can move out of a country just as rapidly as they come in. Even if all developing countries were to place some kind of restrictions on these flows, international supervision would still be needed because their volume is so large that they can overwhelm local economic policy measures. Moreover, the psychology of the market is such that the outflows may have little to do with economic fundamentals. While the Latin American experience of the 1980s and 1990s has shown that foreign capital can play a very beneficial role in supporting growth, it is necessary to design and implement a policy framework to reinforce its positive aspects while minimizing volatility. This may be the most important single lesson of the last 12 months.

IL MACROECONOMIC POLICY

Stabilization gains were consolidated in a context of strong economic growth, despite adverse developments on the international scene in the closing months of 1997. Declining inflation confirmed the success of macroeconomic policies designed to meet the challenges of external openness, policies generally based on the management of the exchange rate as a nominal anchor. This strategy was made possible by abundant inflows of external capital, which allowed demand pressures to be absorbed by increased imports.

Although the exchange rate was the most visible instrument of stabilization policy, it was not the only factor of success in the period considered. Previous experience had shown that use of the exchange rate anchor was not a sustainable strategy by itself without prudent management of other macroeconomic policy instruments, particularly in the fiscal and monetary spheres, or without a moderate decline in the unit costs of production -achieved by tying wage hikes to productivity and keeping imported inflation low.

The positive trend in the economy of the region during much of 1997 translated into an increase in factor incomes. Jobs increased in number by 3%, labour productivity improved by 2% and real wages rose by 2.7%. Labour was not the only factor of production to benefit in real terms; the year was also a good one on the capital markets. The real interest rate on deposits increased from 2.1% to 3.9%, reflecting at first a decline in inflation and later a shift in monetary policy that resulted in higher nominal yields towards the end of the year. It was also an excellent year for the region's stock markets, even though from October on securities exchanges recorded sharp declines because of financial turbulence in Asian markets; the trading year 1997 closed for investors with average gains of close to 20% in dollar terms.

The chapter will explore similarities and differences among the countries of the region in the main results obtained through their macroeconomic policies and will then take a closer look at the fiscal, foreign exchange and monetary aspects. It is difficult to identify common features or draw general conclusions concerning the conduct of macroeconomic policy in the Latin American and Caribbean countries because of their differences in size, location and economic structure. Nevertheless, even allowing for these limitations, it has been possible for some years now to discern a regional consensus regarding the main objectives and instruments of macroeconomic policy, a consensus which has served as a unifying principal in Latin America and the Caribbean. For one thing, inflation control has become central to the conduct of monetary policy. The same applies to foreign exchange policy, despite the wide variety of exchange rate systems in use -either because the authorities implicitly or explicitly use the exchange rate as an anchor in their anti-inflation strategy, or because a heavy influx of external capital imposes its logic on the foreign exchange market. With regard to fiscal policy, concern for balance in government

1 See ECLAC, *Economic Survey of Latin America and the ^ean,* 1996-1997 (LC/G.1968-P), Santiago, Chile, 1997, p. 75, United Nations publication, Sales No. S.97-II.G.2.

finances weighs heavily in the management of public-sector spending, which has become mildly procyclical, i.e., tending to increase in times of expansion and to contract when revenue prospects dim.

In the absence of severe external shocks during the last three years, the similarity in the macroeconomic policy styles and objectives adopted by national authorities has resulted in a convergence of results. The events of the last quarter of 1997 did not succeed in reversing this tendency, and the main indicators of macroeconomic performance for the year show less regional dispersion, as measured by the standard deviation among countries (see table II. 1). The concurrence in the slowing of inflation, for example, is highly significant. Half of the Latin American countries recorded price increases of less than 7%, and the dispersion of inflation rates as measured by standard deviation has been reduced, although high inflation persists in a few countries. Convergence is also observable in the less positive example of larger external deficits; both the regional average and the regional median have increased, and there is less dispersion around these representative values.

The macroeconomic policy measures adopted in the first half of 1998 were also very similar from one country to the next. Once the prospects for ample and affordable external financing appeared to be drying up beginning in October 1997, macroeconomic policy assumed a more restrictive stance, at first in order to prevent capital flight and later in order to cool down domestic demand in an effort to control widening external deficits (see chapter I).

Of course, the very different levels of development to be found among the countries of the region mean that very different rates of growth would be required before convergence in macroeconomic results could translate into convergence in levels of income and well-being. Notwithstanding the slight narrowing observable in the last three years in the differential in per capita income between the poorest and the richest

Table II. 1
LATIN AMERICA: MACROECONOMIC PERFORMANCE INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997 [a]
Economic growth								
- Average [c]	-0.2	3.9	3.2	4.1	5.6	0.4	3.5	5.3
- Median	3.0	3.2	4.9	4.3	4.7	4.5	2.8	4.3
- Standard deviation	3.8	3.2	5.5	2.6	4.4	4.1	2.1	2.0
Unemployment								
- Average [c]	5.9	5.8	6.2	6.2	6.3	7.2	7.7	7.3
- Median	7.8	7.7	7.0	7.0	7.8	7.7	7.9	8.3
- Standard deviation	3.8	4.6	5.0	5.2	4.8	4.5	4.3	3.9
Inflation [b]								
- Average [c]	1 188.8	199.3	426.7	890.2	337.6	25.8	18.5	10.6
- Median	36.5	21.4	17.0	13.0	15.4	12.6	11.8	7.3
- Standard deviation	3 438.2	196.4	264.6	568.7	209.3	15.2	22.4	10.7
Fiscal balance [e]								
- Average	-1.8	-0.4	-1.2	-1.1	-1.9	-1.3	-0.9	-1.2
- Median	-0.7	-0.3	-1.3	-0.4	-0.8	-0.7	-1.6	-1.4
- Standard deviation	4.0	2.3	2.6	2.8	4.1	2.3	2.9	1.7
External deficit[e]								
- Average [c]	-0.2	-1.5	-2.7	-3.2	-3.1	-2.1	-2.0	-3.2
- Median	-3.0	-2.1	-5.0	-5.0	-3.0	-3.4	-2.5	-4.0
- Standard deviation	7.7	7.6	10.0	7.5	9.1	8.4	8.7	8.0

Source: ECLAC, on the basis of official figures.
"Preliminary figures. Annual rate of variation. [c]Weighteda >[7]erage. Percentage of the population that is economically active. [e] Percentage of GDP. Simple average.

countries in Latin America and the Caribbean, over the course of the decade the gap has actually widened. In 1997 the average per capita income in dollars of the five poorest countries of the region equalled barely 10% of the corresponding figure for the five richest countries, whereas in 1990 the percentage was 14%. The gap has widened because per capita income has grown twice as fast in the latter group of countries (at an average rate of nearly 9% annually). However, the de facto harmonization of macroeconomic policies observable in the region has helped to further economic interchange, a development that could facilitate a similar convergence in levels of development (see chapter VIH).

1. Foreign exchange policy

(a) Foreign exchange policies and markets

Foreign exchange policy underwent no great changes in 1997. With a handful of exceptions, the countries continued to use the rate of exchange de facto as a nominal anchor in the service of stabilization. Since the region's economies are increasingly opening to both foreign trade and international financial flows, but lack sufficiently developed and stable domestic money markets, the great majority of the countries have adopted stabilization policies featuring the exchange rate as the most effective instrument for achieving inflation targets -both for its direct impact on domestic price formation and for its value as a signal to guide expectations about future prices.

Despite broad differences in the foreign exchange strategies and institutional arrangements adopted by the countries of the region -from Argentina's convertibility system to Mexico's free float-, there were no major devaluations of nominal rates during the course of the year. As it happened, the pace of nominal devaluation slowed noticeably during the first three quarters of 1997, averaging an annualized rate of 7%, less than half the figure for 1996.

This slowing of devaluation took place in a context of low exchange rate volatility. A number of the countries of the region managed to achieve virtual exchange rate stability, at least until the last quarter of 1997. This was naturally the case with countries that have some form of fixed rate of exchange with respect to the dollar -Argentina, El Salvador, Panama and Barbados- but also occurred in others, such as Chile and Jamaica, which formally have opted for a currency band system. Even in countries that suffered sharp devaluations in the recent past, foreign exchange markets were very calm in 1997. The price of the Mexican peso, for example, remained quite stable in nominal terms over the course of the year, and the pace of devaluation of the Venezuelan bolivar slowed markedly, from an annualized rate of 140% in the fourth quarter 1996 to under 6% in the same period of 1997.

The generally calm tone of the region's foreign exchange markets, already perceptible in the second half of 1996, began to be ruffled in October 1997, as the Asian crisis deepened. The foreign exchange markets reacted, bringing about either nominal devaluation or a loss of international reserves, depending on the country. The average rate of annual devaluation, 6% in the third quarter 1997, rose progressively to 7%, 8% and then 9% during the last quarter of 1997 and the first two quarters of 1998. Only in a minority of the countries, however, did foreign exchange markets experience truly pronounced volatility during these months. This was notably the case in Colombia, Ecuador, Paraguay and Venezuela. In other countries, tensions in the exchange markets resulted instead in a loss of international reserves, as the authorities succeeded in defending the exchange rate or moderating its fluctuations. In the fourth quarter of 1997 and the first quarter of 1998, reserve losses exceeded US$ 2.5 billion in Chile and Venezuela and US$ 1 billion in Colombia. Losses in other countries, although less in absolute terms (between US$ 80 million and US$ 100 million), were significant as a proportion of existing reserves, particularly in Bolivia, Ecuador, Guatemala and Paraguay. In drawing on reserves to defend the exchange rate, the authorities were pursuing the twin goals of controlling the extent of devaluation in order not to compromise achievements in stabilization, while dampening market oscillations and avoiding selling spirals for speculative or hedging purposes.

The region's three largest economies, on the other hand, managed to absorb the foreign exchange shock more easily, although the effort entailed drastic macroeconomic measures in the case of Brazil. After a period of uncertainty in the closing months of 1997, Brazil's international reserves more than recovered, and the increase in the first quarter of 1998 was on the order of US$ 11 billion. Over the same period Argentina's reserves increased by US$ 2.5 billion and Mexico's by US$ 2.8 billion. According to the data so far available, this tendency persisted during the second quarter of 1998.

(b)Trends in real exchange rates

The trends in real exchange rates were primarily related to factors of a financial nature and in particular to abundant capital flows, which fostered an acceleration in the real appreciation of the currencies of the receiving countries. Net capital inflows represented, on average, 4% of the region's output, but in a number of countries exceeded 10% of output (see chapter VIII, section 2). In a continuation of a trend already observable the year before, capital inflows were particularly strong during the earlier quarters of 1997. Hence, while the average rate of nominal devaluation in the region was declining, the inflation differential with the region's main trading partners fell much more sharply, so that local currencies appreciated strongly in real terms.

Except for Ecuador, Haiti and Paraguay, the trend was well marked in the region, and the countries that experienced the greatest real appreciation were those that received the largest net influx of external capital in 1996 and 1997, relative to the size of their economies. In the three countries in which the currency depreciated significantly in real terms, the overall balance of payments in 1996 and 1997 was in deficit or only slightly on the positive side (see table II.2).

As table II.2 makes clear, financial factors, rather than the real fundamentals of the economies, set the tone of the foreign exchange markets. Apart from the strong influence exerted by external capital flows, already discussed, another determining factor was financial yield. The countries that experienced real appreciation of the currency on average offered yields on short-term deposits in local currency that were higher -after correcting for foreign exchange movements with respect to the dollar- than reference rates in the international market. On the other hand, there was little correlation between the extent of real appreciation and real interest rates (i.e., corrected for domestic inflation), since the countries that experienced greater real appreciation of the currency were, in general, among the countries with a higher inflation rate.

In contrast, factors related to the real economy, such as overall factor productivity (represented in table II.2 by growth in GDP) or changes in the relative prices of goods and services traded (terms of trade), do not appear to have influenced the behaviour of the real exchange rate as expected. Strong economic growth had no perceptible impact, and, contrary to what one might expect, countries with worsening terms of trade saw their currencies appreciate, while some that benefited from an improvement in their terms of trade experienced real depreciation. The same inverse correlation between real appreciation and improved terms of trade was observable in 1996 as well, although data covering a longer period (the decade to date) suggest a positive medium-term correlation. This points to possible dangers ahead, since in the not-too-distant future real economic factors may well determine effective parities, correcting fluctuations of purely financial origin.

2 Bear in mind that the real effective exchange rate, the indicator of the extent of real appreciation, is calculated by comparing the variation in the exchange rate with respect to the currencies of the country's main trading partners, corrected for the variations in the respective domestic price indices. Thus, a drop in the real effective exchange rate -equivalent to a real appreciation in the purchasing power of the local currency- can result either from a drop in the nominal effective exchange rate or from a rise in the rate of inflation.

Table II.2
LATIN AMERICA: REAL EXCHANGE RATE AND SOME DETERMINING FACTORS, 1997

	Real exchange rate	Financial factors			Real factors	
		Overall balance 1996-1997[b]	Interest rate		Annual variation	
	Variation		Dollar-equivalent[c]	Real[d]	GDP	Terms of trade
Range of variation of the real exchange rate [a]						
Below-5%	**-10.4**	2.5	6.1	**0.1**	4.7	-1.8
Between 0 and -5%	-2.1	0.8	7.2	7.9	**4.4**	-0.1
Above 0%	2.3	-2.0	4.6	2.3	5.9	4.5
Venezuela	-22.3	6.8	6.0	-16.1	5.6	-8.2
Haiti	-14.1	-0.6			1.3	-17.1
Mexico	-13.3	1.7	6.7	-0.8	7.3	-1.0
Chile	-6.7	3.8	4.7	5.8	6.9	4.3
Colombia	-6.4	0.9	-1.7	5.2	3.2	4.0
Honduras	-5.3	3.5	18.4	8.1	4.4	-1.5
Guatemala	-5.0	1.4	2.6	-1.5	4.0	7.1
Ecuador	-4.2	-0.6	5.4	-2.0	3.7	-9.8
Argentina	-2.9	1.0	7.0	6.6	8.4	-1.1
Bolivia	-2.5	2.8	10.7	7.6	4.2	-7.3
Uruguay	-2.0	1.2	3.5	3.9	5.1	-0.1
Paraguay	-1.7	-1.3	-3.7	9.8	2.6	5.8
Brazil	-1.1	0.1	15.5	19.6	3.0	5.9
El Salvador	-0.4	2.4	11.8	9.7	4.1	6.1
Peru	0.6	2.7	8.5	3.6	7.7	5.6
Dominican Republic	1.9	0.6			7.4	16.0
Costa Rica	2.5	0.2	2.5	1.6	3.1	6.1
Nicaragua	4.1	-11.4	2.8	1.7	5.5	-9.8

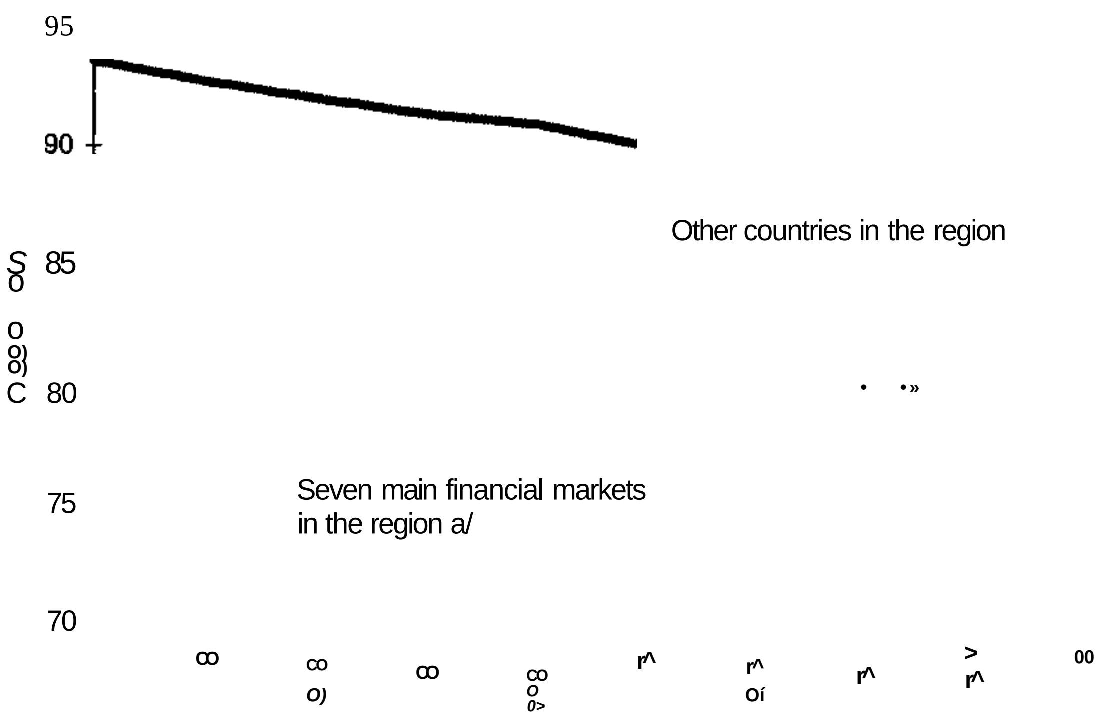
Source: ECLAC, on the basis of official figures and data from the International Monetary Fund.
[a] Average value for the respective country. A drop in the real exchange rate signifies a real appreciation of the currency.
[b] Percentage of GDP. [c] Deflated by the nominal devaluation. Deflated by the consumer price index.

Another indication of the influence of the capital account on movements in the exchange rate can be seen by comparing the economies that have a relatively sizeable securities exchange, by Latin America standards, with those that do not (see figure 1.1). Beginning in the second quarter 1996, and at a progressively faster pace until the third quarter of 1997, the currencies of the region's seven main financial markets showed a marked tendency to overvaluation, reaching annualized rates of around 8% during the second and third quarters of 1997. In the other countries, in contrast, the trend was more moderate and slowed markedly over the period (average appreciation was around 5% in the second quarter of 1996 and gradually declined to around *2%* in the third quarter of 1997).

As the chart shows, towards the end of 1997 the downward trend of the real exchange rate was reversed in the countries with significant capital markets, while for the other countries the overall trend continued as before. Although the pace of inflation slowed in the second half of the year, the break in the pattern of real appreciation was primarily due to the shift in the mood of the region's foreign exchange markets, related to events in world markets. In the fourth quarter of 1997, Latin American and Caribbean currencies underwent a nominal devaluation of 2.2% compared to the previous quarter, a substantially larger change than the 1.3% and 1.2% variations in the two previous quarters. The slide persisted throughout the first quarter of 1998.

Thus, the presence of a relatively large capital market appears to have been a major factor in determining the trend and degree of stability of the real exchange rate in the countries of the region, and this circumstance confirms the

Figure II. 1
LATIN AMERICA: QUARTERLY INDEX OF REAL EXCHANGE RATE



Source: ECLAC, on the basis of official figures and data supplied by the International Monetary Fund.
[a] Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

importance of financial factors, at least over the short term. However, trends in real exchange parities have implications for the real economy, especially now, after the process of trade liberalization the countries of the region have undergone, and a set of dynamics based to a great extent on financial factors can have consequences for productive sectors and investment decisions. One of the most obvious short-term effects of real appreciation is to make imported products cheaper and thus stimulate demand for them in domestic markets. Another effect is that a country's exports lose competitiveness; this is particularly true for its manufactures and other non-traditional exports that are not based on natural comparative advantages.

In 1997, relative prices of imported products in local currencies fell by 7%, on average, in relation to domestic prices in the countries of the region. This effect has been the key argument for stabilization policies using the exchange rate as a nominal anchor, since domestic producers of tradable goods and services, in order to compete in domestic and external markets, must adjust their prices and trim unit costs, chiefly by improving productivity. It has been noted that in countries experiencing greater real appreciation the price index for tradable goods and services is generally much lower than for non-tradables, since the latter do not have to compete with foreign goods. However, this phenomenon, by no means exclusive to Latin American economies, tends to discourage investment in

3 Approximated by the implicit GDP deflator for the goods-producing sectors, including agriculture, mining and manufacturing.

tradables-producing industries. Costa Rica is one of the few countries in the region where the national authorities still use the exchange rate as an instrument of external competitiveness, and where, as a result, relative prices of tradable goods and services have remained comparable to those of non-tradables.

In the financial sphere, overvaluation of the exchange rate tends to encourage producers and financial agents to incur debt in foreign currencies in order to reduce financing costs, even when they do business entirely within the domestic market. As table II.2 shows, dollar-equivalent domestic interest rates in countries with currency appreciation are high compared to international market rates. When this tendency becomes accentuated, the economy becomes more vulnerable to foreign exchange risks, and this situation delays and complicates the eventual correction to the exchange rate, when it becomes necessary. This mechanism is often cited as one of the chief causes of the financial crisis that struck the main emerging economies of Asia. Avoiding this risk is one of the most important objectives of the new banking supervision measures already in use or in the process of adoption in the majority of the Latin American and Caribbean countries.

2. Monetary policy

As was to be expected, since most of the region's economies had opened up their capital accounts to a great extent, the implementation of monetary policy was heavily dependent on foreign exchange policy. That monetary management of this sort is usually called "passive" does not imply that the monetary authorities took a relaxed stance. On the contrary, in order to ensure the credibility of exchange rate targets, monetary and fiscal authorities had to adapt to the imperatives of stabilization.

In the first three quarters of the year, and particularly during the first two, plentiful inflows of external capital facilitated the defence of fixed parities or kept exchange rates close to the floor of the pre-set currency bands, obliging central banks to purchase foreign exchange to prevent greater currency appreciation. Moreover, in the majority of the countries, the financing of increased fiscal deficits with foreign resources injected further liquidity into the domestic economies. As a result, international reserves built up substantially during that period, and it was necessary to sterilize the monetary impact of the influx of foreign exchange through open market operations and changes in reserve requirements. Even the Argentine monetary authorities, despite the country's convertibility system, which requires that all liabilities of the central bank should be covered by external assets, had to intervene on two occasions in 1997 to raise the minimum liquidity requirements for commercial banks.

In general, these monetary measures kept real interest rates high, and the high rates, in turn, attracted more foreign capital and hence led to more pressure on the real exchange rate. Only in Nicaragua and Costa Rica were positive financial yields insufficient to bring about exchange rate appreciation; in both cases, the real interest rate on deposits was barely higher than 1.5% per annum. In some countries, the real interest rate had to be kept high to defend monetary and exchange rate targets; this was the case in Brazil (20%), Paraguay (9.8%) and El Salvador (9.7%). However, quite negative real interest rates did not keep Venezuela's currency from appreciating, this country being the only one that recorded a strong surplus on its current account.

In Mexico, the free-floating exchange rate system allowed for more autonomy in monetary management; the real interest rate was slightly negative, although yields in dollar terms were positive. Even there, however, the monetary authorities were obliged to respond to copious inflows of foreign capital during 1997, which brought about an accumulation of international reserves nearly eight times higher than the minimum anticipated. Banco de México therefore reduced its domestic credit targets to avoid further slippage of the monetary base.

Nevertheless, as most of the region's economies grew faster than initially anticipated in their macroeconomic planning, the authorities relaxed their money supply policies. This was the case, for example, in Chile, which reduced the interbank interest rate on four occasions between February and September, and in Colombia, which raised the monetary base growth target in May. Increased money creation was in response to stronger demand for money, as the volume of transactions mounted. As figure II.2 shows, the upturn in output in the region was already noticeable in the second half of 1996, and the shift in monetary policy was observable towards the end of that year. It was in the first quarter 1997, however, that the ratio of the monetary base to GDP really began to climb, rising by more than 15% compared to the figure 12 months earlier.

In countries where there was uncertainty about the trend of economic activity, monetary policy assumed a more cautious stance. This was notably the case in Brazil, where the process of gradually reducing interest rates came to a halt in May. In Jamaica, the authorities felt obliged to modify their expansive monetary policy when depositors withdrew from the local currency and took refuge in foreign currency assets.

In general, the effect of the relaxation of monetary policy was to increase the importance of domestic credit among the monetary expansion factors. Despite the intensification of lending activity, however, the percentage of broad money represented by external assets decreased only from 39.4% to 38.5%, still higher than the average for the rest of the decade (31.8%) and nine percentage points above the figure observed prior to the 1994 crisis. In the majority of the countries studied, over 90% of the monetary base continued to be backed by external assets.

The ratio of narrow money to output (Ml/GDP), which had declined in relative terms by 2.1 % in 1995 and 6.7% in 1994, rose again by over 11%. Greater demand for money due to an increase in transactions does not fully explain the liquidity increase, or the reversal of the declining trend of the previous two years. The shift can be attributed in general to increased confidence in the local currencies and the maintenance of their purchasing power. In some cases other technical factors relating to monetary policy played a role, as in Brazil, where the strong expansion of the money supply had to do not only with a rise in real reserve requirements but also with the imposition of a tax on financial transactions.

Overall, this regional tendency reflected a restoration of confidence two years after the Mexican peso crisis and its repercussions in Latin America's largest economies. It also reflected the progress made in controlling inflation, which for the region as a whole averaged just a little over 10% and for the majority of the countries was around 7%. It is significant in this regard that greater liquidity did not result in a resurgence of inflation and that the tensions perceptible at the beginning of 1998 were attributable to supply shocks associated with El Niño weather patterns or the prices of imports, rather than to internal imbalances.

Since the supply of money was in line with demand, interest rates did not change significantly during the reporting period. The median real interest rate on deposits remained at around 4.5% in 1996 and 1997, and the increase in the regional average was due to Venezuela, where the real rate -although still quite negative- rose by 15 percentage points. Nevertheless, towards the end of the year some countries adopted emergency measures to offset a greater perception of exchange rate risk and deal with the turbulence caused by the Asian crisis. This was particularly the case in Brazil and Paraguay. Other countries -Chile, Colombia, Mexico- followed suit early in 1998.

Money markets in most of the region's economies did not react drastically to the Asian crisis in 1997. As figure II.2 shows, the increase in the monetary base eased off towards the end of the year, in line with the slowing of output growth, but without a return to a highly restrictive stance. In the last quarter of 1997, the regional average for real growth in the monetary base dropped back to the level prevailing in the first quarter. In the majority of the countries, the slowdown was even greater (the median rate of real growth of the monetary base, 5.5% in the first quarter and as high as 8.4% in September, fell to

4% in December). This tendency was accentuated in the first quarter of 1998, when there occurred a slight contraction of the monetary base (a monthly average of -0.8%), which in most countries went beyond the expected seasonal variation.

In the financial sphere, Governments continued to work towards better banking supervision in the light of the experience of the 1994-1995 crises, and no major problems arose, except in Paraguay and El Salvador. The banking sector was strengthened by an infusion of capital as international banking groups acquired stakes in local banks. Merger and acquisition activity was particularly lively in 1997, particularly in the main financial centres of the region, such as Argentina, Brazil and Mexico, but the move towards globalization extended to other countries as well, including Chile, Colombia and Venezuela (see chapter III). However, the cost of earlier bank bail-outs continued to rise in the countries that had suffered most from banking crises, as the non-performing loan portfolios of problem banks swelled and Governments continued their efforts to save these institutions from bankruptcy. Mexico is a case in point; early in 1998 the Government announced a plan to absorb such bank losses into the domestic public debt, which would then increase by 15 percentage points of GDP.

Despite the rebound in demand for local currencies, discussed earlier, the trend towards dollarization of the region's economies continued. The ratio of deposits in foreign currency to broad money in local currency (M2) rose from 103% to 107%, on average for all the countries for which information is available. Although it is true that the average is skewed by some very high ratios in a few countries (Bolivia, Nicaragua, Peru and Uruguay), the trend was widespread (in over half the countries, the dollarization ratio was 45%, 15 percentage points higher than at the start of the decade).

Lastly, a regional trend towards a slight narrowing of the spread between deposit and lending rates, observable earlier, continued during 1997; on the average for the year the spread was 13 percentage points, one point lower than the year before. In a few cases (Bolivia and Uruguay, for example), the spreads were at times extremely wide (more than 35 and 50 points, respectively), but it should be borne in mind that their practical significance is small, since the vast majority of financial transactions in these countries are conducted in dollars, at much lower rates.

3. Fiscal policy and public finance

In 1997, the average non-financial public-sector (NFPS) deficit for the Latin American and Caribbean region expanded slightly to 1.2% of output, owing primarily to external shocks that reversed the upward trend in fiscal revenue observable during the two previous years.

(a) Overall situation and prospects

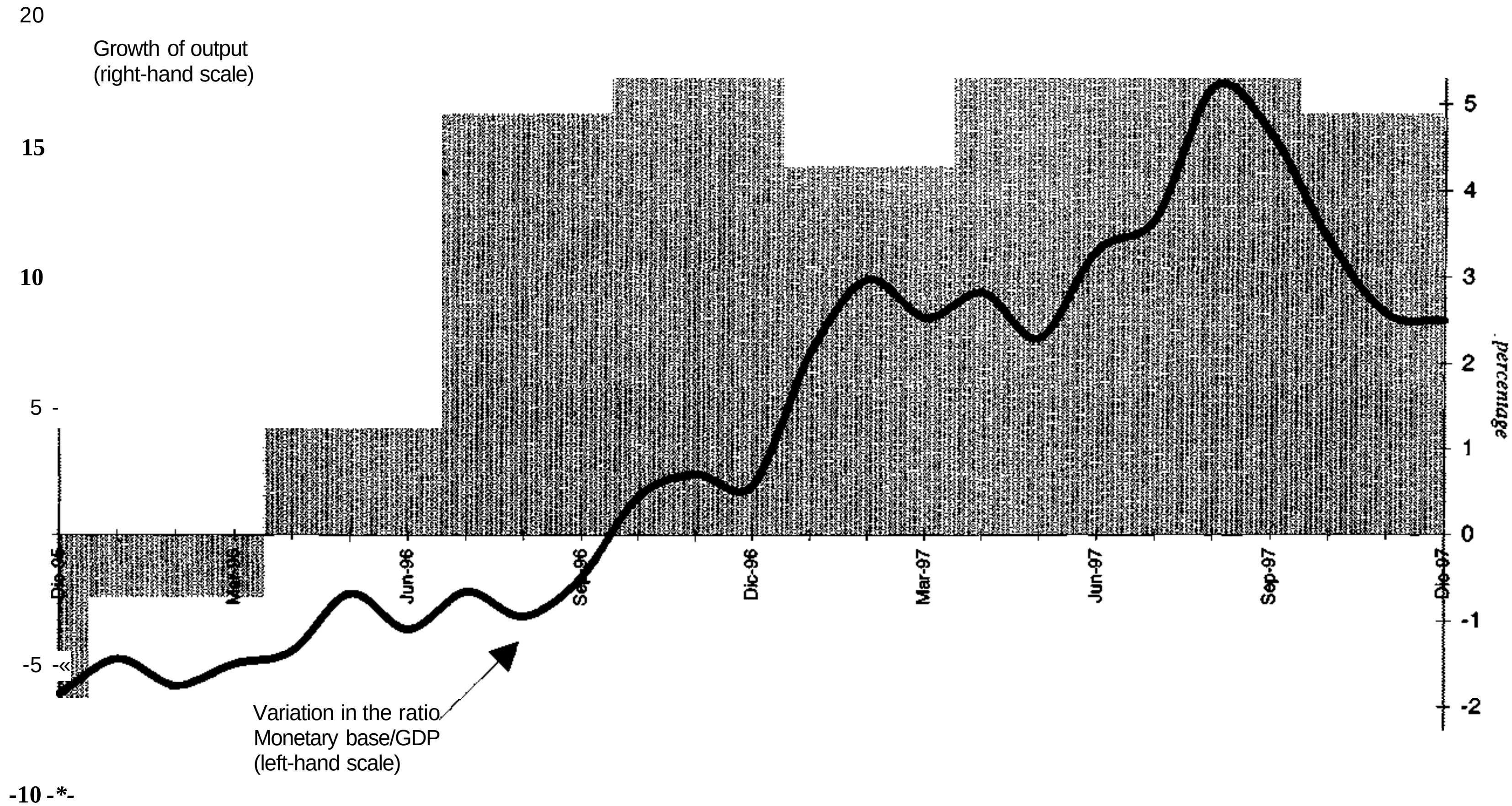
An important fiscal policy objective of the countries of the region was to support efforts to consolidate macroeconomic stability, and in particular to ensure low levels of inflation, by controlling the public-sector deficit. To achieve this goal, however, Governments had to adopt austerity measures, since, in contrast to the trend in 1995 and 1996, non-financial public sector revenue declined in 1997, by half a percent of output, despite efforts to improve collection. Faced with declining revenues, a number of countries in the region cut back on spending but succeeded only partially in closing the gap (see figure II.3). The widening of the NFPS deficit was due principally to the results of decentralized

4 This is a simple average for 19 countries of the region and include proceeds from the sale of assets only when a particular country counts them as part of its capital revenue. For results net of such proceeds, see section (b). The weighted average NFPS deficit for the region (by GDP in constant 1990 dollars) increased from 1.5% of GDP in 1996 to 2.1% in 1997. The difference between the simple and weighted averages is explainable by the relative weight of the fiscal deterioration in Brazil, Colombia, Mexico and Venezuela. In the countries of the English-speaking Caribbean, fiscal deficits expanded less, and this was particularly true of Jamaica and Guyana. The economies of this group of countries are discussed in Part Two of this Survey.

Figure II.2

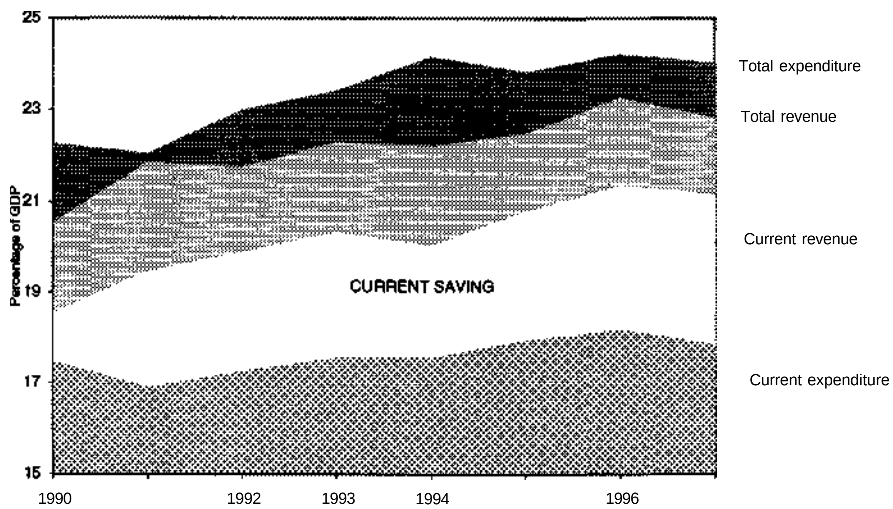
LATIN AMERICA: ANNUAL VARIATION IN THE RATIO OF THE MONETARY BASE TO GDP

(December 1995-December 1997)



Source: ECLAC, on the basis of official figures.

Figure II.3
FISCAL POSITION OF THE NON-FINANCIAL PUBLIC SECTOR, 1990-1997



Source: ECLAC,on the basis of official figures.

entities, sub-national states, municipalities and State-owned enterprises. On the other hand, the simple average central government deficit (1 % of GDP) declined slightly, thanks to an increase in total revenues.

The prospects in 1998 are for even greater pressure on both revenue and expenditure, leading to a further deterioration in fiscal accounts. These expectations have already been reflected in raised official targets for the public sector deficit. Revenues will be affected by a slowdown in economic activity because of the Asian economic crisis. Lower prices for the region's primary commodities (especially oil and copper) will reduce the income of State-owned enterprises in Chile, Colombia, Ecuador, Mexico and Venezuela even more than in 1997, because the Asian crisis only became evident in the second half and did not have its full impact last year. Moreover, the heavy damage caused by the El Niño weather patterns in 1997 and early 1998 will require extra government spending to repair infrastructure in Argentina, Ecuador, Paraguay and Peru. Governments in the region have therefore begun to implement packages of fiscal adjustment measures, including spending cuts, higher tax rates, broader tax bases and campaigns against tax evasion.

(b)Trends in fiscal revenue

In 10 of the 19 countries studied, total revenues declined, with the result that average NFPS revenue for the region also declined, by half a percentage point of output. Most of the decline was due to reasons external to the normal revenue collection process. A number of countries suffered declines in grant income (Bolivia and Nicaragua), proceeds from sales of assets (Peru) and profits from State-owned oil companies (Colombia, Ecuador, Mexico and Venezuela). On the other hand, nine countries did succeed in increasing revenues compared with the year before, chiefly through tax collection (see table II.3).

In general, the steps taken by the authorities to improve tax revenues were seconded by a higher level of economic activity, and hence of imports as well. On average, taxes collected in the region equalled nearly 14% of output in 1997, the highest percentage in any year of the decade, as a result of an increase of 6% compared to the amount collected in 1996. In a number of

Table II.3
LATIN AMERICA AND THE CARIBBEAN: TOTAL REVENUE OF THE NON-FINANCIAL PUBLIC SECTOR [a]
(Percentages of GDP)

	1990	1991	1992	1993	1994	1995	1996	1997[b]
Argentina	13.5	16.3	18.9	20.2	18.2	17.9	16.1	17.0
Bolivia	28.6	30.4	31.5	31.2	33.5	33.2	31.3	30.6
Brazil	28.9	24.6	24.2	26.3	28.5	27.2	28.1	28.9
Chile [c]	21.8	23.2	23.9	24.0	23.3	22.9	23.8	23.3
Colombia	23.7	25.9	25.6	28.7	28.5	31.7	33.9	33.6
Costa Rica	26.1	27.7	28.3	28.5	26.0	28.2	28.9	30.4
Ecuador	27.1	25.4	25.8	26.6	24.4	25.5	24.5	23.4
El Salvador	14.9	15.1	16.7	16.4	17.7	18.0	17.6	15.5
Guatemala [c]	7.9	9.0	10.1	9.1	7.7	8.5	9.0	9.4
Haiti [c]	9.8	8.7	7.1	6.0	2.9	7.0	7.9	9.2
Honduras [c]	16.4	17.4	18.0	18.0	16.7	19.1	17.3	17.3
Mexico	29.6	30.2	27.0	24.0	23.3	22.8	23.2	22.9
Nicaragua	21.8	36.5	32.8	37.5	35.5	39.9	40.8	38.6
Panama [c]	17.4	18.5	18.3	18.7	17.7	18.6	18.4	18.6
Paraguay	16.6	16.2	16.4	16.5	18.5	20.8	20.0	18.4
Peru[0]	7.8	9.1	11.1	11.6	17.7	15.3	17.9	15.0
Dominican Republic[c]	10.4	13.6	16.1	16.7	15.5	15.1	14.3	16.1
Uruguay	28.9	31.2	31.8	31.7	32.0	31.1	31.0	31.6
Venezuela	32.9	31.1	24.3	25.8	27.8	26.3	36.5	32.2

Source: ECLAC', on the basis of official figures.
[a] Calculated on the basis of figures in the local currency at current prices. Preliminary figures. [c] Refers to central government. Includes grants.

countries the authorities decided to raise the rates on some indirect taxes, in addition to income taxes. Tariff trends in the region were mixed. Mercosur member countries decided to increase their common external tariff temporarily by three points. Colombia and Ecuador also raised their tariffs. Costa Rica decided to postpone a scheduled tariff reduction in an effort to reduce its sizeable deficit, but El Salvador, Guatemala and Honduras went ahead with their schedule of tariff cuts. Non-tax revenues declined for the reasons mentioned in the foregoing paragraph.

On average, capital revenue in the region declined slightly in 1997. The Governments of Bolivia and Peru saw a decline in capital revenues due to a decrease in grant disbursements and privatization proceeds, respectively. In recent years sales of tangible and intangible assets have been an important source of capital revenue for a number of economies. However, they are not always included in the fiscal accounts; in some countries only a portion are reported. Moreover, these special proceeds may be accounted for in one of two different ways: as capital revenue or as sources of financing. Hence, their inclusion often distorts the true state of public finance, given their non-recurrent nature, and complicates comparison between countries. Excluding all proceeds from sales of assets recorded under capital revenue, deficit financing or both, the average deficit for the region would increase to 1.4% of output (see table II.4).

(c) Trends in fiscal expenditure

Average NFPS expenditure in the region (24% of GDP) declined slightly, chiefly because of cuts in investment proj ects, reduced interest payments

5 Including, for example, the sale of rights to work oil or mineral deposits.

Table n.4

LATIN AMERICA AND THE CARIBBEAN: NON-FINANCIAL PUBLIC SECTOR BALANCE WITH AND WITHOUT PROCEEDS FROM SALES OF ASSETS[2]

(Percentages of GDP)

Country	1996		1997	
	Without sales of assets	With sales of assets	Without sales of assets	With sales of assets
Latin America	*•12*	-0.7	-1.4	-0.7
Argentina	-2.0	-1.8	-1.5	-1.4
Bolivia	-2.0	-1.0	-3.4	-2.8
Brazil	-3.8	-0.3	-4.4	0.2
Chile[a]	2.2	2.3	1.8	1.9
Colombia	-1.9	-1.0	-3.1	0.6
Costa Rica	-3.3	-3.3	-1.6	-1.6
Ecuador	-3.0	-3.0	-2.5	-2.5
El Salvador	-2.5	-2.5	-1.8	-1.8
Guatemala[a]	-0.1	-0.1	-1.1	-1.1
Haiti[a]	-1.6	-1.6	-2.0	-2.0
Honduras *	-3.8	-3.8	-2.5	-2.5
Mexico	-0.1	-0.1	-0.7	-0.7
Nicaragua	-5.1	-4.8	-2.1	-1.9
Panama *	-1.7	-1.7	-0.6	-0.6
Paraguay	1.7	1.7	0.5	0.5
Peru	-1.1	2.4	-0.1	0.8
Dominican Republic[a]	-0.4	-0.4	0.8	0.8
Uruguay	-1.1	-1.1	-1.2	-1.2
Venezuela	7.0	7.6	-1.5	2.4

Source: ECLAC, on the basis of official figures.
[a] Refers to central government.

on the debt and, to a lesser extent, decreases in consumption expenditure (see table II.5).

Current expenditure, which constitutes three fourths of total expenditure, increased at a slightly slower pace than during most of the decade. Within current expenditure, consumption expenditure, which includes remuneration of public-sector employees and purchases of other current goods and services, has remained steady at about the same percentage of output throughout the 1990s. This suggests that wage payments have, on average, tracked the growth of output. Current transfers, especially under the social security system, have increased in most of the countries. Several countries are in the process of reforming their social security systems in one form or another. Most of the new schemes are designed to decrease public contributions to the system but entail maintaining expenditure levels in the medium term and will result in a deficit at least during the initial phase of the changeover (see chapter III).

Interest payments as a percentage of GDP declined in nearly all the countries of the region. In the case of Venezuela, the most striking example, interest payments on the debt dropped from 5% to 3% of GDP because of lower interest rates. This trend should not, however, obscure how heavily public debt service still weighs in government budgets: on average, interest payments equal one tenth of total expenditure in the countries of the region. In Costa Rica, Ecuador and Honduras, interest payments equalled nearly 5% of GDP. In these three countries plus Mexico, nearly one-fifth of total expenditure went to interest payments. Chile, the Dominican Republic and Paraguay, on the other hand, paid out only half a percent of GDP in interests (see figure II.4). Capital expenditure, which on average accounts for one fifth of total NFPS expenditure, went down in 1997. The decrease in public works that this reflects was due in large part to changes of administration in some countries that resulted in temporary delays. There

6 For more information, see also ECLAC, "The fiscal covenant: strengths, weaknesses, challenges" (LC/G.1997(SES.27/3)), Santiago, Chile, 1998.

7 Average for 16 countries for which data was available.

Table II.5
LATIN AMERICA AND THE CARIBBEAN: TOTAL EXPENDITURE OF THE NON-FINANCIAL PUBLIC SECTOR"
(Percentages of GDP)

	1990	1991	1992	1993	1994	1995	1996	1997[b]
Argentina	17.3	17.9	18.9	18.8	18.3	18.4	17.9	18.3
Bolivia	33.0	34.7	35.8	37.2	36.5	35.2	33.2	34.0
Brazil	33.2	30.6	30.7	33.3	29.3	32.8	32.9	34.1
Chile[c]	21.0	21.7	21.6	22.0	21.6	20.3	21.5	21.4
Colombia	24.4	25.7	25.8	28.6	27.5	32.3	35.9	36.7
Costa Rica	28.6	27.8	27.6	27.6	32.7	30.2	32.2	32.0
Ecuador	27.0	26.4	27.5	26.9	24.6	26.9	27.6	25.9
El Salvador	15.3	17.9	20.1	18.1	18.2	18.1	20.1	17.4
Guatemala[c]	10.2	9.1	10.7	10.6	9.2	9.2	9.1	10.5
Haiti[c]	10.8	8.9	11.4	9.2	6.0	11.7	9.5	11.2
Honduras[c]	22.8	20.7	22.9	27.9	23.8	23.3	21.1	19.9
Mexico	31.8	27.0	25.4	23.4	23.6	22.9	23.3	23.6
Nicaragua	36.5	32.4	36.2	37.7	41.4	42.4	45.6	40.5
Panama[c]	18.0	21.0	19.6	18.2	18.4	17.9	20.1	19.2
Paraguay	11.4	13.3	16.3	15.3	16.1	18.3	18.3	18.0
Peru[c]	10.3	10.7	12.6	12.7	14.8	16.8	15.9	14.9
Dominican Republic[c]	10.1	10.4	12.5	16.5	16.3	14.5	14.7	15.4
Uruguay	28.6	29.9	30.3	32.5	34.5	32.4	32.2	32.9
Venezuela	32.8	33.3	30.2	27.1	41.6	33.2	28.9	29.9

Source: ECLAC, on the basis of official figures.
[a] Calculated on the basis of figures in the local currency at current prices. Preliminary figures. [c]Refers to central government.

were also cases in which the authorities were obliged to postpone investment to meet their fiscal targets. Some countries, however, such as Guatemala and Haiti, actively undertook infrastructure projects, in the first as part of the peace accords, and in the second as part of its development plan.

(d)Trends in the overall balance and its financing

In quantitative terms, 8 of the 19 countries studied improved their overall balance; the average improvement was 1 % of output. Of these 8, there were 4 -Costa Rica, Dominican Republic, Honduras and Nicaragua- that did better than the average. One country, Uruguay, had results roughly similar to the previous year's. The other 10 increased their deficit or reduced their surplus by an average of 1.5% of output, a variation more pronounced than that of the countries that improved the balance on their accounts (see table II.6).

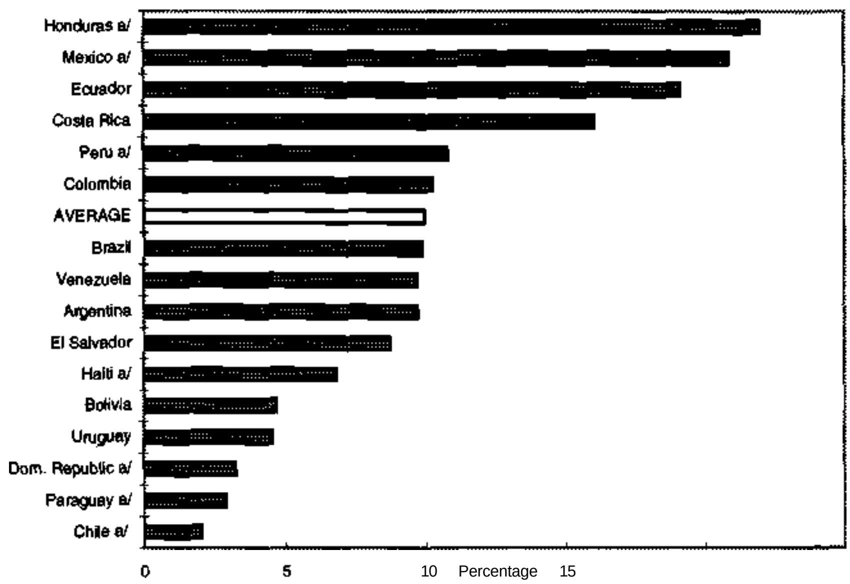
While the regional NFPS overall balance shows a slight deterioration, it does not reflect situations that are qualitatively different. Most of the countries that managed to reduce their deficit (or hold it steady) did so by reducing current expenditure or increasing current revenue. In Ecuador, Nicaragua and Honduras some investment projects were suspended, in the first two because of delays related to a change of administration and in the last in order to meet fiscal targets.

Of the 10 countries that widened their deficits, half did so by increasing investment expenditure, social spending and transfers to social security systems undergoing reform. The other half collected less in revenue. Three in the latter category were affected by factors independent of fiscal policy, such as a loss of grant revenue, fewer privatizations or a decline in the local-currency value of proceeds from sales of State-owned enterprises because of changes in foreign exchange policy.

Concern for improving the fiscal situation was evidenced by a slight increase in public saving in

Figure **II.4**

SHARE OF INTEREST PAYMENTS IN TOTAL EXPENDITURE OF THE NON-FINANCIAL PUBLIC SECTOR, 1997



Source: ECLAC, on the basis of official figures.
[a] Refers to central government.

Table II.6

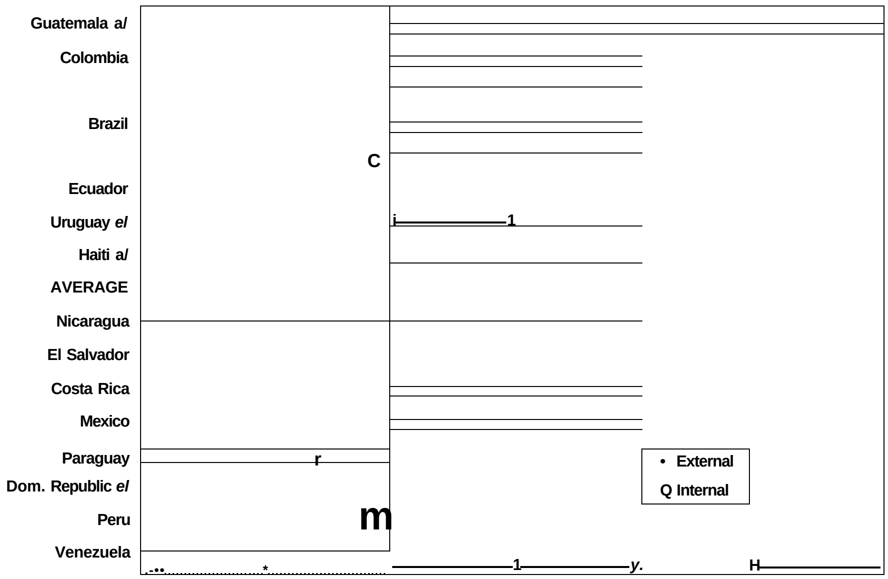
LATIN AMERICA AND THE CARIBBEAN: NON-FINANCIAL PUBLIC SECTOR BALANCE '

(Percentages of GDP)

	1990	1991	1992	1993	1994	1995	1996	1997 b
Argentina	-3.8	-1.6	-0.1	1.4	-0.2	-0.6	-1.8	-1.4
Bolivia	-4.4	-4.3	-4.4	-6.1	-3.0	-1.8	-2.0	-3.4
Brazil[c]	1.4	-0.2	-1.8	-0.8	1.1	-4.9	-3.9	-4.3
Chile [d]	0.8	1.5	2.3	2.0	1.7	2.6	2.3	1.9
Colombia	-0.7	0.2	-0.2	0.1	1.0	-0.6	-2.0	-3.1
Costa Rica	-2.5	-0.1	0.7	0.6	-6.6	-2.0	-3.3	-1.6
Ecuador	0.1	-1.0	-1.7	-0.4	-0.2	-1.5	-3.1	-2.5
El Salvador	-0.4	-2.8	-3.4	-1.6	-0.6	-0.1	-2.5	-1.8
Guatemala	-2.3	-0.1	-0.5	-1.5	-1.4	-0.7	-0.1	-1.1
Haiti [d]	-1.0	-0.3	-4.4	-3.3	-3.3	-4.8	-1.6	-2.0
Honduras	-6.4	-3.3	-4.9	-9.9	-7.0	-4.2	-3.8	-2.5
Mexico	-2.8	3.3	1.6	0.7	-0.3	-0.2	-0.1	-0.7
Nicaragua	-14.7	4.1	-3.4	-0.2	-5.9	-2.5	-4.8	-1.9
Panama	-0.7	-2.5	-1.3	0.5	-0.7	0.7	-1.7	-0.6
Paraguay	5.2	2.9	0.1	1.2	2.4	2.5	1.7	0.5
Peru[d]	-2.5	-1.6	-1.5	-1.5	2.9	-1.6	2.2	0.1
Dominican Republic	0.3	3.2	3.6	0.2	-0.8	0.6	-0.4	0.8
Uruguay	0.4	1.3	1.4	-0.8	-2.4	-1.3	-1.1	-1.2
Venezuela	0.1	-2.2	-5.9	-1.3	-13.8	-6.9	7.6	2.3

Source: ECLAC, on the basis of official figures.
[a] Calculated on the basis of figures in local currency at current prices. [5] Preliminary figures. : Operational balance; includes adjustments. Refers to central government.

Figure II.5
NON-FINANCIAL PUBLIC SECTOR DEFICIT FINANCING
(As a percentage of GDP)



Source: ECLAC, on the basis of official figures.
[a] Refers to central government.

1997 to a little over 3% of GDP, achieved by reducing current expenditure by somewhat more than the decline in current revenue. Average public saving in the region has risen slightly for the last three years (see figure II.3).

Only two countries incurred "dissaving" in 1997. The Argentina national public sector recorded negative saving for the second consecutive year as a result of increased transfers and the merger of provincial pension funds into the national system. A sizeable increase in current revenues was still not enough to offset a surge in expenditure in Haiti, where saving has been negative throughout the 1990s.

Interest payments pushed the financial balance into the red, since on average the region ran a primary surplus that was down to only 1% of output in 1997, in a reversal of the trend of the two previous years. Only Bolivia, Brazil and Haiti recorded large primary deficits, with real interest rates higher than rates of output growth (especially in Bolivia and Brazil). If this tendency continues in the future, interest payments and levels of public debt will progressively rise.

As in 1996, the Governments of the region preferred to finance their deficits with external resources. External financing averaged 1% of output, very similar to the level of the deficit (see figure II.5). Bolivia, Ecuador, Honduras and Nicaragua borrowed nearly 2% of GDP in external capital in view of the potentially higher cost of domestic credit. In contrast, domestic financing of the deficit was equal to less than 1% of output.

8 The primary surplus equals total revenue less total expenditure excluding interest payments.

9 The average for 16 countries for which data were available.

III. STRUCTURAL REFORMS

1. General trends

The outstanding trend in 1997 was a second wave of privatization that yielded a record amount, largely thanks to Brazil. In addition, further progress was made in social security reform, regional integration and trade liberalization.

The Governments of the region continued to carry out structural reforms designed to open up their economies to international competition, reduce State intervention in the production of goods and services and promote private-sector activity. Such efforts have played a crucial role in the profound changes the region has undergone in the last 10 years in adapting to new global circumstances. The reforms, in effect, constitute a medium- and long-term economic policy, since their aim is to influence the performance of the economy by changing the ground rules for economic agents.

Within the region, those in charge of recent reforms in South America made strenuous efforts in 1997, particularly in the area of privatization, to catch up with countries further along in the reform process. Significant advances were also made during the year by Central American countries. The Caribbean countries were less active in this regard.

Privatization initiatives in 1997 yielded record proceeds of US$ 25 billion, a large portion of that being Brazil's share. Concessions also became an increasingly common option in the region. The preparation and adoption of social security reforms moved forward in 1997; new social security schemes were put in place in three countries (Mexico, Uruguay and Bolivia).

In the sphere of trade reform, there were a few setbacks in 1997, as in the preceding years, due primarily to macroeconomic problems related to external balances. The Central American countries, however, managed to move ahead with their reforms. All in all, regional integration processes continued to reshape the economic geography of the continent.

Financial reforms, together with the banking crises of previous years, resulted in a process of banking and financial consolidation that went to great lengths in many countries, a trend accentuated by the arrival of foreign banks. Meanwhile, monetary authorities persisted in their efforts to improve financial supervision and oversight.

Indeed, the resilience shown by the Latin American economies during the last quarter of 1997 and the first half of 1998 in the face of the Asian crisis was attributable in good part to the reforms in financial regulation and supervision already adopted.

2. Public-sector reforms

(a) Privatization

In 1997, the privatization process maintained the momentum established the year before, and proceeds from that source doubled. The region took in around US$ 25 billion, an all-time high, bringing total proceeds from privatization over the last eight years to US$ 100 billion. This boom was facilitated by an abundance of resources in international markets and favourable expectations on the part of investors, at least until October 1997, which resulted in strong demand for acquisition of State-owned enterprises. Moreover, Brazil, the region's largest economy, after careful preparation, was ready to enter into a full-blown phase of privatization. The size of the proceeds is also explained in part by the fact that Brazil, Colombia and other countries sold off many enterprises in the highly capital- and technology-intensive electric power sector. Moreover, in many cases the prices obtained were well above the pre-set minimum for the sale.

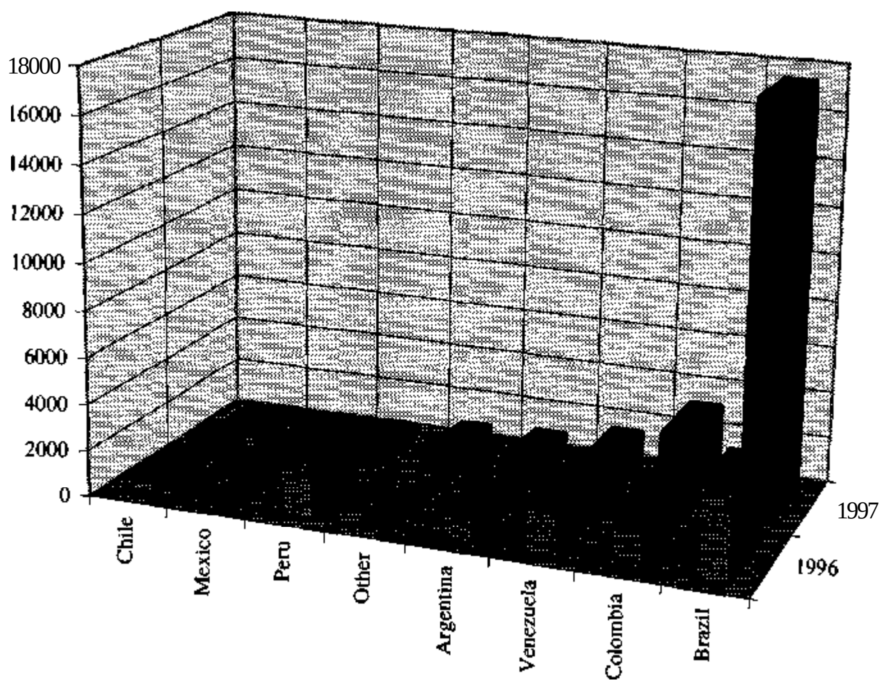
Brazil's leading role in the region's wave of privatization in 1997 can be clearly seen from figure III.l below. Of total privatization proceeds, Brazil collected 70%. Colombia also realized a significant amount (US$ 3,180 million), double the figure for 1996. Other countries in the region, in contrast, realized less than the year before.

The electric power sector loomed large in the privatization process (see figure III.2), accounting for 60% of total proceeds. The sale of electric power companies accounted for 100% of proceeds in Argentina, 80% in Colombia and 65% in Brazil. In Panama, the sale of a 49% stake in the national telecommunications company (INTEL) brought in the bulk of the year's proceeds. The main privatization initiative in Venezuela was the sale of the iron and steel firm Siderúrgica del Orinoco (SIDOR) for US$ 1.2 billion, 80% of the country's privatization proceeds in 1997. On the other hand, the banking and telecommunications sectors accounted for a smaller share regionally than in previous years (see figure III.2).

Figure III. 1

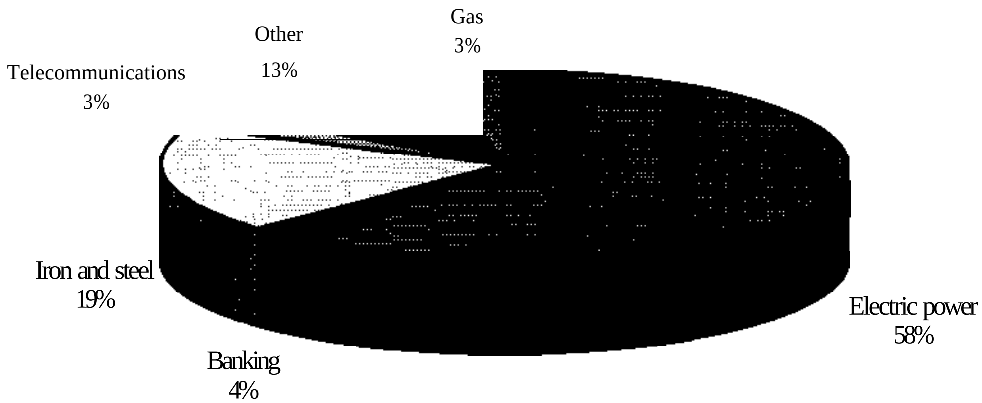
PRIVATIZATION PROCEEDS BY COUNTRY IN 1996 AND 1997

(Billions of dollars)



Source: ECLAC, on the basis of information from official and non-official sources (see table III.l).

Figure in.2
SHARE OF PRIVATIZATION PROCEEDS BY SECTOR IN 1997, LATIN AMERICA AND THE CARIBBEAN



Source: ECLAC, on the basis of official figures.

With respect to the national origin of the firms that acquired State assets in 1997, the list is headed by Brazilian companies. Around two thirds of privatization proceeds in Brazil came from national firms. It is observable, however, that the participation of foreign firms in the acquisition of State assets has steadily increased since the Government of Brazil eliminated barriers to foreign interests when it began implementing the *Real* Plan. After Brazilian firms, companies from the United States, Chile, Spain and other nationalities follow in that order on the list. Among Latin American firms, only Chilean companies actively participated in acquisitions of State-owned enterprises in countries other than their own. Brazilian firms, in contrast, showed minimal interest in acquisitions beyond their borders.

Privatization, broadly speaking, includes concessions. In the region there are many and varied projects being carried out on a concession basis, involving highways, ports, airports, surface and underground railways, nuclear power plants and television channels, among others. The Government of Chile, for example, proceeded with its programme of highway concessions in 1997 and for 1998 announced a similar programme for its shipping ports, as did the Government of Peru. The Government of Colombia awarded concessions to operate television channels to the private sector, ending 40 years of State monopoly; it also announced that it would grant a concession to operate the prison system. The Government of Argentina awarded a concession for the postal service in 1997 and for 33 airports early in 1998, and is preparing to do the same for three nuclear power plants. The Governments of Mexico and Honduras are preparing for a bidding for concessions to run the national airports. In Brazil, concessions were awarded in 1997 for railway lines, highways, container terminals and a metro system.

Among the major contracts awarded during the year were cellular telephone concessions in Brazil and various petroleum concessions in

Table nil

LATIN AMERICA AND THE CARIBBEAN: VALUE OF PRIVATIZATIONS, 1990-1997 [a b]

(Millions of current dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	Total
Argentina[c]	2 139	1 896	5 312	4 589	1 441	1340	1033	969	18 719
Bolivia	-	-	7	14	-	848 [d]	874 [e]	-	1 743
Brazil	-	1564	2 451	2 621	1972	910	3 752	17 400	30 670
Chile	29	117	21	-	203	3	579	12	964
Colombia	117	105	27	4	681	138	1476	3 180	5 728
Mexico	3 580	10716	6799	2 507	771	-	-	84	24 457
Peru[c]	-	3	208	317	2 578	946	2 460	421	6 933
Venezuela	10	2 276	30	32	15	21	2 090	1 505	5 979
Other	1	25	31	95	868	75	68	837	2000
Total	**5 876**	**16 702**	**14 886**	**10179**	**8 529**	**4 281**	**12 332**	**24 408**	**97 193**

Source: Data for 1996 and 1997 from official sources. For 1990-1995, R. Cominetti, "La privatización y el marco regulatorio en Bolivia y Nicaragua: un análisis comparativo", Reformas de políticas públicas series, No. 43 (LC/L.973 and Add.l), Santiago, Chile, ECLAC, 1996; own estimates based on information from *Latin Finance, Privatisation International, Latin American Weekly Report, Latin American Economy and Business.*

[a] Cash proceeds plus proceeds in the form of external and domestic bonds reported at their value in the secondary market, except in the case of Brazil, for which domestic bonds are reported at nominal value. [b] Figures do not include concessions, except in the case of Argentina and Peru. [c] Includes concessions. [d] Includes US$ 51 million in privatization and US$ 797 million in capitalization. [e] Capitalization.

Venezuela. The cellular telephone awards brought in some US$ 5.1 million to the Brazilian Treasury; in some cases the floor price was exceeded by as much as 400%. Under the programme of opening up the petroleum industry, the Government of Venezuela collected some US$ 2.2 billion for awarding concessions to reactivate 18 old and abandoned oil fields.

These efforts at reform were not always problem-free, as is shown by the example of highway concessions in Mexico, where the process had to be reversed in part. The programme was initiated in 1987 and 52 concessions were awarded, under which 5,400 kilometres of limited access highways were built. Demand was overestimated, however, so that the operators suffered losses. In 1997, the Government decided to rescind 23 of the concessions it had awarded and assume the losses, estimated at US$ 7.5 billion.

The region's plans for 1998 suggest that a new record will be reached in privatization proceeds, again thanks to the Brazilian projects, including the sale of Telecomunicações Brasileiras (Telebras) in July 1998, the largest privatization deal so far in the history of Latin America and the Caribbean, and one which has brought Brazil more than its entire proceeds for 1997 (see box III.l). The successful sale of El Salvador's electric power companies augurs well for the Central American countries, which suffered some setbacks in this regard in previous years.

(b)Institutional changes

During the 1990s, reforms involving sales of assets have succeeded in reducing the size of the public sector substantially. But much less progress has been made on the other outstanding task -that of bridging the wide gap between society's demands and needs and the capacity of the State to meet them. Successful macroeconomic stabilization programmes and "first generation" structural reforms have increased the efficiency of the private sector but have not improved the efficacy of public action. Meanwhile, social demands have been accumulating steadily, and the aforementioned gap between need and action has widened. One

Box HM
PRIVATIZATION OF TELEBRAS

In preparation for the privatization of Telecom unicações Brasileiras (Telehras). the Government of Brazil divided the Tclcbras system into 12 companies: three fixed-line operators, eight cellular telephone firms and one long-distance and international communications operator. The Government .sold 19.3'/fc of the shares of the group, representing 51 .8*% of the voting rights. The floor price for the deal had been set at IiS$ 11.5 billion, but the Government was hoping for amund US$ 13.9 billion. The interest of investors was so great, however, that the proceeds amounted to USS 19 billion, constituting an average premium of 65'* over the floor price. In the case of one company, the premium exceeded 240'*. It is significant that, in contrast to previous privatizations, foreign companies (bidding alone or with Brazilian partners) were heavily represented. The majority of the successful bidders were European firms. The rales stipulate that the buyers must pay 4()9f of the total amount in 199K and the remaining *60%* over the following two years. Another interesting point is that the Government proposes to use the bulk of the proceeds to retire its domestic debt, Iherebv reducing lhe public-sector deficit.

approach to narrowing the gap has been to reform the existing institutional framework in order to enhance the State's capacity to do its job. Institution-building is intended to improve the delivery of social services and make both market and State functioning more transparent.

Little has been done in this area, however. Several Central American countries, including El Salvador and Nicaragua, undertook reforms of their public administrations in 1997. In Brazil, on the other hand, such initiatives have been bogged down for three years. Mexico, Peru and Venezuela, countries in different phases of structural reform, are now starting to consider reforms to the State itself.

Judicial reforms are slowly getting underway in the region. With the aim of enhancing legal safeguards, Bolivia completed the restructuring of its judiciary in 1997. In addition to the existing institutions, it created the Office of Ombudsman, the Judiciary Council and the Constitutional Court. Chile, by enacting new legislation governing its Supreme Court, took the first steps in reform of the judicial structure with the aim of increasing both the transparency and the credibility of the judicial system. In Peru, on the other hand, judicial reforms were stymied and even suffered some reverses.

Another fundamental issue the region is timidly beginning to address, one closely linked to administrative and judicial reforms, is that of corruption, a problem that has become increasingly serious and widespread, not only within the region but throughout the world. The Government that recently took office in Bolivia made it one of the priority issues in its new programme. In Chile, a bill was introduced in the legislature in 1998 aimed at raising the level of administrative probity and transparency in the functioning of government. The Government of Ecuador, on the other hand, was unsuccessful in its plan to modernize the customs service and was forced to decree a state of emergency in customs. In mid-1998 it finally succeeded in setting up new customs institutions designed to increase efficiency and put an end to corruption. Argentina announced that it would consider privatizing customs inspections in 1998.

Technological changes that have diminished the importance of economies of scale in the telecommunications sector, combined with increased demand for telecommunications

1 "First generation" reforms comprise fiscal reform, price decontrol, liberalization of trade and financial markets, deregulation and privatization.

2 "Second generation" structural reforms include administrative and judicial reforms, decentralization, improvement of regulatory and legal frameworks and more effective oversight of financial systems.

services, have facilitated their transfer to the private sector and the break-up of monopoly. In many countries, Governments have privatized State-owned enterprises and in some cases created regulatory agencies responsible for increasing competition and protecting consumers. This process is now underway in many countries of the region; in 1997 El Salvador, Colombia and Brazil joined their ranks. That year, the Government of Brazil opened the telecommunications sector to competition and set up a regulatory agency for the industry; in 1998 it went on to privatize the State-owned telephone company.

The electric power sector is following the same path, but more slowly. While the gap between supply and demand is comparable to that in the telecommunications sector, there have been far fewer technological innovations. Nevertheless, private-sector interest in investing in the industry has been growing, as shown by the privatization figures for 1997. Moreover, during the year Governments in the region put emphasis on measures to avoid the formation of electric power monopolies (Peru and Ecuador) and created regulatory agencies (Brazil).

With regard to property rights, Nicaragua passed a law aimed at resolving outstanding land claims and accelerating the process of issuing deeds. Mexico and Ecuador adopted new intellectual property legislation, and Brazil passed a law making software piracy a tax fraud, as well as a law on music copyrights.

(c) Social security reforms

Of the countries in the region that have reformed their social security systems in recent years, only Chile adopted a pure funded system. The others opted for a mixed system combining both economic and social functions, i.e., both capitalization and distribution elements, in an effort to harmonize the diverse goals of improving public finances, increasing savings and developing capital markets with the need to provide an adequate income in old age.

As Chile had done earlier, Argentina began a process of consolidation involving mergers and acquisitions of retirement and pension fund management companies (AFJPs) in a bid to reduce costs and achieve greater competitiveness. Of the 26 AFJPs created at the time of the 1994 reform, 18 remain, covering 5.7 million participants. The process was reinforced by the simultaneous consolidation of the Argentine banking system.

Three reformed social security systems went into effect in 1997 (in Mexico, Bolivia and Uruguay). The first two have run into problems. In Mexico, a private pension system began to operate in 1997 with 18 retirement fund management companies (AFOREs). In their first year of operation, the AFOREs enrolled over 11 million workers, making that the largest and speediest enrolment process in all the countries that have introduced new systems. Over one fourth of the participants, however, make no regular contributions to their retirement, and this undercuts the profitability of the funds. Moreover, AFORE investments are not highly diversified; most of the money is invested in government bonds.

The new Bolivian social security system is also encountering problems. One of the key elements of the new system was the "Bonosol", or solidarity benefit, to be paid to all persons over 65 years of age. The purpose was to provide a universal old-age pension in the form of a life annuity. But the Bonosol was paid out for the first and apparently the last time in 1997. The new Government suspended payment of the Bonosol on the grounds that it was not financially viable, since the first and only payment had resulted in a debt of US$ 50 million. In its place, the Government is proposing to distribute the shares of stock the State still holds in capitalized enterprises, but the final decision has not yet been announced.

Seven countries are considering or preparing for reforms to their social security pension systems (El Salvador, Venezuela, Brazil, Panama, Paraguay, Honduras and Costa Rica). El Salvador completed the preparatory stage in

3 For further details on the new social security systems in Mexico and Bolivia, see ECLAC, *Economic Survey of Latin America and the Caribbean, 1996-1997* (LC/G.1968-P), Santiago, Chile, 1997, p. 75, United Nations publication, Sales No. S.97-II.G.2.

1997, and in the first half of 1998 authorized the operation of five pension fund management companies (AFPs), four created with foreign capital and one with local capital. Venezuela made significant progress in 1997 in preparing for changes in its social security system as part of the reforms contemplated under the Agenda Venezuela programme. The new system is supposed to cover pension, health, unemployment, disability and housing benefits. It is to be based on individual funding and will be mandatory for workers and employees in all categories. The plan also involves the establishment of a trust fund to guarantee a minimum pension, thereby protecting the rights acquired.

In contrast, reform of the pension system in Brazil has been awaiting approval for three years. The plan is to do away with the patchwork of retirement schemes and to set a minimum retirement age of 60 years for men and 55 for women. Other features are to calculate the pension on the basis of years of contribution rather than years of service and to eliminate the special privileges some occupations enjoy. It is estimated that these changes would result in US$ 3 billion annually in savings to the public sector.

3. Reforms of the banking sector and capital markets

Prior to the wave of deregulation in the early years of the decade, the region's banking systems were heavily regulated, undercapitalized and composed of a large number of financial institutions with high operating costs. Financial liberalization and successful macroeconomic stabilization programmes, however, radically altered the ground rules, and financial systems were forced to adapt. In some cases the changes led to banking crises, in others to consolidation through mergers and acquisitions. The particular severity of the banking crises in 1994 and 1995 induced the countries affected to strengthen the regulatory framework and oversight of the sector (see box III.2).

In 1997, serious financial problems or banking crises arose only in Paraguay, Jamaica and El Salvador. The Central Bank of Paraguay was obliged to intervene, and later, in 1998, to order the liquidation of two banks, one of them the largest locally-owned private bank. The Government of Jamaica spent nearly 10% of GDP to facilitate the restructuring of the financial sector. Three other countries (Bolivia, Ecuador and Uruguay) encountered localized problems involving one bank or one financial institution.

On the other hand, consolidation of the sector went further in a number of countries during 1997. In Colombia, for example, the financial sector continued on a course of consolidation begun in mid-1996; between June 1996 and April 1998, 48 financial institutions were created, acquired, merged or liquidated. Financial systems in Argentina, Brazil, Mexico and Venezuela underwent similar changes. In all these cases, the active participation of foreign banks accelerated the consolidation. In Venezuela, for example, it is estimated that in the two years following the banking crisis the number of banks was reduced by 50%, and half of those remaining were owned by foreign interests.

In the area of regulation and oversight, Panama adopted measures to strengthen local banks and improve the competitiveness of the financial system in general. It also has plans to create a banking superintendency with oversight of local financial institutions and the power to impose sanctions when appropriate. In mid-1998 the Banking Superintendency of Colombia assumed oversight of cooperative financial institutions, and the introduction of a mandatory risk rating system is planned for 1999. The Governments of Colombia, Ecuador, Peru and Venezuela signed an agreement to tighten the control they exercise over bank transactions between countries, in order to prevent financial institutions from transferring risks to the balance sheets of branches located in other countries and to increase the transparency of

Box 1112

FINANCIAL REFORMS AND THE ASIAN CRISIS IN THE REGION

Prior to the Mexican crisis in 1994, financial reform in the region typically involved liberalization without an accompanying effort to strengthen oversight and regulation. Since then, however, the situation has changed radically. During the three years from 1995 to 1997, baied on the experience gained from the so-called "tequila effect". Governments in the region have adopted programmes designed to strengthen their control of the financial sector, facilitate the capitalization of weak institutions and promote the restructuring and consolidation of hanking systems. They also privatized State-owned banks and re-privatized banks that had been taken ovcrduring periods of crisis, in the process attracting the interest of foreign banks and thereby improving and strengthening the structure of the financial system. As a result, the region's banking systems held up well against the external shocks generated by the Asian crisis. Thai strength, together with the timely adoption of macroecononiic measures and the absence of serious macroeconomic imbalances, enabled the countries to avoid banking and foreign exchange crises of the kind that had earlier hit Mexico and more recently the countries of South-East Asia. Hence, capital continued to flow in during the first half of 1998, despite the adverse global economic environment.

flows of money and capital between the signatory countries.

In the area of regulation, a number of countries intensified their efforts to combat money-laundering. Brazil adopted legislation establishing heavy penalties for the crime and making it mandatory for financial institutions to report suspicious transactions to the monetary authorities. Panama passed a law making the crime of money-laundering punishable by 20 years in prison.

Capital markets also came in for their share of attention. Several laws were passed in the region aimed at developing them. The legislature of Ecuador passed a stock market act and an investment guarantee act to attract more investment. In Chile, legislation was adopted that should make it easier for Chilean banks to penetrate other markets by opening branches or acquiring interests in foreign financial institutions. In addition, a further step was taken towards all-purpose banking by expanding the line of services banks can provide. Lastly, minimum capital requirements were harmonized with the rules of the Bank for International Settlements in Basel. The new investment law adopted in Uruguay included tax breaks and incentives for both local and foreign capital (exemption from wealth taxes, value added tax and some other specific internal taxes). The result was to put foreign and local investment on an equal footing. The law also guaranteed the free transfer of investment capital and profits. In addition, the range of investments open to the pension fund management companies recently created under the country's new social security system was expanded. Other new laws in this area were passed in 1998: a new foreign investment act was passed in Guatemala; a stock market act adopted in Bolivia set new rules for the operation of stock exchanges; and amendments to the General Banks and Other Institutions Act in Nicaragua represented a major step towards all-purpose banking.

Honduras passed the Central Bank Act in 1997 granting greater autonomy to the country's monetary authority. Cuba established a central bank and expanded the banking activities that could be conducted under market conditions. In Nicaragua, meanwhile, the Central Bank made reserve requirements uniform.

4. Labour reforms

Little has been done recently in the region in the area of labour reform. In most cases, Governments are trying to improve the efficiency of the labour market while still providing (or maintaining) adequate protection for workers. It is not easy, however, to find a way to achieve both these objectives simultaneously; hence the first steps towards reform are erratic, prolonged and hotly contested.

The situation in 1997 was no exception. In Honduras the merits of a reform of the labour code were still under study. In Argentina debate continued concerning the future of limited-term contracts and non-wage labour costs, debate unresolved on either issue by mid-1998. The same was true in Chile with regard to a proposal concerning unemployment insurance. In Paraguay, a proposal was put forward to limit the job security of civil servants and to place them on the same footing as employees in the private sector in terms of employment conditions, but the initiative was vehemently rejected.

Among the main changes in labour legislation in 1997 and early 1998 was Brazil's decision to expand the opportunities for limited-term contracts and to introduce the "time-bank" method for compensating overtime with time off. Both innovations are subject to collective bargaining. The aims are greater labour flexibility and lower labour costs. In Nicaragua, a new labour code, approved in 1996, took effect in 1997. In Venezuela, wages and supplementary allowances were combined into one, and an accrued severance bonus was legislated in preparation for the transition to a new social security system. In addition, provisions concerning dismissal without cause were amended. As a result of these changes, the Government recognized implicit liabilities of around US$ 8 billion for accrued payment obligations. That amount, plus the US$ 6 billion needed to re-capitalize the social security system, will have profound implications for the macroeconomic management of the country.

5. Progress in trade reform and the regional integration process

Most trade reform in recent years has occurred within already existing customs unions or bilateral trade agreements, or between individual countries and customs unions, in contrast to the trade reforms early in the decade, when economies were opened to the world in general. In consequence, nearly all recent changes in customs regimes have been part of the regional integration process: tariff reductions between members of a group or between the group as a whole and the rest of the world. Regional integration, however, covers many other areas besides trade policy.

(a) Trade reforms

The linkages of Latin American and Caribbean countries to international markets have strengthened as the decade has progressed, as a result of a policy of trade openness and the increasing globalization of the world economy. In the majority of the South American countries trade was liberalized early in the 1990s. In Central America the process has recently been reactivated, while the Caribbean countries are proceeding somewhat more slowly. This pattern reflects greater caution on the part of the latter two subregions in view of the vulnerability of their economies to external shocks and their level of preparedness. Although some Caribbean countries can count on earnings from a small *maquila* industry, tourism or offshore financial services, overall their economies are dependent on a few export products -natural resources or tropical agricultural products- with low value added. Hence, certain changes in established trade regimes, such as the ruling of the World Trade Organization against the preferential treatment accorded to Caribbean exports by European Union countries, could have serious economic and social consequences for the subregion.

As in previous years, macroeconomic problems induced the economic authorities of some countries of the region to adopt protectionist measures in 1997, but not to the extent of reversing the region's general tendency towards openness. The devaluation of Asian currencies, however, roused fears of a drastic increase in imports of Asian products and unfair trade practices. In a number of countries measures were announced to protect domestic producers, such as safeguard clauses, compensatory quotas, anti-dumping provisions and other non-tariff restrictions.

(b) The integration process

Widening external deficits in many countries of the region, aggravated by the spillover of the Asian crisis starting in October 1997, only marginally affected the regional integration process. The four existing customs unions moved toward full realization of their trade regimes and, to varying degrees, addressed related issues, such as institution-building, integration of the service sector and the free movement of persons and capital. Bilateral negotiations lagged, but subregional groups showed increasing interest in signing free trade agreements with non-member countries in the region. These rapprochements were motivated in part by the challenges raised by the launch of hemisphere-wide negotiations early in 1998.

(i) The Southern Common Market (Mercosur)

With the eleventh meeting of the Common Market Council (Forteleza, Brazil, December 1996), Mercosur entered a phase of deepening that transcends purely trade issues. Among other aims, it intends to strengthen the political dimension of the integration process. In the institutional sphere, the Council approved an agreement locating the headquarters of the Mercosur Administrative Secretariat in Montevideo.

In 1997 the Mercosur customs union completed three years of existence, although there are still exceptions to its free trade regime and common external tariff (CET). The timetable for tariff reductions on the few products not yet covered is being adhered to, and the countries are gradually converging on the agreed CET. Among recent advances, the protocol in defence of competition, the social security agreement and the Montevideo Protocol on Trade in Services in the Southern Common Market deserve special mention.

In early 1997, Brazil put restrictions on short-term financing of imports, and Argentina initiated a series of investigations of suspected dumping of Brazilian imports. So far, the friction generated by such measures has been resolved through direct negotiation between the countries concerned, without recourse to the dispute settlement mechanism. To counter their growing external deficits, Argentina and Brazil decided to apply a general surcharge of 3% to the common external tariff starting in November, leaving Paraguay and Uruguay at liberty to apply the surcharge or not.

During 1997, trade within the group again grew strongly (by 17.7%), exceeding the US$ 20 billion mark and raising the share of intra-group exports to 24.3% of the group's total exports. The expanded market has become a powerful inducement to foreign direct investment in the area, while investment between member countries, although still at an early stage, is picking up.

In February 1997, an associate membership agreement between Mercosur and Bolivia took effect, similar to the one signed with Chile the year before. No concrete progress was made on a rapprochement between Mercosur and the Andean Community, but in April 1998 a framework agreement was reached on negotiations for a free trade area between the two groups by the year 2000.

(ii) Andean Community

With the ninth session of the Andean Presidential Council (Sucre, Ecuador, April 1997) the Trujillo Act and associated protocol went into effect, transforming the Andean Group into the Andean Community. The purpose of the institutional change was to make the group's structure stronger and more flexible. The Board of the Cartagena Agreement was replaced by the General Secretariat, which unites in one executive body the responsibility for most of the decisions that affect the regular functioning of the Community. In addition, there are decision-making bodies composed of the presidents and the foreign ministers of the member States, to provide the Andean Community with a strong political underpinning.

Peru, which had not participated in the free trade regime of the Group since 1992, rejoined the Andean Community at the end of June 1997 after arduous negotiations. It was agreed that the country would have until the year 2005 to bring itself gradually into line with the free trade regime governing trade between the other member countries. It should be recalled that both Peru and Bolivia still apply their own national tariffs to third-country imports and have no plans to adhere to the Community's common external tariff. Intra-group trade increased by 14.9% during 1997, while exports to the rest of the world increased by 7.7%; as a result, the share of intra-group exports in total exports rose to 11.2%.

In terms of outward expansion, the most significant development was the framework agreement signed between the Community and Mercosur in April 1998, which opens up concrete prospects for the establishment of a free trade area comprising nearly all the South American countries.

In the face of temporary macroeconomic problems that developed in the course of the year, Colombia and Ecuador raised their tariffs in 1997, the first for three months, the second for nine. Peru, on the other hand, reduced its average tariff from 16% to 13% for most imported products.

(Hi) Central American Common Market (CACM)

The Central American integration process moved forward in 1997 on two fronts: in the deepening of its regulatory and formal aspects and in efforts to broaden its scope. At the nineteenth Summit Meeting of Central American Presidents (Panama City, July 1997), the issue of strengthening Central American integration institutions was addressed and the possibility of a free trade agreement with the host country was explored. On the latter issue, the participants set the objectives and framework for negotiations with Panama. Among the reorganization measures adopted, the most significant was the decision to combine all existing secretariats into one General Secretariat with headquarters in El Salvador.

The assembled presidents further agreed to supplement trade integration with cooperation in the political sphere and to step up efforts to reach an understanding with the Dominican Republic; as a result, negotiations successfully culminated in a free trade agreement between that country and CACM in April 1998. On 18 September 1997, Nicaragua signed a free trade agreement with Mexico (Costa Rica had done so in 1995); the other three Central American countries (El Salvador, Guatemala and Honduras), referred to collectively as the Northern Triangle, continued negotiating with Mexico towards a similar agreement.

During 1997 CACM members advanced trade liberalization by progressively reducing tariffs, cutting back on safeguard clauses in reciprocal trade and virtually eliminating nearly all tariffs on their trade in agricultural products. In June 1997, however, they proposed postponing for five years (until 2005) full implementation of the common external tariff. On the other hand, the countries, with few exceptions, lifted exchange controls, a move that also facilitated the development of trade within the group. Intra-group trade grew by 3.5%, while total Central American exports increased by 11.7%. Thus, despite some structural weaknesses, intra-group trade continued to rebound.

(iv) Caribbean Community (CARICOM)

The CARICOM countries have made strides in implementing their customs union. Basically, there is free trade between them in all goods

4 In any case, Panama's tariffs for all imports averaged 8.25% in January 1998, compared with 35% in 1995. The tariff structure comprises six categories, with rates from 0% to 20%. Quotas were eliminated, and ad valorem duties replaced specific taxes.

that satisfy the rules of origin. At the beginning of 1997, however, there were still four countries that were requiring import licences on a limited number of products. In addition to advances in free trade of goods, all but two countries signed a protocol in July 1997 providing for free movement of capital. The members had previously implemented concrete measures to facilitate free movement of persons, such as reciprocal acceptance of identification papers other than passports and exemption of university graduates from the need for work permits. In addition, in March 1996 the countries had signed an agreement providing for mutual recognition of the social security rights of their citizens. It is planned that the common external tariff (CET) structure will assume its final form in 1998, a step that will involve a gradual reduction of tariffs on non-agricultural goods to a range between 5% and 20%. The third phase of CET implementation was scheduled for the first half of 1997. In July 1997, Haiti was accepted as the rifteenth member.

(v) Start of negotiations on the Free Trade Area of the Americas (FTAA)

Preparations to launch another round of FTAA talks intensified in 1997, a proposal given definite form at the second Summit of the Americas (Santiago, Chile, April 1998). In the four vice-ministerial meetings held in 1997 and the third Trade Ministerial Meeting in Belo Horizonte, Brazil, in May, the general principles that are to govern the talks were elaborated, stressing the following: (i) the outcome of the negotiations would constitute a single under- taking); (ii) FTAA could co-exist with already established integration agreements; (iii) countries could negotiate individually or as members of a group; (iv) special attention should be given to the needs of the smaller economies; and (v) negotiations should be concluded by the year 2005.

IV. LEVEL ACTIVITY

In 1997 the Latin American economies, supported by dynamic growth in exports and strong investment, turned in one of the best performances in recent decades. The region averaged GDP growth of 5.3%, more than one and a half percentage points above the average for the 1990s to date. Per capita output increased on average by 3.6%. In the Caribbean, on the other hand, economic growth was modest and below the levels achieved during the previous three years (see tables IV. 1 and IV. 6).

Three external factors can be identified that influenced economic trends in the region in 1997 and its growth prospects in 1998. First, the crisis affecting a number of countries in East and South-East Asia since mid-1997 has had repercussions on the global and regional economies that continue to be felt in 1998. Second, the El Niño climatic phenomenon caused either severe drought or intense rains very damaging to agriculture and infrastructure. Third, there was a strong increase in foreign direct investment flows to the region; this factor, unlike the first two, had a positive effect on level of activity.

The region began to feel the impact of the Asian crisis in October 1997 (see figure IV. 1). At first the effects were largely financial and were particularly adverse in Brazil, Colombia and, briefly, Argentina. Then, towards the end of the year, the crisis began to spill over into the region via the less direct channel of trade and will continue to do so in coming quarters. Its impact on trade has been manifested more in falling prices for certain primary commodities than in reduced export volumes.

Many of the countries of the region suffered and are still suffering from the effects of the El Niño climatic phenomenon. By altering ocean temperatures and rainfall systems it brought drought to some areas and excessive rainfall and flooding.to others, reducing not only fish catches and agricultural output, but also hydroelectric power generation (especially in Central America), and causing forest fires and widespread destruction of infrastructure and housing.

The third external factor mentioned above was a significant increase in foreign direct investment (FDI) flowing into the region, as shown in figure IV.2. The upward trend in FDI in recent years has also implied a shift in the composition of flows towards longer-term capital. While this shift has cut down on the volatility in the capital account, it will mean an increase in factor payments to the rest of the world in the future.

The effects of the three external factors mentioned and their domestic repercussions have persisted into 1998, although their impact on the growth rates of the countries of the region has been uneven. Extrapolating from the trends observed during the first half of 1998, one can anticipate that GDP growth will drop off sharply from 5.3% in 1997 to 3% for the year as a whole. Among domestic demand factors, it seems likely that investment will be most affected. It is projected that foreign direct investment may remain at 1997 levels or even increase modestly, and this underlines the

1 Although a few Latin American countries, notably Brazil, jmbia and Paraguay, had relatively low growth rates.

2 See also the section that deals more specifically with the C bean subregion in Part Two of this survey.

Table IV. 1

LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT

(Annual growth rates)

	1991	1992	1993	1994	1995	1996	1997 [a]	1981-1990	1991-1997
Latin America and the Caribbean	3.9	3.1	4.1	5.5	0.5	3.5	5.3	1.1	3.7
Subtotal (19 countries)[b]	3.9	3.2	4.1	5.6	0.4	3.5	5.3	1.2	3.7
Argentina	10.0	9.5	5.7	7.5	-5.0	3.6	8.4	-0.7	5.6
Bolivia	5.3	1.6	4.3	4.7	4.6	4.1	4.2	0.2	4.1
Brazil	1.0	-0.5	4.9	5.8	4.2	2.8	3.0	1.6	3.0
Chile	8.0	11.4	6.6	5.6	10.1	7.3	6.9	3.0	8.0
Colombia	1.6	4.0	5.8	6.0	6.2	2.2	3.2	3.7	4.1
Costa Rica	2.1	7.3	6.0	4.3	2.2	-0.5	3.1	2.2	3.5
Cuba[c]	-10.7	-11.6	-14.9	0.7	2.5	7.8	2.5	3.8	-3.7
Ecuador	5.4	3.7	2.5	4.8	2.7	2.0	3.7	1.7	3.5
El Salvador	3.6	7.5	7.4	6.1	6.4	2.0	4.1	-0.4	5.3
Guatemala	3.7	4.9	4.0	4.1	5.0	3.0	4.0	0.9	4.1
Haiti	0.1	-13.8	-2.2	-8.3	5.0	2.8	1.3	-0.5	-2.4
Honduras	2.0	6.3	7.0	-1.7	4.7	3.4	4.4	2.4	3.7
Mexico	4.3	3.8	1.9	4.7	-6.6	5.3	7.3	1.9	2.9
Nicaragua	-0.4	0.8	-0.4	4.0	4.5	4.8	5.5	-1.5	2.7
Panama	9.0	8.1	5.2	2.9	1.9	2.4	4.3	1.4	4.8
Paraguay	2.4	1.6	4.1	2.9	4.5	1.0	2.6	3.0	2.7
Peru	2.8	-0.9	5.8	13.9	7.7	2.4	7.7	-1.2	5.5
Dominican Republic	0.8	6.7	2.2	4.2	4.8	7.0	7.4	2.4	4.7
Uruguay	3.2	7.8	3.3	6.4	-2.1	5.3	5.1	0.0	4.1
Venezuela	9.7	6.1	0.7	-2.2	3.9	-0.1	5.6	-0.7	3.3
Subtotal Caribbean	1.8	0.5	0.3	2.4	2.8	2.7	1.9	0.1	1.8
Antigua and Barbuda	4.3	0.9	3.3	4.8	-4.2	5.4	4.8	6.1	2.4
Barbados	-3.5	-5.6	0.9	3.4	2.6	4.9	3.0	1.1	0.7
Belize	3.1	9.5	4.3	1.5	3.8	3.5	4.5	4.5	4.3
Dominica	2.2	2.7	1.9	2.1	1.8	3.7	1.9	4.4	2.4
Grenada	3.6	1.1	-1.3	2.3	2.3	3.1	4.6	4.9	1.8
Guyana	7.9	11.2	2.8	14.8	4.6	8.3	5.6	-2.9	7.8
Jamaica	0.7	1.7	1.6	1.1	0.7	-1.4	-2.3	2.2	0.3
Saint Kitts and Nevis	3.8	3.6	4.0	3.2	2.0	5.6		5.8	3.7[e]
Saint Vicent and the Grenadines	3.1	6.5	1.3	0.4	3.0	1.0	2.3	6.5	2.5
Saint Lucia	2.3	7.1	2.3	2.8	4.1	0.8	0.7	6.8	2.9
Suriname	3.5	4.0	-2.2	-7.0	5.0	3.0		0.5	1.0[e]
Trinidad and Tobago	3.3	-1.4	-1.3	4.1	4.2	4.4	3.9	-2.6	2.4

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.

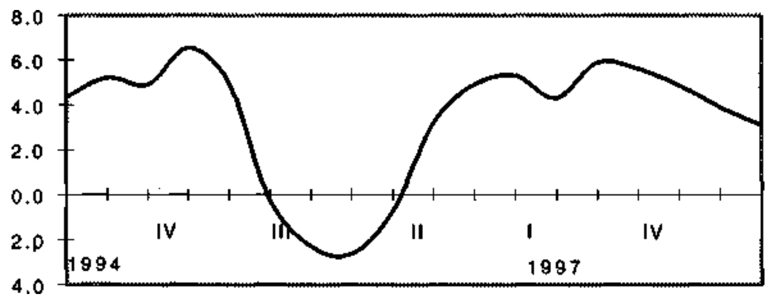
[a] Preliminary figures. Does not include Cuba [c] Calculated on the basis of the relevant local currency at constant prices.

[d] Based on figures at factor cost. [e] 1991-1996.

importance of the long-term component of the capital account. A major slowing in the growth of imports is expected, whereas the growth of exports may well remain at a level comparable to that of the last few years.

So far in 1998, slower growth has been most evident in Brazil, owing to its adjustment policies, and also in Chile, Ecuador, Mexico and Venezuela, where the effects of the slowdown have been exacerbated by a drop in prices of export products, notably petroleum and copper. In Peru, the loss of dynamism has been due in part to the lingering effects of El Niño.

Figure **IV.** 1
LATIN AMERICA: QARTERLY GROWTH IN GDP



Source: ECLAC, on the basis of ofiicial figures.

1. Supply and demand

In 1997 the performance of the Latin American and Caribbean economies was characterized by highly dynamic growth in the various components of supply and demand. Aggregate supply grew at the highest rate so far in the 1990s, thanks to an extraordinary expansion in imports (19%) and average GDP growth of over 5%. The result was that aggregate supply expanded one and a half times as fast as GDP (see table IV.2).

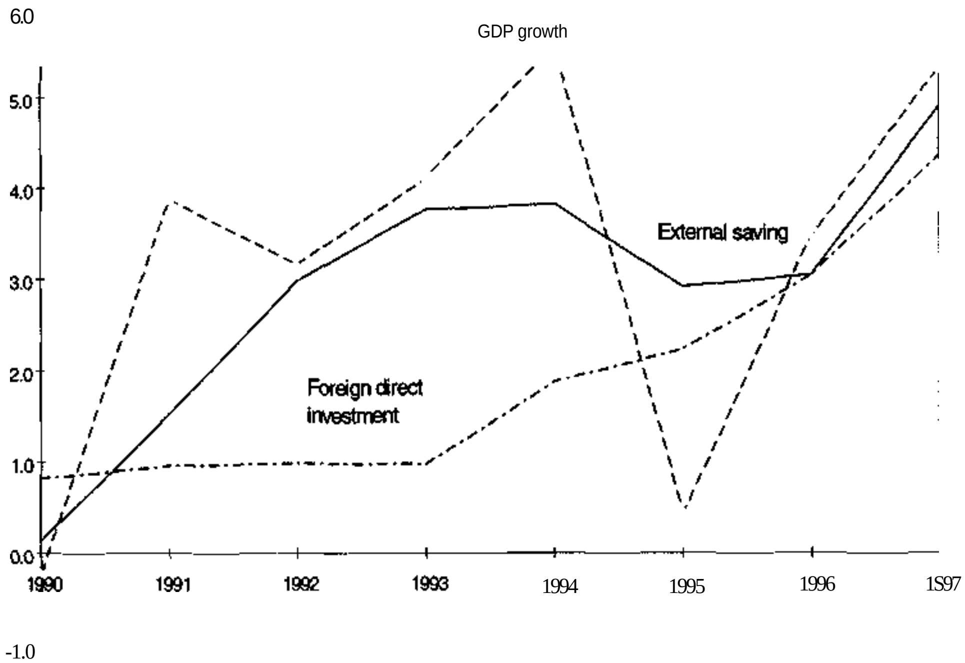
A number of factors contributed to stronger economic growth in the region in 1997. The first was a vigorous expansion of investment. As figure IV.3 shows, investment had dropped off sharply during the economic crisis of 1995, which hit Mexico and Argentina particularly hard. Within investment, the component of imported capital goods assumed growing importance in 1997, permitting the incorporation of technical progress into the region's stock of productive capital. At the same time, a decline in public-sector investment was observable. Second, external demand contributed strongly to the quickening of economic activity. The export sector performed very well in terms of volume, which increased by 11%. Third, growth in consumption closely tracked that of gross domestic product. Government consumption maintained a steady rate of growth and was much less affected by the economic cycle than were other variables.

The expansion of aggregate demand was due to the strong recovery of investment and continued growth in exports, the latter owing largely to increased volumes, since average prices for the region's exports declined slightly. Consumption expanded in tandem with GDP, although the stronger growth was in private rather than public consumption, which grew by less than 2%.

Regional imports expanded in volume by nearly 20%, thanks in part to a widespread tendency towards appreciation of local currencies. The four big Latin American economies -Argentina, Brazil, Mexico and Venezuela- recorded the highest rates of increase in import volume, on the order of 20%. In the other countries, the figure was in the 10% to 20% range. Only Haiti, Honduras and Paraguay had very low or negative rates.

Among the more dynamic components of imports were capital goods. Argentine imports of capital goods, largely for the industrial sector, grew by 37%. In Brazil, the strong expansion of capital goods imports was a result of both the rising activity level and consolidation of the trade liberalization process. The highest rates of growth in capital goods imports were recorded in Mexico and Venezuela. In most of the other countries, such imports also expanded significantly in response to the upturn in

Figure IV.2
LATIN AMERICA: EXTERNAL SAVINGS, FOREIGN DIRECT INVESTMENT AND GDP GROWTH
(Percentage of GDP and growth rates)



Source: ECLAC, on the basis of ofiicial figures.

production. Given the limitations of their industrial structures, the countries still found it necessary to buy capital goods abroad to increase capital formation (see chapter VIII). On the other hand, the incorporation of technological progress inherent in these imports should enable the countries to expand their production frontier and improve productivity.

In a closely related trend, treated in greater detail in chapter VI, investment proved to be the most dynamic component of domestic demand. Regional growth in investment reached its highest level in the 1990s and was especially strong in Argentina (27%), Costa Rica (23%) and the Dominican Republic (over 20%). Greater external demand helped considerably to raise the level of activity: the growth of exports more than doubled that of GDP.

The trend in domestic consumption tracked that of output, as a result of a strong expansion in private expenditure (6.5%) and a very modest increase in public consumption (2%). Per capita consumption increased by 3% in 1997 as a regional average, and by over 4% in Argentina, Chile, Colombia, Mexico, Panama and Uruguay. The rate was lower, however, in Costa Rica, Ecuador, Haiti, Honduras and Paraguay. In general, per capita consumption levels in the region were only 10% above those recorded early in the 1980s. The highest values compared to 1980 were achieved in Colombia (138%), Chile (137%), Uruguay (130%), Paraguay (130%) and Panama (127%). However, in seven countries (Bolivia, Ecuador, Haiti, Honduras, Nicaragua, Peru and Venezuela) per capita consumption was actually lower than in 1980.

Even so, regional per capita output increased by 3.7%; despite a population growth rate that was still relatively high (1.6%), most of the countries showed progress in this regard. Argentina, Peru, Dominican Republic, Mexico and Chile achieved relatively high rates in 1997. Exceptions to the general trend were Haiti and Paraguay, which recorded negative rates. This

Table IV.2

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES): GROSS DOMESTIC PRODUCT BY TYPE OF EXPENDITURE [a]

(Annual growth rates)

Item	1990	1991	1992	1993	1994	1995	1996	1997[b]	1981-1990	1991-1997
1. Total supply (2 + 3)	1.1	5.5	5.3	5.2	7.0	1.4	4.8	7.9	1.0	5.3
2. Gross domestic product at market prices	-0.2	3.9	3.2	4.1	5.6	0.4	3.5	5.3	1.2	3.7
3. Imports of goods and services	12.1	18.2	19.8	11.7	14.7	6.0	11.0	18.9	0.0	14.2
4. Exports of goods and services	6.3	4.6	6.6	9.8	8.3	13.3	10.5	10.9	5.3	9.1
5. Domestic availability of goods and services (2 + 3 - 4) = domestic demand (6 + 7)	0.3	5.7	5.1	4.5	6.8	-0.6	3.7	7.2	0.5	4.6
6. Final consumption expenditure	1.5	5.8	4.5	3.9	5.4	0.4	3.4	5.4	1.3	4.1
7. Gross fixed investment[c]	-4.7	5.3	7.9	7.0	12.4	-4.7	4.8	14.6	-2.4	6.6
8. Factor payments	-14.5	-5.5	-2.2	15.2	2.9	6.6	5.9	12.0	4.4	4.7
9. Real gross national income (2 - 8)[d]	-0.7	3.6	3.0	4.4	5.5	0.6	3.6	5.5	1.2	3.7

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] 19 countries. Preliminary figures. [c] Includes change in inventories in Haiti. Includes current transfers and terms-of-trade effect.

important indicator of well-being was on average only slightly higher in 1997 than in 1980, having finally surpassed that level only in 1996. In a few countries the level in 1997 was well above that at the start of the preceding decade: Chile (75%), Colombia (40%) and the Dominican Republic and Uruguay (slightly over 20%). On the other hand, it remained well below the 1980 value in Haiti (-42%), Nicaragua (-39%) and Venezuela (-23%). In the other countries, levels of per capita output were similar to those at the beginning of the 1980s.

Generally speaking, gross national income in the region increased in step with output, although a few countries recorded wide discrepancies. In Nicaragua, Dominican Republic, Chile and Colombia, national income grew far more than output. In Nicaragua, this was attributable to a significant decline in factor payments abroad and a simultaneous increase in current transfers. In the other countries mentioned, the terms of trade improved. In Venezuela, Ecuador and Costa Rica, on the other hand, national income grew more slowly than output, and in all three of these countries the terms of trade deteriorated. In Venezuela current transfers also became negative.

2. Output growth

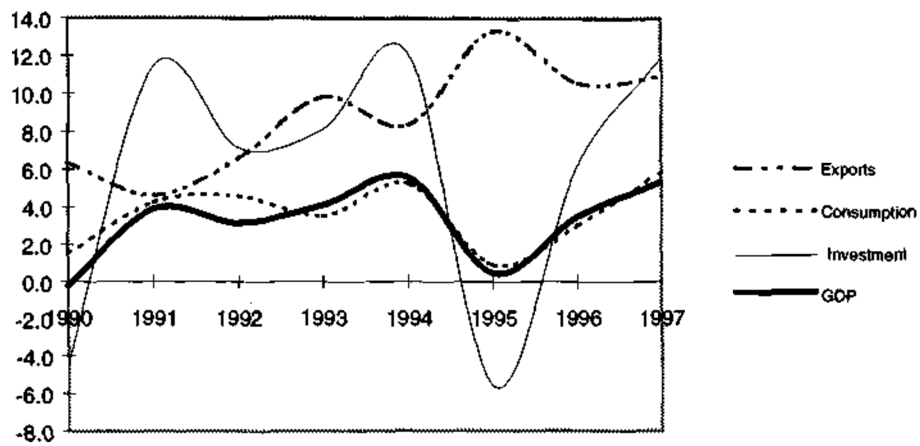
In the following analysis, output trends in the countries of the region, grouped according to growth rate, are examined in the light of the three basic sets of factors that influence the dynamism

3 Only 1% in the Caribbean subregion.

Figure IV. 3

LATIN AMERICA AND THE CARIBBEAN: EXPORTS, CONSUMPTION, INVESTMENT AND GDP, 1990-1997

(Growth rates)



Source: ECLAC, on the basis of ofiicial figures.

of economic activity: consumption, investment and the external sector (see table IV.3).

In the five countries that recorded growth of over 6% (Argentina, Peru, Dominican Republic, Mexico and Chile), there were also strong increases in each of the three above-mentioned areas. In the case of Mexico, while fixed investment was relatively low, total investment expanded by 23%.

In the intermediate group with growth rates close to the regional average (between 4% and 6%), domestic demand factors showed less dynamism than in the first group. Consumption followed closely the average rate of output growth, while investment increased on average by only 9%, compared to the figure of 17% for the top group. Under external sector variables, both imports and exports tended to expand less. The median current account deficit (the simple average is heavily skewed by Nicaragua) was smaller than that of the third group.

In the countries with output growth of less than 4% (Brazil, Colombia, Costa Rica, Ecuador, Haiti and Paraguay) the external variables showed less dynamism (except in the case of Brazil). What is striking is that, despite the poor economic performance of this group, the external deficits were quite high (in some cases exceeding 5% of GDP), since imports outstripped exports.

In the countries of the Caribbean, a disappointing economic performance was due in large part to El Niño weather patterns, which hurt agriculture in general and depressed activity in Barbados, Jamaica and the members of the Organization of Eastern Caribbean States (OECS)[4] in particular. In 9 of the 13 Caribbean countries studied, the output growth rate was lower than in 1996, and the subregional average was only 1.9%, compared with 2.6% for the three preceding years.

4 OECS members are Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines.

5 See also the last section of Part Two of this survey.

Table IV.3

LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH AND GROWTH OF CONSUMPTION, INVESTMENT AND THE EXTERNAL SECTOR

	GDP	Consumption	Investment	Exports"	Imports"	Current account balance
	(Growth rate)					(As a percentage of GDP)
GDP growth >6%						
Argentina	8.4	6.3	27.4	7.7	28.2	3.1
Peru	7.7	4.1	17.4	14.0	12.6	5.2
Dominican Republic	7.4	5.4	24.6	15.2	17.5	1.5
Mexico	7.3	7.7	2.9	13.0	22.0	1.8
Chile	6.9	7.2	13.2	9.9	14.8	5.3
Simple average	7.5	6.1	17.1	12.0	19.0	3.4
Median	7.3	7.2	13.2	13.0	17.5	1.8
4% < GDP growth < 6%						
Venezuela	5.6	4.0	19.0	12.8	22.3	-6.9
Nicaragua	5.5	9.0	8.4	4.0	13.0	35.1
Uruguay	5.1	5.3	8.3	12.4	13.7	1.6
Honduras	4.4	1.6	8.3	1.0	-1.9	2.1
Panama	4.3	9.0	8.8	8.8	14.7	4.0
Bolivia	4.2	5.7	11.7	-0.5	10.3	8.5
El Salvador	4.1	1.8	3.0	25.2	10.6	-0.8
Guatemala	4.0	3.9	5.4	12.0	10.3	2.6
Simple average	4.7	5.0	9.1	9.5	11.6	5.8
Median	4.4	4.7	8.4	10.4	11.8	2.4
GDP growth < 4%						
Ecuador	3.7	5.5	4.0	3.5	8.8	4.0
Colombia	3.2	6.3	3.2	8.9	13.7	6.0
Costa Rica	3.1	6.7	14.0	8.6	15.4	4.4
Brazil	3.0	3.9	7.7	10.5	18.4	4.3
Paraguay	2.6	2.2	3.0	-5.1	0.1	6.8
Haiti	1.3	1.5	-1.5	7.7	2.7	2.8
Simple average	2.8	4.4	5.1	5.7	9.9	4.7
Median	3.1	4.7	3.6	8.2	11.3	4.4

Source: ECLAC, on the basis of official figures.
Volume. Based on dollars at current prices.

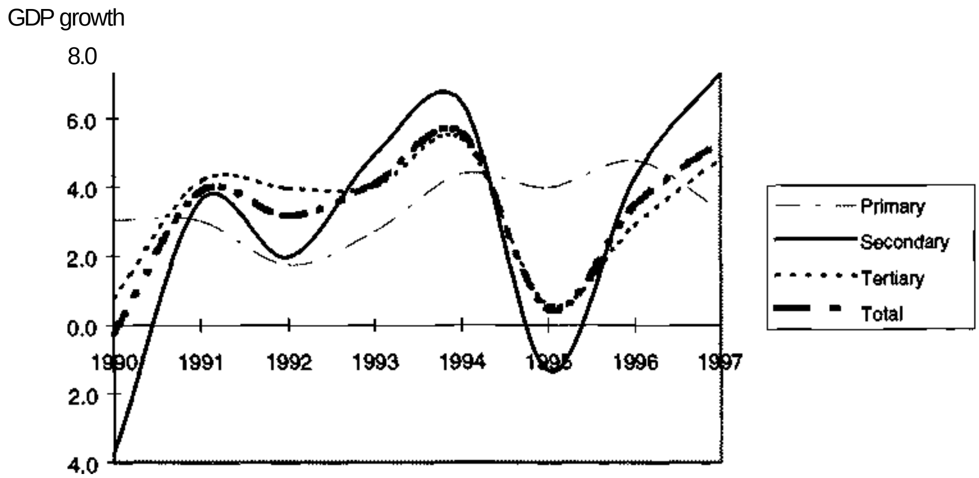
3. Production sectors

The performance of the region's production sectors was very uneven in 1997. Construction, manufacturing and basic services grew vigorously. Mining continued to grow, although at a somewhat more moderate pace than in 1996. Agriculture and other services were the categories with the slowest growth in 1997.

Since the early 1980s, the primary sector has maintained roughly the same share of output, showing a slight increase attributable to mining. The secondary and tertiary sectors have

6 Sometimes divided into primary (agriculture and mining), secondary (manufacturing and construction) and tertiary (other activities).

Figure IV.4
LATIN AMERICA: GROWTH OF PRODUCTION SECTORS



Source: ECLAC, on the basis of ofiicial figures.

experienced divergent trends: rising in the case of services and construction and falling in the case of manufacturing. Over the same period, however, there have been major changes in sectoral productivity, reflecting important structural transformations in production sectors over the last few decades. The restructuring has been brought about by policies aimed at external opening of the region's economies, market deregulation and privatization (see table IV.4).

In 1997, labour productivity followed the paths marked out earlier. Back in the 1970s, productivity rose in all sectors, but the situation changed in the 1980s, when there were productivity gains in the primary sector (largely in mining) but losses in the secondary and tertiary sectors. Labour productivity in the primary sector has picked up in the 1990s, and industrial productivity has also shown significant gains; however, there has been a loss of productivity in the service sector.

(a) Agriculture

Agriculture suffered a slowing of growth in 1997 from 3.3% to 1.5%, largely as a result of adverse weather patterns caused by the El Niño phenomenon. Agriculture turned in the poorest sectoral performance, in comparison both to the figures for the other sectors and to its own figure for the previous year.

The reduction in quantity prevented producers from taking full advantage of higher prices for some products (coffee, for example) in 1997. By the end of the year, prices of a number of agricultural products were on the decline. On the other hand, the agro-industrial complex developing in Bolivia, Argentina, Paraguay and Brazil continued to expand strongly during the year, with significant increases in acreage under cultivation in various crops (such as soybeans).

(b) Mining

Although the rate of growth of mining activity slowed somewhat, it remained up around the high levels of previous years. The sector continues to be one of the most important recipients of foreign direct investment. In 1997 mining received a boost from the process of energy integration occurring in Latin America, aimed at supplying gas to southern Brazil, particularly São Paulo.

Table IV.4

LATIN AMERICA: LABOUR PRODUCTIVITY BY SECTOR, 1970-1997

(Annual growth rate)

	1970-1980	1980-1990	1990-1994	1994-1997
Primary sector	1.8	2.4	3.2	5.6
Secondary sector	1.1	-0.6	3.6	4.0
Tertiary sector	1.5	-3.1	0.1	-1.7
Total	2.2	-1.3	2.0	0.8

Source: ECLAC, on the basis of official figures.

Table IV.5

LATIN AMERICA: GROSS DOMESTIC PRODUCT AT MARKET PRICES

(Annual growth rates)

	Agriculture		Mining and quarrying		Manufac-turing		Construction		Subtotal: goods		Basic services		Other services	
	1996	1997	1996	1997	1996	1997	1996	1997	1996	1997	1996	1997	1996	1997
Latin America and the Caribbean	3.3	**1.5**	**7.9**	6.9	4.3	6.3	4.1	**11.5**	4.4	6.1	6.1	6.4	**1.7**	**4.0**
Argentina	1.6	2.6	8.1	7.7	5.2	9.1	1.1	23.7	4.3	9.9	5.5	6.5	4.3	6.7
Bolivia	3.6	4.9	-1.0	-0.3	3.9	4.2	10.3	7.5	3.2	3.7	8.8	6.9	3.9	4.6
Brazil	4.1	1.2	8.3	7.3	2.7	4.1	5.2	8.5	3.6	4.4	6.0	4.0	-0.2	0.8
Chile	3.9	-0.2	13.0	8.1	3.5	4.4	9.0	6.8	6.9	5.0	7.6	11.9	6.8	6.5
Colombia	0.2	-0.7	7.7	4.4	-2.7	2.6	-0.5	-0.1	0.4	1.6	4.2	5.0	4.4	3.6
Costa Rica	-0.4	-0.7	[a]	[a]	-4.1	4.5	-9.7	16.3	-3.0	3.1	2.5	3.8	0.8	2.9
Ecuador	3.5	4.1	-0.5	1.8	2.7	6.1	2.5	2.8	1.7	3.8	3.1	3.9	3.6	2.7
El Salvador	2.0	-0.3	4.0	4.9	1.6	8.2	2.4	6.0	1.8	5.0	1.3	3.7	2.4	**4.0**
Guatemala	2.6	2.8	24.1	26.5	1.9	2.6	0.8	5.5	2.6	3.4	4.0	7.5	3.1	3.6
Haiti	-0.3	-2.5	8.8	11.3	3.0	0.8	17.2	11.5	3.8	1.3	5.3	-0.2	1.0	0.5
Honduras	2.5	3.2	7.3	4.9	4.6	6.1	-4.2	-7.4	2.6	3.1	8.1	4.9	3.3	5.5
Mexico	3.6	1.4	8.1	4.3	10.9	9.8	9.8	10.2	8.9	7.6	7.6	9.0	2.4	6.8
Nicaragua	6.6	8.5	30.9	23.1	2.4	3.1	16.5	9.0	6.3	7.2	4.9	5.4	2.9	3.1
Panama	0.7	-1.2	-5.8	17.3	0.7	3.6	-4.1	5.0	-0.2	2.1	6.0	4.3	2.8	4.8
Paraguay	1.3	4.1	1.5	2.0	-2.2	1.0	3.0	3.0	0.3	3.0	4.3	2.2	1.1	2.2
Peru	4.9	3.8	2.3	5.0	2.4	6.0	-4.5	18.9	1.1	8.5	6.1	7.8	4.2	7.7
Dominican Republic	9.5	3.4	2.4	3.1	4.1	7.9	13.0	17.1	8.0	7.8	10.8	12.0	5.5	6.2
Uruguay	8.5	-1.2	7.6	2.9	4.0	5.8	4.2	2.9	5.5	3.2	5.2	5.0	4.3	5.1
Venezuela	1.9	2.7	8.1	8.9	-2.6	4.1	1.9	12.6	3.2	7.0	1.2	6.0	-5.4	2.1

Source: ECLAC, on ithe basis of official figures converted into dollars at constant 1990 prices.

Included under manufacturing.

Table IV.6

LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GROSS DOMESTIC PRODUCT

(Annual growth rates)

	1991	1992	1993	1994	1995	1996	1997 [a]	1981-1990	1991 - 1997
Latin America and the Caribbean [b]	2.0	1.3	2.3	3.8	*-12*	1.8	3.6	-0.9	**1.9**
Subtotal (19 countries) [b]	2.0	1.3	2.3	3.8	*-12*	1.8	3.7	-0.9	**1.9**
Argentina	8.5	8.1	4.3	6.1	-6.2	2.3	7.0	-2.1	4.2
Bolivia	2.8	-0.8	1.8	2.2	2.2	1.7	1.8	-1.9	1.6
Brazil	-0.5	-2.0	3.4	4.4	2.8	1.4	1.7	-0.4	1.6
Chile	6.2	9.6	4.8	3.9	8.4	5.8	5.4	1.4	6.3
Colombia	-0.4	2.0	3.8	4.1	4.3	0.4	1.4	1.6	2.2
Costa Rica	-0.4	4.7	3.5	1.9	-0.1	-2.7	0.9	-0.6	1.1
Cuba [c]	-11.4	-12.2	-15.4	0.1	2.0	7.3	2.0	2.8	-4.3
Ecuador	3.0	1.4	0.3	2.5	0.5	0.0	1.7	-0.9	1.3
El Salvador	1.4	5.0	4.7	3.5	3.9	-0.2	1.7	-1.4	2.8
Guatemala	1.1	2.2	1.3	1.4	2.2	0.3	1.3	-1.6	1.4
Haiti	-1.9	-15.6	-4.2	-10.1	2.9	0.7	-0.8	-2.4	-4.3
Honduras	-1.0	3.2	3.9	-4.5	1.8	0.5	1.5	-0.8	0.7
Mexico	2.3	1.8	0.0	2.9	-8.2	3.5	5.5	-0.2	1.0
Nicaragua	-3.0	-2.1	-3.3	1.0	1.6	2.1	2.7	-3.9	-0.2
Panama	6.9	6.1	3.2	1.0	0.2	0.7	2.6	-0.7	2.9
Paraguay	-0.5	-1.1	1.3	0.2	1.8	-1.6	-0.1	0.0	0.0
Peru	0.9	-2.6	4.0	12.0	5.9	0.7	5.8	-3.3	3.7
Dominican Republic	-1.2	4.6	0.3	2.3	2.9	5.2	5.6	0.2	2.8
Uruguay	2.6	7.2	2.7	5.8	-2.7	4.7	4.5	-0.6	3.5
Venezuela	7.1	3.6	-1.6	-4.3	1.7	-2.2	3.4	-3.2	1.0
Subtotal Caribbean	1.0	-0.3	-0.6	1.5	1.9	1.8	1.0	-0.9	**0.8**
Antigua and Barbuda	3.6	0.3	2.7	4.1	-4.8	5.4	3.2	5.6	1.8
Barbados	-3.9	-6.0	0.5	3.0	2.2	4.4	2.6	0.7	0.3
Belize	0.5	6.7	1.7	-1.1	1.1	0.8	1.7	1.9	1.6
Dominica	2.2	2.7	1.9	2.1	1.8	3.7	1.9	4.8	2.4
Grenada	3.4	0.9	-1.5	2.1	2.1	2.7	4.2	4.7	1.6
Guyana	7.2	10.2	1.7	13.7	3.4	7.2	4.4	-3.4	6.7
Jamaica	0.0	1.0	0.9	0.4	0.1	-2.1	-3.0	1.1	-0.4
Saint Kitts and Nevis	4.3	4.1	4.5	3.7	2.5	5.6		7.0	4.1 [e]
Saint Vicent and the Grenadines	2.2	5.6	0.4	-0.5	2.1	0.1	1.4	5.5	1.6
Saint Lucia	1.0	5.7	0.9	1.5	2.7	-0.5	-0.7	5.3	1.5
Suriname	2.3	2.8	-3.3	-8.0	3.8	1.9		-0.7	-0.2 [e]
Trinidad and Tobago	2.1	-2.5	-2.3	3.0	3.1	3.2	2.7	-3.9	1.3

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] Preliminary figures. Does not include Cuba. [c] Calculated on the basis of the relevant local currency at constant prices
Based on figures at factor cost. [e] 1991-1996.

(c) Manufacturing

The sector, as noted earlier, has undergone major changes in recent years as a result of government programmes to open up the external sector, privatize State-owned enterprises and deregulate markets. In 1997 manufacturing achieved growth of over 6%, one of the highest rates recorded in the 1990s. Investment played a considerable role in this result. Not a single country showed a decrease in industrial output, and in general the trends were quite even across the region.

In several countries, high levels of manufacturing activity went hand in hand with a similar dynamism in the construction industry.

Among the higher rates of growth in manufacturing were those recorded in Mexico (9.8%), Argentina (9.1%), El Salvador (8.2%) and the Dominican Republic (7.9%). Another factor that explained the strong performance of manufacturing was the increase in investment. Moreover, the *maquila* industry showed strong growth in Mexico and some of the Central American countries.

(d) Construction

Construction was the more dynamic component of the secondary sector, thanks to generally strong economic growth and the surge of investment in construction, due in some countries (Brazil, for example) to the execution of infrastructure projects associated with privatization and concession programmes. Construction output expanded by 24% in Argentina and by over 10% in Costa Rica, Haiti, Mexico, Peru, Dominican Republic and Venezuela.

(e) Services

The tertiary sector as a whole expanded in step with GDP. Basic services showed the same strength as in 1996, chalking up very high growth rates in Chile, Mexico and the Dominican Republic. Other services more than doubled their performance of the previous year; in most of the countries the figures were close to the regional average (4%).

V. INFLATION

The inflation rate for Latin America and the Caribbean as a whole in 1997 continued the downward trend begun in 1994. The rate of price increase, 888% in 1993, had been reduced to 18.5% by 1996, and in 1997 dropped further to only 10.4%, the lowest level in nearly 50years. In the first half of 1998 inflation crept up slightly, but this by no means reversed the gains the region has made, which are all the more impressive in that they have coincided with a phase of regional output growth (5.3% in 1997). The inflationary pressures generated by the strong expansion of domestic demand were neutralized by the existence of idle capacity and the substantial increase in external supply. Moreover, an increase in the labour force dampened the potential for wage hikes resulting from a greater demand for labour.

In addition to the reduction in the overall rate of inflation, it is noteworthy that in the last three years none of the countries have suffered three-digit inflation except for Venezuela, which in 1996 saw prices of consumer goods rise by a little over 100%. These results are in sharp contrast to the figures for the 1980s and early 1990s, when three-digit inflation rates were common and persistent. Moreover, low inflation was a widespread phenomenon in 1997. In most of the countries the pace of price increase slowed or remained at the low levels achieved in previous years. Inflation accelerated only in Barbados, Ecuador and the Dominican Republic, but in two of these economies it still remained under 10%. Even Venezuela brought down its inflation rate dramatically in 1997 to 38% from 103% in 1996. All in all, the year was marked by low rates of price increase: of the 22 countries studied, 14 achieved single-digit inflation, and another 6 had rates of between 10% and 20%. Only Ecuador and Venezuela recorded higher rates of between 30% and 40%.

In the first half of 1998 a few countries suffered a slight setback, among them Nicaragua, where prices in the 12 months ending June 1998 rose by 14%, double the rate in 1997, and Paraguay, which experienced inflation of nearly 12%, five percentage points higher than the previous year's rate. Inflation should also rise slightly in Colombia but is expected to remain below 20% for the year as a whole. Uruguay and the Dominican Republic, on the other hand, have seen a major drop in inflation, and Chile a somewhat smaller one. Other countries have done no more than hold their ground in terms of price stabilization. In some cases, the explanation of an acceleration in price increases is to be found in the climatic effects of the El Niño phenomenon, which have significantly raised the cost of some staple foods in a number of countries by causing major losses in agricultural production. There have also been isolated causes, such as increases in government-controlled utility rates. Another factor has been the depreciation of a number of currencies in the region.

The progress made in recent years in controlling inflation has been remarkable, as detailed in the previous issue of the *Economic Survey of Latin America and the Caribbean* in the

Table V.l

LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES

(December-to-December percentage variation)

Country	1991	1992	1993	1994	1995	1996	1997	1998[a]
Latin America	**199.7**	**417.2**	**882.4**	**335.1**	**25.9**	**18.5**	**10.4**	**10.9**
Argentina	84.0	17.6	7.4	3.9	1.6	0.1	0.3	1.2
Barbados	8.1	3.4	-1.0	0.5	3.4	1.8	3.6	
Bolivia	14.5	10.5	9.3	8.5	12.6	7.9	6.7	7.9
Brazil	475.1	1 149.1	2 489.1	929.3	22.0	9.1	4.3	4.6
Chile	18.7	12.7	12.2	8.9	8.2	6.6	6.0	5.4
Colombia	26.8	25.1	22.6	22.6	19.5	21.6	.17.7	20.7
Costa Rica	25.3	17.0	9.0	19.9	22.6	13.9	11.2	10.8
Ecuador	49.0	60.2	31.0	25.4	22.8	25.6	30.6	35.9
El Salvador	9.8	19.9	12.1	8.9	11.4	7.4	1.9	3.2
Guatemala	10.2	14.2	11.6	11.6	8.6	10.9	7.1	7.4
Haiti	6.6	16.1	44.4	32.2	24.8	14.6	15.6	
Honduras	21.4	6.5	13.0	28.9	26.8	25.3	12.7	14.2
Jamaica	80.2	40.2	30.1	26.9	25.5	15.8	9.2	
Mexico	18.8	11.9	8.0	7.1	52.1	27.7	15.7	15.3
Nicaragua	865.6	3.5	19.5	14.4	11.1	12.1	7.3	14.1
Panama	1.6	1.6	1.0	1.3	0.8	2.3	-0.5	0.3
Paraguay	11.8	17.8	20.4	18.3	10.5	8.2	6.2	11.6
Peru	139.2	56.7	39.5	15.4	10.2	11.8	6.5	7.7
Dominican Republic	7.9	5.2	2.8	14.3	9.2	4.0	8.4	4.5
Trinidad and Tobago	2.3	8.5	13.4	5.5	3.8	4.3	3.5	3.7[b]
Uruguay	81.3	59.0	52.9	44.1	35.4	24.3	15.2	10.2
Venezuela	31.0	31.9	45.9	70.8	56.6	103.2	37.6	39.1

Source: ECLAC, on the basis of information from official national services.
[a] Variation June 1997 to June 1998. [b] Variation March 1997 to March 1998.

chapter devoted to analysis of inflation trends over the past 50 years. Throughout much of the half-century the region suffered from serious inflation, which constituted one of the most pressing concerns of Governments and the community as a whole. But it was in the 1980s that the most violent outbreaks of inflation occurred, in the wake of the debt crisis, and few economies escaped. In five countries (Argentina, Bolivia, Brazil, Nicaragua and Peru) annual inflation rates rose above 1,000%, not once but repeatedly, on occasion reaching the point of classical hyperinflation. A number of other countries also experienced high inflation, without reaching the extremes seen in the five mentioned above. Countries with low inflation rates were rare. Only Barbados, Panama and the small Caribbean States displayed consistent price stability.

For some years now, however, stabilization policies have begun to show promising results, and this has been one of the most striking aspects of the performance of the majority of the Latin American and Caribbean economies. The marked slowdown in the pace of inflation in the 1990s is primarily due to a change in the thrust of economic policy, which has made inflation-fighting a top priority and directed much effort to overcoming macroeconomic imbalances. In their determination to achieve stabilization, Governments have given out unequivocal signals, which have positively influenced the expectations of economic agents. This effect has been facilitated by a favourable international

1 See ECLAC, *Economic Survey of Latin America and the Caribbean,* 1996-1997 (LC/G. 1968-P), Santi ago, Chile, 1997, United Nations publication, Sales No. S.97.II.G.2.

economic situation characterized by clear price stability in the developed countries, a strong expansion of trade and readily available financial resources for investment in emerging economies. An abundant influx of capital has made it possible to keep exchange rates relatively stable in nominal terms, so that exchange rates have fallen in real terms. As this phenomenon has been widespread, the rate of exchange has acted as a nominal anchor and has been the chief factor in the decline in inflation. At the same time, Governments have undertaken thorough-going structural reforms, which have had the effect, among other things, of reducing large fiscal deficits and improving the competitiveness of the region's economies.

Despite the gains made by stabilization programmes, lately inflation has been showing some resistance to further reduction. In a number of economies, inflation rates, after dropping sharply, have hovered at levels higher than those of the developed countries, although in general fairly low compared with traditional patterns in the region. This phenomenon may be related to the continued use of indexation mechanisms but could also be due to a mild shift in the direction of economic policy. The rigour of austerity policies has been eased as the more extreme instances of inflation have disappeared. In some countries fiscal and monetary policies have become less restrictive, while in some others devaluation of the local currency persists.

The most striking examples of successful inflation control in recent years are to be found in the five countries which suffered most from runaway inflation in the 1980s and early 1990s. In 1997, all five recorded single-digit price increases, the most notable achievement being that of Argentina, where inflation was near zero for the second straight year. In 1998, there has been a very slight rise (1%) attributable to public-sector rate hikes. Brazil has also achieved considerable success in moderating price increases in recent years: its inflation rate for 1997 was only 4%, whereas during the 12-month period ending June 1994 it had reached levels of around 5,000%. In 1998, the variation has continued to be very low, although a little higher than during the previous year. Inflation's resistance to disappearance is attributable in part to the slippage of the exchange rate (0.6% per month), which should continue as long as the wide gap in the external accounts persists.

Three other countries that had experienced runaway inflation (Bolivia, Nicaragua and Peru) also achieved major reductions in inflation rates from very high levels, but after the initial drop the descent slowed considerably. In 1997 inflation declined in these economies, but in 1998 the rate has moved upward again. The reversal has been due in part to inability to stabilize the exchange rate, because doing so might hurt the economy's competitiveness, and in part to imbalances in the external sector and, more recently, the problems caused by the El Niño phenomenon. In Bolivia, the stabilization process begun in 1985 and in effect for over 12 years enabled the country to extricate itself quickly from a state of virtual hyperinflation; in 1997 the country recorded its lowest inflation rate in 20 years. In Nicaragua, after a series of bad inflationary episodes between 1985 and 1991, the inflation rate dropped drastically and then stalled at around 10%. In Peru, price increases reached their most critical point in 1990, but under a draconian stabilization plan initiated in the second half of that year inflation began to decline rapidly. After stabilizing at a little over 10% annually for three years, the rate declined appreciably in 1997 thanks to a slower rise in the nominal exchange rate and the economy's ability to divert the pressure of domestic demand towards imports, thanks to an abundant inflow of external capital. In 1998, inflation has increased slightly.

There have also been major advances in Uruguay, a country which has had a long history of inflation without ever suffering an extreme espisode. In recent years it has achieved a gradual decline in its inflation rate, which was down to 15% in 1997 and may reach a single-digit figure in 1998, something the country has not seen since the mid-1950s. Mexico has also made progress in recent years in controlling inflation. Since the end of the 1980s the trend has been downwards, with a blip in 1995 because of the sharp devaluation of the currency towards the end of the preceding year. Inflation resumed its slowing trend in 1996, when the rate of variation was

Table V.2

LATIN AMERICA AND THE CARIBBEAN: BREAKDOWN OF ANNUAL INFLATION BY LEVEL AND NUMBER OF COUNTRIES, 1980-1998

Inflation rate	1980	1985	W0	1995	1996	1997
Under 2%		1	1	2	2	3
2 - 4.9%	1	2	1	2	2	2
5 - 9.9%	1	2	1	3	6	9
10 - 19.9%	10	2	2	6	5	5
20 - 49.9%	7	8	10	7	6	3
50 - 99.9%	2	2	2	2		
100 - 199.9%	1	1	1		1	
200 - 999.9%		3				
1 000 - 9 999.9%		1	3			
10 000% and above				1		
Total number of countries	22	22	22	22	22	22

Source: ECLAC, on the basis of official figures.
"Refers to June 1997 - June 1998.

28%, a little more than half the figure for 1995; in 1997 it declined further to around 15%, and it appears to be stabilizing at that rate in 1998. Residual inflation may persist until the rate of exchange can be stabilized; the exchange rate continues to float, with occasional intervention by Banco de México. Jamaica has enjoyed relatively low inflation in the last two years, a relief from the high rates recorded in the early part of the decade. The reduced inflation has resulted from the adjustment measures applied beginning in 1996, including the adoption of a strict monetary policy, together with the gradual opening of domestic markets.

Eleven economies that had enjoyed moderate inflation in the past displayed some further progress in controlling inflation in 1997. Eight of these countries achieved single-digit inflation. In Panama the rate, typically, was close to zero. Barbados again recorded very low inflation, although a little higher than the year before; consumer prices rose significantly early in 1997 as a result of the imposition of a value added tax, but the situation returned to normal in October when the incidence of the tax was reduced. Another country with very low inflation was El Salvador, with arate (1.9%) only one third of that recorded a year earlier, thanks to a decline in the prices of food and gasoline and to the tight monetary policy applied by the Central Reserve Bank through operations to sterilize excess liquidity. In Chile inflation continued to descend gradually, a tendency that persisted through the first half of 1998, although lately the descent has been slower. In previous years, the real rate of exchange noticeably declined, and yet did not hasten the drop in inflation. The continued use of indexation, of course, makes it harder to eliminate inflation, but the strong economic growth in recent years has also played a role.

In Costa Rica, Guatemala, Paraguay and Trinidad and Tobago, inflation declined slightly in 1997. In Costa Rica the rate has fluctuated between 10% and 20% for a number of years; when the rate goes up, the authorities tighten monetary controls, then relax their grip on the macroeconomic variables, when the rate goes down. In the Dominican Republic and Guatemala, inflation rates have been low but fluctuating. A certain amount of price increase is allowed, but steps are taken to keep it from getting out of hand. The Dominican Republic experienced inflation of over 8% in 1997, in part because of adverse climatic conditions that reduced the supply of agricultural products and the introduction of a uniform exchange rate in 1996, which had a particularly strong impact on the domestic price of fuel. In Colombia, inflation has hovered around 20% for a number of years, and no quick way out of this situation is foreseen. In 1997 inflation dipped to under 18%, thanks to the drop in the real exchange rate in the first half.

Thereafter inflation rose to over 20% as a result of a rising rate of exchange and problems related to the El Niño weather patterns. By mid-1998, however, it was brought under control, giving reason to hope that it will not exceed 20% for the current year. Honduras registered important gains in inflation control in 1997: the rate was only half the previous year's figure, though still over 10%. Whereas in the previous decade the country experienced moderate inflation considerably lower than in most of the countries in the region, in the 1990s the rate has picked up significantly. The downward trend in 1997 has reversed in 1998 because of persistent macro-economic imbalances.

Another three countries (Ecuador, Haiti and Venezuela) performed less well in 1997. In Ecuador, inflation, at a little over 30%, was higher than the year before, reversing the moderate declining trend of previous years. The situation has deteriorated further in 1998 as a result of the catastrophic rains brought on by El Niño and the uncertainties generated by the political crisis the country has been undergoing in recent years. Venezuela began to experience rising inflation in 1993; severe macroeconomic imbalances combined with a banking crisis of vast proportions propelled the inflation rate into the three-digit range in 1996. The stabilization programme implemented in April of that year brought the rate down rapidly, but the trend came to a halt in the second half of 1997, as the variation in the index stuck at around 40%. Haiti, which once enjoyed low inflation, in 1997 recorded one of the higher rates in the region. This change is directly attributable to the political crisis the country has been undergoing for a number of years, including, at its most critical moment, an international embargo.

Despite the impressive gains that have been made, the current stabilization processes continue to present certain weaknesses. The events in Mexico towards the end of 1994, manifested in a sharp devaluation of the currency, an outbreak of inflation and a period of economic recession, reawakened misgivings. The country's subsequent recovery, though far more rapid than after previous crises, has not wholly assuaged fears of new inflationary episodes, since the majority of the countries of the region still suffer from internal and external imbalances. Moreover, there may well be new crises to come, whether international (price shocks, rationing of capital flows, sharp increases in interest rates) or domestic (widening fiscal deficits, imprudent monetary policies, heavy currency devaluation, collapse of banking systems, natural disasters) that destabilize the region's economies and create the conditions for new outbreaks of inflation. So far, the South-East Asian crisis has not had a detrimental effect on domestic price indices; if anything, it has tended to dampen inflation by lowering the prices of imported products from Asia. However, some economies have suffered a deterioration in their external accounts, which has caused serious tension in foreign exchange markets; if this situation should persist or deepen, it may erode the relative price stability some countries have recently achieved. Moreover, the much-mentioned El Niño phenomenon has hurt some of the region's economies by diminishing agricultural output and damaging road infrastructure, with resultant increases in the prices of some staples.

Problems persist in the fiscal area, despite the gains made in the late 1980s andearly 1990s. The clearest example is the case of Brazil, where inability to control the fiscal deficit has obliged the authorities to resort to monetary policy with increasing intensity by raising interest rates. This in turn has aggravated the fiscal situation by upping the amount the Government has to pay in interest, a situation that could undermine the credibility of stabilization policy if it should result in an explosive expansion of the public debt. Colombia has also been running a large fiscal deficit, which makes it harder to reduce inflation. Costa Rica, on the other hand, has seen some improvement in its deficit. Argentina has reduced its fiscal deficit in part by controlling expenditure and raising taxes and in part thanks to the increase in public revenues resulting from economic recovery. Since the fiscal situation is highly procyclical, an end to the upturn could result in a widening of the fiscal deficit.

The external accounts of some of the countries present some weak points, such as very large current account deficits. In 1997, the region as a whole posted a current account deficit equivalent to 3.2% of GDP, one percentage point higher than the figure for the year before. This deterioration could undermine the present stability of exchange rates and thus lead to an acceleration of inflation. Again, the most worrisome case is that of Brazil, which is running a large current account deficit (4.3% of GDP and 56% of the value of exports of goods and services). Since the country's price stability is of recent date, an increase in the exchange rate caused by the current account imbalance could rapidly influence trends in domestic prices, and that, in turn, given the size of Brazil's economy, could have an adverse effect on neighbouring countries. Argentina, in particular, could face problems with its external sector if its trade with Brazil should shift from a surplus to a deficit. Other countries are also encountering difficulties owing to significant imbalances on their current accounts, which threaten the stability of their exchange rates, a key factor in the success of most stabilization processes.

The persistence of inflation, even though much reduced, in a number of countries of the region, combined with the potential problems that could originate in the fiscal or external sectors, might create the conditions for a revival of the practice of indexation, which has by no means disappeared, although currently maintaining a low profile. For example, labour contracts might once again include clauses for automatic pay hikes based on past inflation, and automatic adjustments for inflation might again be applied to interest rates, and indeed to all types of contracts. Given that scenario, inflation might accelerate in the face of some external or domestic shock, and the inertia built in by indexation would make it hard to bring the rate back down.

There is some doubt about the direction inflation may take in the immediate future, in the light of the impact of the Asian crisis on some countries of the region and the fall in the prices of basic commodities, particularly petroleum and copper. The resultant lower export earnings could depress the external accounts of some countries and thereby affect the exchange rate and, through that mechanism, domestic inflation. There is, however, a positive side to the crisis, especially for the petroleum-importing countries, which are benefiting from a reduced outflow of foreign exchange and from lower fuel costs, which, since they weigh heavily in domestic demand, are having a distinctly favourable impact on domestic prices. Moreover, if the low interest rates in international financial markets continue to prevail, they will help the region through their positive effects on external accounts and public finances.

VI. INVESTMENT AND SAVING

1. General overview

In all the countries of the region except Haiti, gross fixed investment outpaced GDP growth, and this was reflected in an across-the-board increase in the coefficients for this variable. Gross capital formation approached 25% of GDP, a level not seen since the early 1980s.[1] Figure VI. 1 illustrates the relationship between GDP growth and the coefficient for fixed investment during the period 1995-1997.

Viewed from a dynamic perspective, saving and investment may be regarded as the "bridge" between the short term and the medium and long terms. As may be seen in figure VI. 1, the region's growth pattern is a highly investment-intensive one. Nonetheless, domestic saving, which provides the bulk of investment financing, has been virtually stalled for several years now and is therefore not high enough to finance the level of real investment needed to attain higher growth rates. Meanwhile, external saving has become the fastest-growing component of investment financing and is nearing unsustainably high levels.

The figures for 1997 indicate that the region's economic growth and stabilization processes have been coupled with an extraordinary upswing in investment and saving, especially external saving. Within the favourable international environment that has existed since 1996, foreign direct investment has continued its steep ascent and has far outstripped the rate recorded for that year (see chapter VIII).

The region's high levels of economic activity, in conjunction with the buoyancy of investment, indicate that its economic growth in 1997 is not merely a sign of reactivation but that it also signals an increase in regional production capacity. According to ECLAC estimates, investment needs to exceed 26% of regional GDP in order for the region to achieve a growth rate of 6%. In 1997, the countries that had fixed investment coefficients near or above this level grew at an average rate of 6.5%. In Argentina, Chile, the Dominican Republic, Honduras, Mexico, Nicaragua, Panama and Peru, fixed investment climbed, on average, to 28% of GDP.

Because of the limited nature of the region's capital-goods production capacity, it has had to import large amounts of such items, and this poses the problem of how to go about financing those purchases. As in earlier years, the growth of investment in the region was largely financed by an increase in external saving, while national saving held steady at around 20% of GDP. In

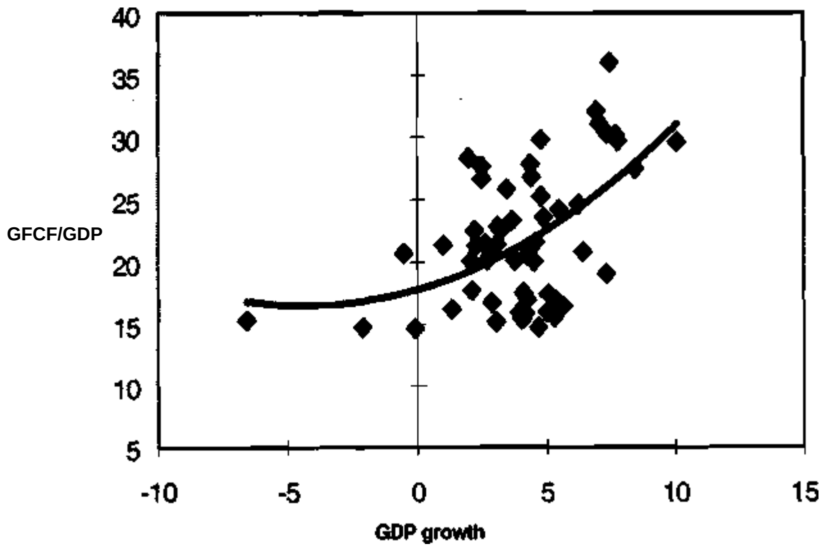
1 The region's gross fixed investment rate reached 22.3% of GDP in 1997 (see table VI. 1).

2 In this chapter saving and investment are analysed on the basis of data series at constant 1990 prices. It should be noted that these series differ from the series at current prices used in the summary of the *Economic Survey*. The saving-investment balance at current prices is a better indicator for use in flow analyses, particularly in the case of financial flows, whereas investment at constant prices is a better measurement of the expansion of production capacity and of potential economic growth.

3 ECLAC, *Fortalecer el desarrollo. Interacciones entre macro y microeconomia* (LC/G. 1898/Rev. 1 -P), Santiago, Chile, 1996. United Nations publication, Sales No. S.96.II.G.2.

Figure VI. 1

LATIN AMERICA AND THE CARIBBEAN: RELATIONSHIP BETWEEN GDP GROWTH AND FIXED INVESTMENT COEFFICIENTS, 1995-1997



Source: ECLAC, on the basis of official figures.

Table VI. 1

LATIN AMERICA AND THE CARIBBEAN: GROSS FIXED INVESTMENT

(As percentages of GDP, in dollars at constant 1990 prices)

	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997 [a]
Latin America and the Caribbean[15]	**26.3**	**18.8**	**18.4**	**18.7**	**19.S**	**20.1**	**21.4**	**20.3**	20.S	22.3
Argentina	28.8	17.4	14.0	16.7	20.4	22.4	25.4	22.4	23.4	27.5
Bolivia	12.8	11.1	12.6	14.2	15.7	15.4	13.5	14.7	15.9	17.0
Brazil	27.8	20.5	20.7	19.5	18.3	18.5	20.0	20.6	20.5	21.4
Chile	19.8	16.5	23.1	21.3	23.7	26.3	26.4	29.6	30.3	32.0
Colombia	20.5	19.1	16.6	15.4	16.6	21.4	24.5	24.6	22.5	22.5
Costa Rica	22.8	17.6	22.4	19.1	21.7	25.1	22.1	21.4	20.7	22.9
Ecuador	31.8	20.5	18.4	19.4	20.0	19.7	19.7	20.2	20.1	20.2
El Salvador	12.8	11.8	13.7	15.4	16.9	18.2	19.4	20.8	17.7	17.5
Guatemala	18.4	11.5	13.0	13.0	16.1	16.5	15.4	16.0	15.2	15.4
Haiti [c]	15.5	18.8	15.1	14.6	10.1	9.6	9.7	17.4	16.7	16.2
Honduras	27.6	19.6	20.2	19.9	23.7	30.1	30.6	25.3	25.8	26.8
Mexico	24.2	17.5	17.9	19.0	20.3	19.5	20.1	15.3	16.9	19.1
Nicaragua	16.0	21.8	16.0	14.9	17.0	16.3	18.6	20.1	23.6	24.2
Panama	22.4	14.9	8.5	14.8	19.5	26.2	26.9	28.4	26.7	27.8
Paraguay	26.8	19.2	22.0	22.8	21.0	-20.6	21.0	21.6	21.4	21.5
Peru	28.9	19.6	21.2	21.1	21.9	23.3	26.9	29.7	27.6	30.1
Dominican Republic	28.3	20.9	24.9	22.0	25.7	30.6	31.4	29.8	31.1	36.0
Uruguay	23.4	9.6	10.6	12.8	14.0	15.8	15.1	14.7	15.6	16.0
Venezuela	24.9	19.3	14.1	17.4	21.3	19.9	16.7	16.0	14.6	16.5

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. Includes variations in inventories in the case of Haiti. ' Includes variations in inventories.

addition, the Asian crisis has had a strong impact on flows of external finance in some countries. Consequently, given the importance of external saving as a source of investment financing, investment growth rates and levels for 1998 are expected to be more modest.

2. Investment

In 1997 total investment (including variations in inventories) averaged 25% of regional GDP; this was the highest figure in years and was close to the levels seen during the period of sustained growth achieved by the region in the 1970s. Although gross fixed investment was 2.5 percentage points lower than total investment, it followed the same trend.

As mentioned earlier, most of the countries' investment rates were much more similar to one another than they had been in the past. Haiti was the only country to record a decrease in fixed investment, measured as a percentage of GDP. Total investment rose particularly sharply in Argentina (27%), Bolivia (23%), Costa Rica (33%), the Dominican Republic (24%), Ecuador (17%), Mexico (23%), Panama (15%) and Venezuela (15%). In Bolivia, Costa Rica, Ecuador and Panama, inventories increased considerably and fixed investment grew more slowly.

Tables VI.2 and VI.3 present two commonly-used breakdowns of investment. One is based on the sector of origin and distinguishes between public and private investment, while the other disaggregates the figures by use (machinery and equipment, or the construction of buildings and other structures).

One of the after-effects of the crisis of the 1980s has been a downward trend in public investment, whether as a consequence of external constraints or of structural reforms. The privatization process has reduced the role of the State -and, hence, of public investment- in production. In 1997, the vast majority of the countries for which data are available registered an increase in the proportion of private investment, with private-sector investment growing more rapidly than public investment in 10 out of 12 countries.

In 1996 and particularly in 1997, the composition of fixed investment shifted away from construction and towards machinery and equipment. The available data indicate the latter category recorded a higher growth rate than the former in 7 out of 10 countries. This increase is in keeping with the trend towards a progressively higher level of capital goods imports and the strong expansion of foreign direct investment witnessed in many countries.

The existence of external constraints or the lack thereof have a direct effect on the composition of investment and especially on investment in machinery and equipment, since a large portion of these goods are imported. The strong upswing in imports of capital goods and foreign direct investment corroborate this observation. The decline in public investment has been coupled with a downturn in investment in construction, although it is still too early to determine how the award of operating concessions in the region will influence private investment in infrastructure. It is expected that the Asian crisis may lead to the postponement or discontinuation of some of the investment projects being financed and conducted by Asian firms in Latin America and the Caribbean, especially in the industrial sector. Examples include the investments originally planned by Asian enterprises in the automotive and home appliances industries in Brazil and Mexico.

There are other types of investment projects now under way, however, that would be very difficult to defer or that form part of long-term industrial strategies. This is especially the case in the mining sector, which large-scale investments are planned in a number of countries. In the energy sector, a major power integration project is being developed whose objectives include forming a grid of gas pipelines that would connect up Colombia, Ecuador, Peru, Bolivia, Argentina, Chile and Brazil. A number of different transnational corporations are involved in this project, and the gas pipeline between Bolivia and Brazil is already being built. The strength of private investment in Bolivia is

Table VI.2

LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF GROSS FIXED INVESTMENT, BY SECTOR

(As percentages of GDP, in dollars at constant 1990 prices)

	Percentages of GDP				Growth rates, 1996-1997		
	Public		Private		Public	Private	Total
	1990	1997[a]	1990	1997[a]			
Bolivia	7.6	6.9	5.0	10.1	-2.1	28.1	11.7
Colombia					4.4	2.0	3.2
Ecuador	4.0		14.4		0.9	4.6	4.0
El Salvador	2.5	3.5	11.2	14.0	3.6	2.8	3.0
Guatemala	2.7	3.0	10.3	12.4	1.5	6.4	5.4
Honduras	6.6	7.3	13.6	19.6	-11.0	17.7	8.3
Nicaragua	9.3	11.6	6.8	12.6	-17.9	53.4	8.4
Panama	1.1	4.3	7.4	23.5	3.8	9.8	8.8
Peru					12.5	18.2	17.4
Dominican Republic	6.7	6.0	18.2	30.0	-24.2	43.1	24.6
Uruguay	3.0	3.7	7.6	12.4	5.6	9.2	8.3
Venezuela	9.2	9.4	4.9	7.1	11.1	31.4	19.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

Table VI.3

LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF GROSS FIXED INVESTMENT, BY USE

(As percentages of GDP, in dollars at constant 1990 prices)

	Percentages of GDP				Growth rates, 1996-1997		
	Construction		Machinery and equipment		Construction	Machinery and equipment	Total
	1990	1997[a]	1990	1997[a]			
Costa Rica	8.7		13.7		13.1	14.5	14.0
Guatemala	3.8	4.4	9.2	10.9	6.8	4.8	5.4
Honduras	12.0	10.2	8.2	16.6	0.2	14.0	8.3
Nicaragua	6.6	9.8	9.4	14.4	9.0	7.9	8.4
Panama	3.4	14.9	5.1	13.0	5.0	13.5	8.8
Paraguay	10.9	14.3	11.1	7.2	2.8	3.5	3.0
Peru	14.1	20.4	7.1	9.8	18.9	14.3	17.4
Dominican Republic	18.7	20.7	6.2	15.3	19.2	32.9	24.6
Uruguay	6.5	7.2	4.2	8.9	2.8	13.3	8.3

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

closely linked to the construction of this pipeline and to the exploration and development of new deposits in connection with natural gas export activities. On the other hand, the Government of Peru and a consortium of transnational corporations failed to reach an agreement for the development and operation of a major natural gas project in Peru.

3. Saving

Although Latin America has made considerable headway in the area of financial liberalization, the region's domestic savings rates have remained more or less constant. Thus, the buoyancy of investment and economic growth has been accompanied by an increasing dependence on external saving as a source of investment financing.

In 1997 domestic saving remained steady at around 21% of regional GDP, thus continuing the trend of the last five years. One of the issues relating to policies for the promotion of domestic saving which is currently the focus of a great deal of attention in the region revolves around the reforms being undertaken in the financial sector (see chapter III) and the nature of the link between public and private saving. The empirical evidence appears to suggest that public saving can serve as a very effective tool for boosting national saving.

(a)Domestic saving and national saving

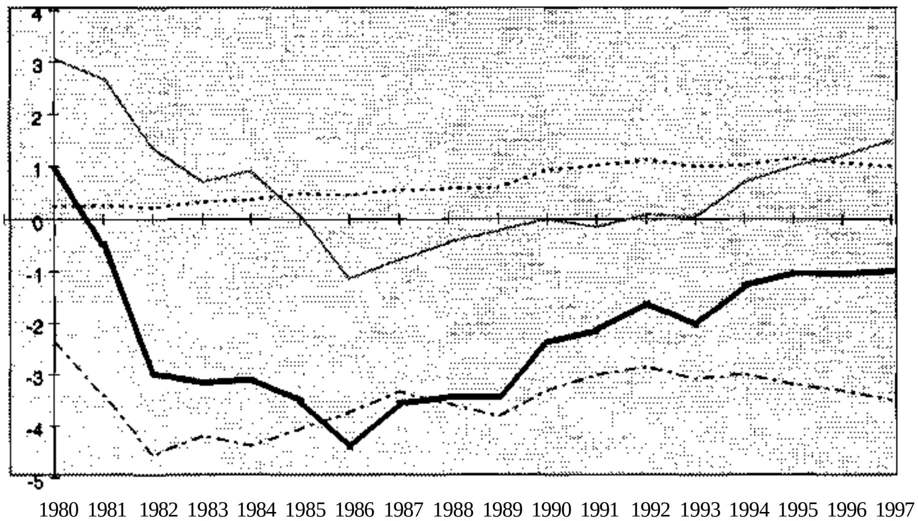
In 1997 the trend of recent years remained unchanged, as national saving held steady at around 20% of GDP, while domestic saving was one percentage point above that level. As may be seen in table VI.4, the differential between the two variables is accounted for by the behaviour of current transfers, the terms-of-trade effect and net factor payments. The combined effect of these variables has remained at about 1% of GDP for several years now. Net factor payments, which amounted to 3.5% of GDP in 1997, have been trending upward and may continue on this path or may even rise more sharply in coming years, given the region's high levels of inward foreign direct investment. Such payments rose by US$ 5 billion at constant 1990 prices, and factor payments abroad by Brazil and Argentina climbed especially sharply. Current transfers were stable at around 1% of GDP, while the

Table VI.4
LATIN AMERICA AND THE CARIBBEAN: nNANCING OF
GROSS CAPITAL FORMATION*
(As percentages of GDP, in dollars at constant 1990 prices)

	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997[b]
1. Gross domestic saving	24.4	23.8	21.8	21.5	20.4	20.9	21.1	20.7	21.1	20.7
2. Factor income	-2.4	-4.0	-3.2	-3.0	-2.8	-3.1	-3.0	-3.2	-3.3	-3.5
3. Current transfers	0.2	0.4	0.9	0.9	1.1	1.0	1.0	1.2	1.1	1.0
4. Terms-of-trade effect	2.9	-0.1	0.0	0.0	0.2	0.1	1.0	1.0	1.3	1.6
5. Gross national saving (1+2 + 3 + 4)	25.2	20.1	19.4	19.4	18.9	18.9	20.1	19.8	20.2	19.8
6. External saving	3.7	0.3	0.2	1.6	2.9	3.8	3.9	2.8	3.0	4.8
7. Gross capital formation (5 + 6)	28.9	20.3	19.6	21.0	21.8	22.6	24.0	22.6	23.2	24.6

Source: ECLAC, on the basis of official figures.
* In the calculations of domestic saving and national saving, in the case of Argentina it was assumed that gross capital formation was equal to gross fixed capital formation. The same assumption was also applied in the case of Brazil for 1980-1985 and 1997 and in that of Chile for 1980-1985. [b] Preliminary figures.

Figure VI.2
***LATIS* AMERICA: VARIABLES ASSOCIATED WITH THE DIFFERENTIAL BETWEEN DOMESTIC AND NATIONAL SAVING**
(As percentage of GDP)



Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.

increase in net factors payments registered in 1997 was offset by the positive effect of the terms of trade.

The terms of trade of most of the countries improved in 1997, but those of the region's major oil exporters registered a marked deterioration. In Mexico the negative effect of the slump in oil prices was counterbalanced by higher prices for other products, since crude oil exports represent only 10% of the country's total external sales.

(b)External saving

External saving continues to be the fastest-growing component of the resources that finance gross capital formation, accounting for 20% of the latter in 1997.[5] Foreign direct investment, which will be discussed in the following section, is the component that has the greatest influence in terms of the expansion of production capacity, however.

Measured at constant prices, external saving has risen to record levels in the 1990s. The figure for 1997 (4.9% of GDP) is the highest in many years and came close to matching the peak figure of 5.1% registered in 1981. This variable was higher in the great majority of the countries in 1997, with the exceptions being the Dominican Republic, El Salvador, Honduras, Nicaragua and Peru. It is interesting to note that average GDP growth for this group is somewhat higher than the average for Latin America and includes the two countries that posted the highest growth rates (the Dominican Republic and Peru) for the year.

4 External saving is the sum of foreign direct investment, portfolio capital, other capital flows and changes in reserves. When calculated at constant prices, this variable has to be adjusted at current prices for, among other factors, the effect of changes in the terms of trade and the exchange rate for the base year.

5 For an analysis of the various components of capital flows, see section 2 of chapter VII.

4. Foreign direct investment

As a result of the events in some Asian countries, the exponential growth of foreign direct investment in recent years slowed somewhat in the final quarter of 1997. Nevertheless, the trend of past years is expected to carry over into 1998, although growth rates are likely to be lower.

In the first half of the 1990s, inflows of foreign direct investment were strongly influenced by the privatization programmes being pursued by various countries in the region. Latin American Governments' revenues from privatization operations have gradually been supplemented by sizeable new direct investments in the modernization of privatized firms, and foreign direct investment has consequently provided a means of increasing the region's pool of productive capital.

The unmistakable trend of recent years whereby foreign direct investment is coming to represent an increasingly large share of external saving remained in evidence in 1997, as foreign direct investment reached an average level of 4% of GDP, or over 15% of total investment. A significant increase was seen in flows to Argentina, Brazil, Colombia, Mexico, Panama, Paraguay and Venezuela.

Generally speaking, most foreign investors' attention has been monopolized by services, mainly in the energy and financial sectors. Investment has also been channeled into extractive industries such as mining and oil production, manufacturing (especially the automotive industry) and export activities such as the *maquila* (assembly) industry. There are also some signs that the share of investment devoted to capital formation is expanding while the share represented by transfers of ownership conducted as part of the privatization process is shrinking.

6 Foreign direct investment is discussed here because it is one of the sources of financing for the balance of payments. It should be noted that it does not always correspond to the increase in production capacity because it also includes transfers of ownership of existing assets.

7 SeeECLAC, *La inversión extranjera en América Latina. Informe* /997 (LC/G.1985-P), Santiago, Chile, March 1998. United Nations publication, Sales No: S.97.II.G.14.

VII. EMPLOYMENT AND WAGES

1. Overview

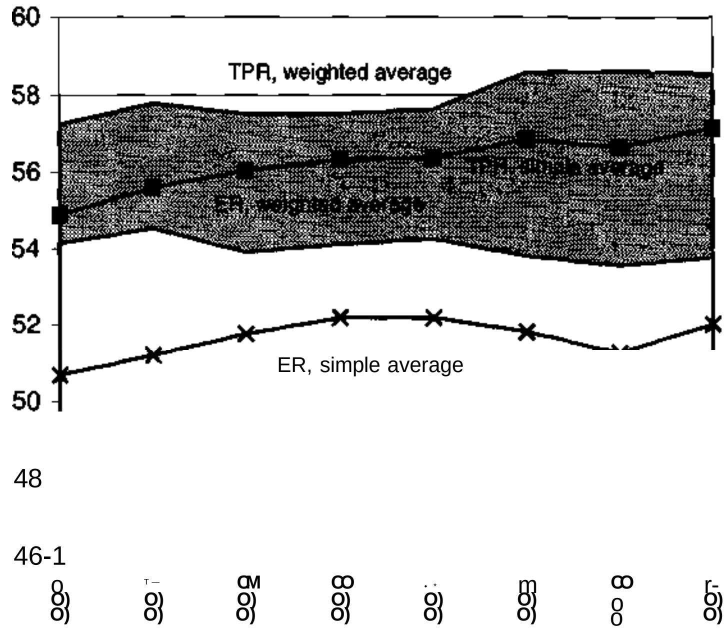
At the regional level, a moderate improvement was seen in the labour market as the pace of economic growth accelerated, and employment and average labour productivity both rose substantially. A small decline was also registered in open unemployment -from 7.7% to 7.3%-but even so the latter rate was still the second highest of the decade. This fact attests to the seriousness of the labour situation in many countries, although it is also true that the figure for the region as a whole was influenced by Brazil's sluggish rate of job creation. Meanwhile, the regional averages for mean and minimum wage levels rose in real terms.

The upswing in economic growth in 1997 resulted in a considerably higher rate of job creation than in preceding years. Consequently, after having declined for the last two years in a row, the regional employment rate climbed sharply, and the increase was even more notable if the results for Brazil are factored out of the calculation. A large proportion of newly-created jobs were in the form of salaried employment, thanks to the stronger demand for labour generated by the swifter growth of the region's economies. The workforce expanded more rapidly as well, after having grown very little the year before. This curbed the reduction in open unemployment, just as the lower participation rate recorded in 1996 had blunted the increase in joblessness during that year. As a re suit, the le vel of open unemployment recorded for 1997 was still high in comparison to its past trend.

Employment in manufacturing was higher in many countries during 1997, after having fallen during the two preceding years. This upturn was accompanied by gains in average labour productivity as the output of this sector rebounded strongly. This positive showing may be due to the attainment of a higher level of competitiveness following the organizational and technological changes made by the sector in earlieryears. Be that as it may, the manufacturing sector's rate of job creation was lower than the overall rate for the economy as a whole, and the downward trend in this sector's share of total employment therefore remained in evidence. The services sector continues to be the largest source of new jobs.

Within this context of greater economic buoyancy, the job creation process has continued to follow two parallel paths, one of which leads to the establishment of high-quality (skilled) jobs while the other gives rise to low-quality occupations (low-productivity jobs that do not provide social security coverage). Thus, in contrast to the relatively widespread improvements seen in terms of higher employment and lower levels of open unemployment, job quality indicators have been mixed. Moderate increases in real terms were recorded, however, in the regional totals for both average and minimum wages, although in many countries the economy's greater forward momentum did not translate into higher mean wage levels.

Figure VII.1
LATIN AMERICA AND THE CARIBBEAN (12 COUNTRIES): TOTAL PARTICIPATION RATE (TPR) AND EMPLOYMENT RATE (ER) [a]



Source: ECLAC, on the basis of official figures.
[a] The TPR and ER are expressed as percentages of the working-age population, as is the weighted average regional open unemployment rate (shaded area).

The macroeconomic trends observed in 1998 appear to herald a slowdown in growth, which would have an adverse impact on job creation. During the first few months of the year, however, no setbacks had as yet been registered in this variable except in the case of Brazil.

2. Labour supply

The growth rate of the labour force has trended downward during the 1990s as a consequence of a slower increase in the working-age population. Even so, the region's workforce tends to expand at annual rates of around 2.5%. One of the reasons for this is that the total participation rate has risen by approximately 0.3 percentage points per year, as a simple regional average, during the decade (see figure VII. 1) as increasingly large numbers of women join the labour force.

The overall (unweighted) average participation rate for 12 countries in 1997 was up by 0.5 percentage points and was thus far above its trend level for the decade. This steep increase

1 Brazil's participation rate has been an exception in that it has remained fairly constant for the last five years; it should be noted, however, that the coverage of the available annual figures is limited to six metropolitan areas.

in the labour supply can be accounted for by earlier changes and by the new employment opportunities that opened up in 1997 as a consequence of the faster pace of economic growth.

One of the factors at work in 1996 was that, as a reaction to a sluggish rate of job creation for the second year in a row, many people ceased to look for work or never even began to do so because they were discouraged by the lack of employment opportunities. This checked the upward trend in the overall participation rate at the regional level, and the labour supply's rate of expansion therefore simply reflected the growth rate for the working-age population or —when calculated as a simple average—actually fell below that rate. More specifically, in many countries the increase in the female participate rate slackened and the male participation rate decreased. The decline in the workforce's growth rate relieved the pressure on the job market and curbed the rise in unemployment levels.

The situation was quite different in 1997, inasmuch as economic growth accelerated in 11 out of the 13 countries for which information on the activity rate was available (see figure VII.2). This greater buoyancy stimulated job creation and, in turn, the appearance of new employment opportunities encouraged members of the economically inactive population to join the workforce. Some of the people who entered the labour market in 1997 had been classified as "hidden unemployed", i.e., people who had not sought work before, even though they wished to work, because they felt that they had little chance of finding a job.

Thus, in 8 of these 11 countries, the increase in the overall participation rate was above the regional trend level of 0.3 percentage points. A slight increase in the male labour participation rate contributed to the sharp upswing in the labour supply in 1997, but the substantial increase in the female participation rate was the main factor.

In contrast to the above trends in the labour supply in 1997, the participation rate, when weighted by the size of the working-age population, remained virtually constant due to the considerable drop in Brazil's rate (see figure VII. 1). This decrease was caused by the economy's sluggish rate of job creation, which prompted a large number of people (especially young people and men) to abandon the job market.

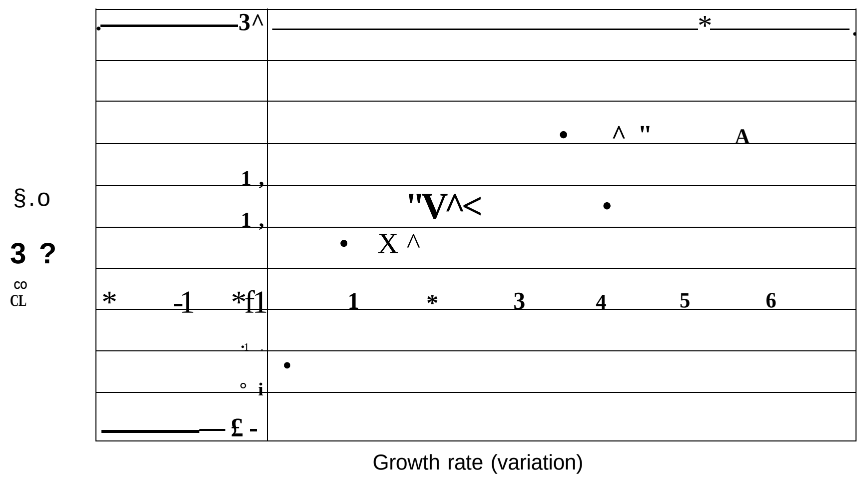
In summary, in 1996 the labour participation rate acted as a cushion for open unemployment at critical junctures, since after looking unsuccessfully for work for some time, many unemployed persons withdrew from the job market. Many of these people joined the ranks of the "hidden unemployed", since although they did not continue to actively seek employment, they still wanted to work. Consequently, when the economy began to rebound in 1997, they re-entered the labour market, thus preventing the more rapid rate of job creation from making a larger dent in the open unemployment rate.

2 Argentina provides a good example of this upward trend in the labour participation rate, even though in its case the trend took shape earlier, during the economic reactivation that occurred in the second half of 1996. Between May and October of that year, the proportion of unemployed persons who ceased to be members of the economically active population (EAP) dropped from 27% to 21% while the percentage of economically inactive persons who entered the labour force climbed from 7% to 9% of the total non-EAP (INDEC *informa,* October 1997, Buenos Aires). The combined effect of these two trends —the smaller number of people leaving the workforce and the larger number of people joining it— was a steep increase in the participation rate.

3 The female participation rate rose especially sharply in Mexico (38.2% to 39.3%), Panama (41.5% to 43.1%) and Venezuela (43.3% to 46.2%).

4 In Brazil's six largest metropolitan areas, the segment of the EAP aged 24 years and under shrank even in absolute terms. The segment between 25 and 39 years of age was unchanged, and the segment aged 40 and over increased slightly. The male EAP shrank slightly while the female EAP expanded; nevertheless, the increase in the female rate was below the growth rate for the working-age population, and the female participation rate therefore descended as well.

Figure VII.2
LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH AND LABOUR SUPPLY
(Percentages)



Source: ECLAC, on the basis of official figures.

3. Job creation

In 1995 and 1996, job creation was so sluggish that both the simple and weighted averages for regional employment levels declined. In 1997, however, mostof the countries'job creation rates outstripped the growth rate of their working-age populations, and their simple average employment rates therefore rose substantially (see figure VII. 1). Job creation was very strong in Argentina, Costa Rica, Ecuador, Mexico, Panama, Peru and Venezuela, where employment rates climbed by 1.5 points or more. Most of these countries had witnessed steep downswings in employment in earlier years, and in some, rates have still not regained their former levels. Here again, Brazil's poor showing had a negative effect on the weighted regional average, which consequently rose very little. Employment was also down in Colombia and Uruguay, but both of these countries saw an improvement during the second half of the year. At the regional level, employment rose by 3.1%, which was considerably higher than the 1.6% and 2.0% rates recorded for the two preceding years, respectively. If the figures for Brazil were left out of the regional average, then the job creation rate would be even steeper, with a 5.2% jump in employment.

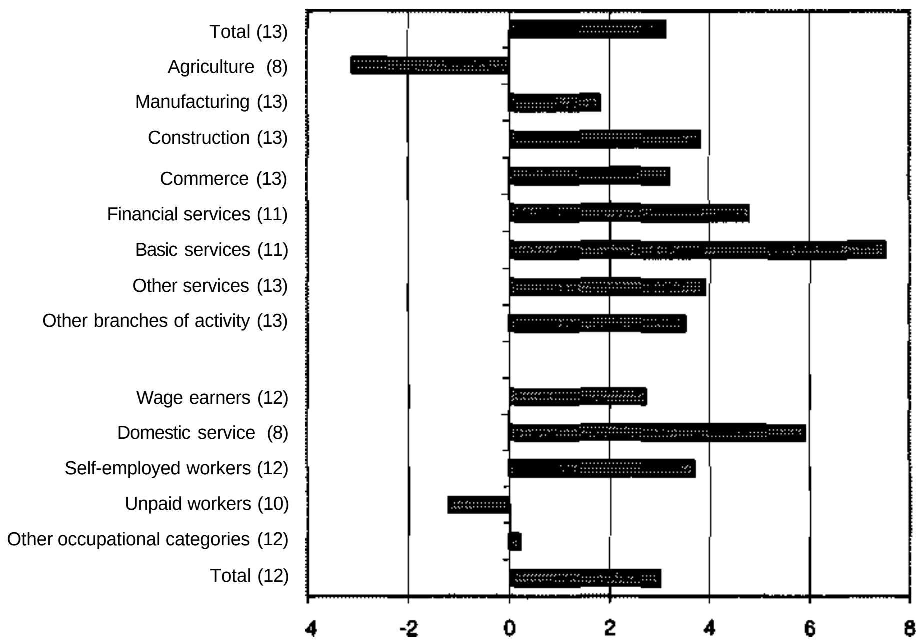
In comparison with the preceding two years, not only was there an increase in the number of new j obs created in 1997, but the composition of employment by occupational category improved as well. Salaried employment rose sharply (2.7%) as the economic recovery fueled the demand for labour (see figure VII.3). The strong increase in domestic service jobs (a weighted average for eight countries of 5.9%) following two years of flat growth may be a reflection of an improvement in the purchasing power of middle-income groups. The number of salaried jobs created in Argentina, Ecuador, Mexico and Venezuela was very considerable while, at the other extreme, Brazil and Colombia actually saw a slight decrease in the average number of wage earners in absolute terms for the year as a whole.

Hence, at the regional level, over 70% of the new jobs that were created were salaried

Figure VII.3

LATIN AMERICA AND THE CARIBBEAN: NET VARIATION IN EMPLOYMENT

(Percentages)



Source: ECLAC, on the basis of official figures.

[a] Varitions in weighted national rates for the population aged 10 and above based on the relative size of each branch of activity and occupational category. Figures is brackets indicate the number of countries for which information was available.

positions (including domestic service), whereas the category had only represented around 40% and 45% of the total in 1995 and 1996, respectively (see table VII. 1).

Even at the fairly high job creation rate of 2.7%, however, salaried employment expanded more slowly than total employment. Consequently, the downward trend observed in recent years in salaried jobs as a percentage of total employment slowed but nonetheless remained in evidence.

The counterpart phenomenon was that self-employment increased more than salaried employment did, thereby maintaining its growth rate (3.7%) and continuing to make an important contribution to job creation (accounting for 30% of the total, as compared to 40% in 1995 and 45% in 1996); the increases registered in this occupational category in Colombia, Costa Rica and Panama were particularly striking. This further strong increase in self-employment indicates, on the one hand, that even though the upswing in the creation of salaried jobs was more pronounced than in earlier years, it was still not enough to absorb the significant increase in the labour force and, on the other, that in some cases the resurgence of economic growth created new income-earning opportunities within this occupational category. The changes seen in the other categories (unpaid workers, owners and others) were minor and offset one another.

As in the case of the breakdown for job creation by occupational categories, its disaggregation by branch of activity also reveals

Table VH.l
LATIN AMERICA AND THE CARIBBEAN: CONTRIBUTION TO NET JOB CREATION
(Percentages)

Contribution of each branch of activity to non-agricultural employment		Contribution of each occupational category to total employment	
Total (13 countries)	**100**	**Total** (12 countries)	**100**
Manufacturing	10	Wage earners (including domestic service)	70
Construction	7	Self-employed	30
Commerce	19	Unpaid workers	-2
Basic services	16	Other	2
Community, social and personal services (including finance, insurance, real estate and business services))	50		
Other	-2		

Source: ECLAC, on the basis of official figures.

changes in relation to past years in some cases and a continuation of pre-existing trends in others. The decline in the agricultural sector's importance as a source of jobs, even in absolute terms, continued. The weighted average for eight reporting countries for 1997 showed a 3.1 % contraction in the number of agricultural workers, with especially sharp decreases in Chile, Colombia and Venezuela. In Brazil, where the difference between the performance of labour-intensive and non-labour-intensive crops translated into a reduction in the demand for manpower, formal agricultural employment was down by 3.0%.

Another trend that held firm was the increase in tertiary-sector employment. Employment in social, community and personal services and in commerce continued to rise at much the same rates as in earlier years (approximately 4% and 3%, respectively). The growth rate for employment in financial, real estate and business services, while quite robust (4.8%), was lower than in past years due to the consolidation process now under way in the financial sectors of a number of the countries in the region. Employment in basic services again climbed sharply (7.5%), with a particularly marked expansion being observed in the transport, storage and communications industries.

In a turnaround from the preceding years' decreases in absolute terms, employment in the manufacturing sector was up by 1.8%. This weighted average masks the existence of widely differing situations, however, since the growth rates for employment in manufacturing were very high in 4 of the 12 countries for which information is available (Argentina, Ecuador, Mexico and Venezuela), negative in two (Brazil and Colombia) and moderate (up to 2%) in a third group of countries (Chile, Costa Rica, Dominican Republic and Panama).

The manufacturing sector's fairly strong performance in terms of employment marked a contrast with the rates registered for other years during the decade, such as 1996, when in many countries this sector reacted to difficult conditions with lay-offs and increases in labour productivity (as reflected in the weighted regional average and the national averages for 7 out of 15 countries) (see figure VII.4). In another five countries, average productivity had descended, and in two of these cases, the decrease was associated with a contraction in manufacturing output. Only three countries -Chile, Ecuador and Mexico-registered increases both in employment and in average labour productivity in this sector in 1996.

In contrast, in 1997 a considerable percentage of the countries (8 out of 13) reported upturns in manufacturing production as a result of increases in both employment and labour productivity. The combination of declining employment and rising labour productivity that had been so prevalent in this sector the year before was observed in only three countries in 1997: Colombia, El Salvador and Brazil. In Brazil, the steep downturn in employment in manufacturing carried over into 1998, and this country's sluggish rate of job creation once again pulled down the regional average. At the other extreme, the available data indicate that there were two cases (Ecuador and Venezuela) in which employment in the manufacturing sector expanded rapidly at the expense of productivity.

Despite the overall increase in employment in manufacturing, the downward trend in this sector's share of total employment -a characteristic feature of the 1990s-held firm (see box VII. 1).

At the regional level, employment in the construction industry had also contracted during the preceding two years due to the difficult conditions encountered by a number of countries. In 1997, this trend was reversed as employment in this branch of activity strengthened considerably (3.8%). The increase in the number of construction jobs was especially striking in Argentina, Chile, Costa Rica and Venezuela, but the prevailing circumstances in Brazil took their toll in this subsector as well, driving employment in construction down in absolute terms.

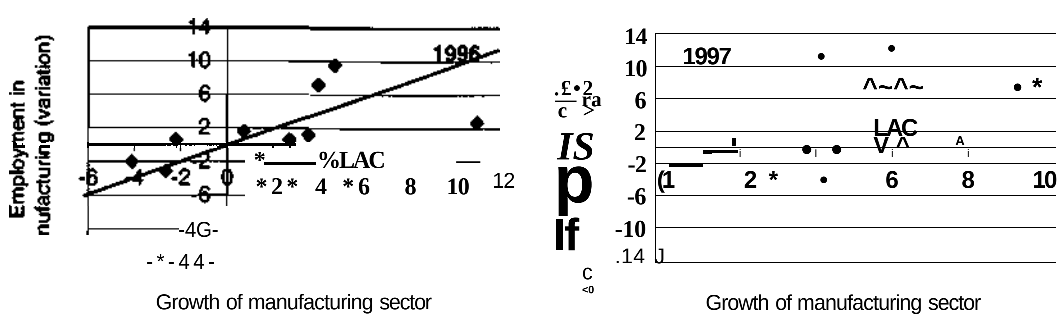
Hence, the two branches of activity in which employment had declined during the preceding two years -manufacturing and construction- accounted for 10% and 7%, respectively, of non-agricultural job creation in the region, which rose by an overall rate of 3.5%. As in previous years, however, the majority of these new jobs were in the tertiary sector, which accounted for 85% of all new non-agricultural employment; the most important components of this sector in terms of employment were social, community and personal services (including financial, insurance, real estate and business services), which were responsible for half of all net job creation in 1997.

As mentioned earlier, the sluggish rate of expansion in employment in 1995-1996 generated pent-up supply pressures which, as the pace of growth picked up, spurred the creation of both salaried and unsalaried jobs. As a result, the correlation between the rates of job creation and of economic growth has been quite weak (see figure VII.5), and in some countries job creation rates have risen at the expense of average labour

Figure VII.4

LATIN AMERICA AND THE CARIBBEAN: OUTPUT, EMPLOYMENT AND LABOUR PRODUCTIVITY OF THE MANUFACTURING SECTOR, 1996 AND 1997

(Percentages)



Source: ECLAC, on the basis of official figures.

Box VIL 1

EMPLOYMENT TRENDS IN THE MANUFACTURING SECTOR

A number of interesting facts can be gleaned from an examination of employment trends in the manufacturing sector during 1997 within the context of the predominant trends of the 1990s. During the first half of the decade, the share of total non-agricultural employment accounted for by the manufacturing sector shrank in almost all the countries of the region. The drop was quite widespread but was especially steep in large firms, where employment was down even in absolute terms, than in the sector as a whole (see table VII.2).

New organizational mechanisms -such as outsourcing and the subcontracting of support services-played a part in this trend, and Lhe decline in employment in large manufacturing firms has thus been partly offset by the creation of jobs in small and medium-sized industrial concerns and service companies. Nevertheless, a large part of the decrease in industrial employment is clearly due to the effects of net job destruction.

This poor performance in terms of job creation should be viewed within the context of the thoroughgoing reorganization process that has taken place in a large part of the manufacturing sector in many countries of the region. In response to mounting competition in both domestic and external markets, many firms have taken steps to make themselves more competitive, and others have been forced to close their doors. Consequently, average labour productivity has risen considerahk while the use of labour inputs has declined, since many of the changes made by these firms have involved the substitution of capital and technology for labour. During the 1990s this trend has been strengthened in many countries by the appreciation of the real exchange rate since, by making imported capital goods less expensive, this has raised the cost of labour relative to other factors of production.

tn most cases, these steep upturns in Labour productivity have not translated into matching increases in real wages, and this has done a great deal to lower the unit cost ol labour." In those instances where the appreciation of the local currency has caused domestic goods to become less competitive in relation to imports, however, a large number of jobs have been lost in labour-intensive branches of industry.

The exception to this pattern of declining industrial employment has been the *maquila* sector, which expanded very rapidly in Mexico, Central America and the Caribbean during the first half of the 1990s. *Maquila* industries have traditionally engaged in very simple production processes, and the bulk of their workforce has been made up of women and young people having no more than a basic education. Tn the past few years, however, these industries' production processes have become increasingly differentiated, and new, more technologically sophisticated activities are being undertaken which require more highly educated personnel. As the rest of the manufacturing sector is also beginning to import more and more of the machinery, intermediate goods and inputs it needs, in the Future the occupational profiles of *maquila* and traditional industries may become more alike.

In summary, as the manufacturing sector in many Latin American countries becomes more capital-intensive and Jess labour-intensive, its direct job creation capacity is diminishing. In particular, the adjustments that many manufacturing firms have had to make in order to cope with increased competition have had the effect of lowering their employment "floors"' and have therefore led to a substantial reduction in this sector's share of total employment. Nonetheless, the figures for 1997 do not indicate that the sector is heading towards a jobless growth situation. Starting from this new and lower employment "floor", and within a context ol rapidly growing industrial activities, the sector has continued to create |obs on the basis of higher levels of productivity and conipetui\eness. However, Us rate of direct job cieation appears as though it will remain below both the growth ol the labour supply and the economy's overall job creation rate, and it is therefore not expected to emerge as an engine of direct job creation; on the contrary, it is likely that its share of total employment will continue to shrink.

Out of 18 countries in the region, the onl} exceptions ore Bolivia and Honduras. See the International Labour Organization (ILO), *Labour Overview 'V7*, Lima, Regional Office for Latin America and the Caribbean, December 1«W7.
See the International Labour Organization f II .0). *Costrn labórale?* v *compctitividad industrial en Amciu a latina*. Geneva. 1997.

productivity (see country group "B" above the diagonal line in figure VII.5). In four of the five countries in this group, employment levels had sunk the year before, and the sizeable increases in employment seen in 1997 can therefore be interpreted in part as a manifestation of formerly pent-up supply pressures. This is especially the case in those countries where the upswing in employment was largely accounted for by increased self-employment.

In contrast to the situation the year before, among the countries for which information is available only Brazil, Uruguay and, to a lesser extent, El Salvador raised average labour productivity at the expense of their job creation rates, whereas 6 out of 15 countries had done so in 1996.[5]

The four countries in group "A" in figure VII.5 turned in the best performances, with moderate-to-high increases in both job creation and average labour productivity. Chile, which has maintained high growth rates over a lengthy period of time and has fairly low unemployment, registered a larger increase in productivity (as signified by the fact that its position is further away from the diagonal line), whereas the number of employed persons rose more sharply in the other countries in this group. As was also true of the countries in group "B", these three countries had witnessed major decreases in employment in 1995 (Dominican Republic and Mexico) or in both 1995 and 1996 (Argentina).

The performances of the larger countries in the region (in which the increases were more skewed towards employment in some cases and towards productivity gains in others) evened out fairly well, since the overall regional figures showed a 3% expansion of employment and an improvement of approximately 2% in average labour productivity.

A positive macroeconomic performance on the part of the region as a whole accompanied these significant gains in employment and productivity. This fact highlights how important a role economic growth plays in the improvement of labour indicators, even though the correlation between the growth of the economy and job creation was quite weak in 1997.

4. Open unemployment

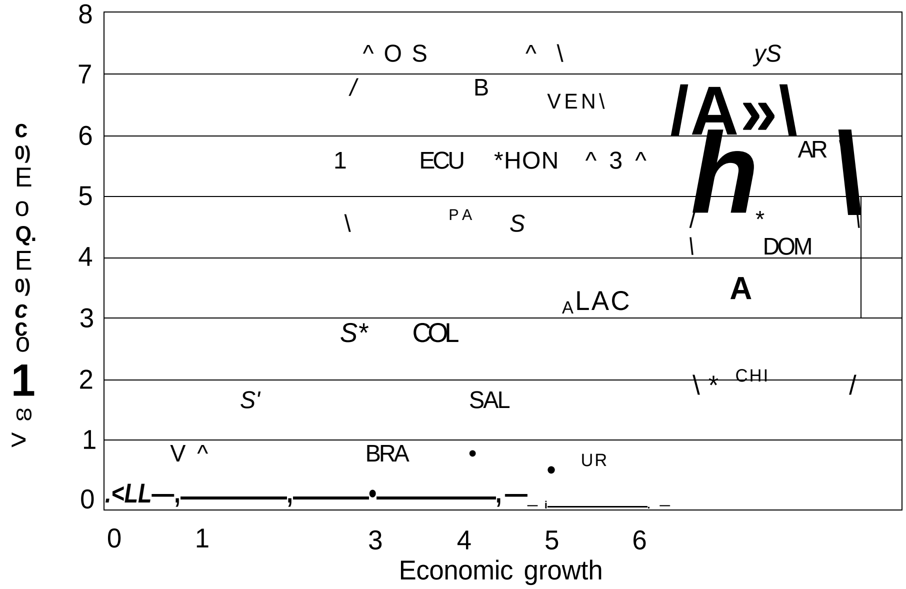
Thanks to the strong rate of job creation, open unemployment trended downward in many of the countries. As noted earlier, however, in many instances the entry or re-entry of large numbers of people into the labour market prevented the reduction in unemployment from being as sharp as it would otherwise have been. On the other hand, in Brazil (which heavily influences the weighted regional average), the decline in the activity rate held the rise in open unemployment in check. As a result, the urban unemployment rate for the region fell from 7.7% to 7.3%, although this was still the second-highest level to be recorded in the 1990s (see table VII.3).

Eleven of the countries for which information is available managed to reduce their rates of open unemployment. In another seven countries it rose, and in three countries it remained virtually stationary, varying by less than a tenth of a point. Relatively sharp drops in unemployment were recorded in some countries where it had previously been quite high, such as Argentina, Barbados, Dominican Republic, Nicaragua, Panama, and Trinidad and Tobago. In Argentina, unemployment continued to follow the downward trend that had appeared in the second half of 1996, while in Barbados, Nicaragua and Trinidad and Tobago, it has been declining gradually for several years now. Nonetheless, in all of these countries a considerable percentage of the economically active population remains unemployed.

Significant reductions in unemployment were seen in Costa Rica, Ecuador and Mexico as well. Unemployment levels had risen sharply in these countries in previous years, however, and

5 The figures given for average labour productivity are often fairly rough estimates, particularly when the survey data cover only a portion of a country's territory.

Figure VH.5
LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH, EMPLOYMENT AND LABOUR PRODUCTIVITY
(Percentages)



Source: ECLAC, on the basis of official figures.

therefore were still higher than they had been at the start of the decade despite the decrease.

Unemployment rose in seven countries. In Cuba, Jamaica and Paraguay, the increase was attributable to the slow pace of economic growth; in Bolivia, Brazil and Colombia, it was due to the fact that job creation was slack despite a fairly satisfactory average rate of economic growth for the year; and in Peru, it was because the increase in the labour supply was so steep that it outstripped the rate of job creation even though the latter was also quite high.

The unemployment rate for women is usually higher than it is for men. For example, in 1997 the open unemployment rate in Brazil for men was 5.3% whereas it was 6.3% for women; in Mexico, the figures were 5.3% for men and 6.1% for women; and in Peru, the corresponding rates were 6.1% and 9.2% (third quarter). Unemployment among women is an even more serious problem than these figures suggest, however. In countries having indicators that take hidden unemployment into account as well, not only is the rate much higher, but the differential between the rates for men and women is also larger. For example, in Colombia the third-quarter unemployment rate for seven metropolitan areas was 9.8% for men and 15.1% for women; in Panama, the male and female unemployment rates were 10.6% and 18.1%; and in the Dominican Republic, they were 9.5% and 28.7%. This wider differential is attributable to the entry barriers faced by women seeking certain types of jobs and to the workload represented by women's household duties, which discourage or hinder many of them from undertaking an active, ongoing job search.

6 This category corresponds primarily to people who have ceased to look for work because they think they will be unable to obtain a job.

Table VIL 2

LATIN AMERICA AND THE CARIBBEAN: INDUSTRIAL EMPLOYMENT INDICATORS

(Indices 1990 = 100)

	1980	1990	1991	1992	1993	1994	1995	1996	1997"
Formal-sector industrial employment									
Argentina		100.0	95.6	95.9	93.6	91.3	86.0	82.7	85.2
Brazil	108.9	100.0	93.4	88.4	87.7	87.8	87.7	83.6	82.3
Colombia[0]	111.6	100.0	101.2	102.4	103.8	101.2	98.3	94.7	89.5
Costa Rica		100.0	98.6	102.0	102.7	103.5	103.2	94.3	94.6
Ecuador		100.0	101.1	97.6	96.2	89.7	84.8	81.0	79.0
Guatemala	81.5	100.0	114.2	125.7	130.6	145.3	136.0	124.8	131.8
Mexico									
Non-maquila	105.7	100.0	98.6	95.0	88.9	86.3	78.5	80.2	84.4
Maquila	26.0	100.0	102.8	110.5	118.7	128.1	141.5	166.5	198.3
Peru [8]	122.9	100.0	94.9	85.2	78.3	77.3	75.4	73.6	74.6
Uruguay	94.5	100.0	94.6	85.8	74.6	61.3	54.8	52.2	52.2
Venezuela '	91.8	100.0	103.7	107.2	105.7	95.3	79.4		
Total industrial employment									
Argentina[J]	140.9	100.0	102.7	102.6	96.4	90.8	85.3	80.3	86.7
Bolivia [k]		100.0	121.8	135.7	136.1	148.2	157.6	169.0	
Chile[1]	74.6	100.0	103.0	108.9	118.7	114.8	114.3	116.4	117.5
Colombia"[1]		100.0	106.4	113.9	113.0	113.5	116.8	108.7	105.4
Costa Rica	93.7	100.0	103.1	107.7	107.5	111.2	105.3	103.2	104.4
Honduras		100.0	109.7	124.8	147.9	160.7	162.2	175.5	176.0
Nicaragua		100.0	99.7	90.6	87.1	82.7	87.4	101.5	104.7
Panama[h]	79.4	100.0	101.3	117.3	125.5	133.1	134.9	137.1	139.8
Venezuela	69.6	100.0	110.8	116.2	113.7	113.3	117.1	113.4	126.6

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. [b] The indices for formal-sector industrial employment reflect the situation in large and medium-sized firms; the indices for total industrial employment also include small business, microenterprises and self-employment. All manufacturing activities except coffee milling. Industrial enterprises having 20 employees or more. [e] Industrial enterprises having 10 employees or more. [f] Workers paying into the social security system; includes mining. [g] Industrial enterprises in the Lima metropolitan area having 100 employees or more. The figure given for 1980 actually corresponds to 1982. ' Industrial enterprises having 5 employees or more. [J] Up to 1990, refers to employment in formal-sector manufacturing; from 199Ion, refers to total employment in the manufacturing sector of Greater Buenos Aires as of October of each year. Departmental capitals only. Metropolitan region. Seven metropolitan areas, fourth quarter of each year.

5. Job quality

The available indicators have reflected a considerable and quite widespread deterioration in job quality in recent years, but in 1997 they suggested that the situation had improved somewhat, although the results were still quite mixed (see table VII.4). Changes in job creation and labour productivity trends, together with a number of institutional elements, were contributing factors in this respect.

Table VII.3

LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT

(Average annual rates)

	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997 [a]
Latin America	6.2	7.3	5.9	5.8	6.2	6.2	6.3	7.2	7.7	7.3
Argentina										
Urban areas [c]	2.6	6.1	7.4	6.5	7.0	9.6	11.5	17.5	17.2	14.9
Barbados										
Total nationwide				17.2	23.0	24.3	21.9	19.7	15.8	14.5
Bolivia										
Departmental capitals		5.8	7.3	5.8	5.4	5.8	3.1	3.6	3.8	4.4
Brazil										
Six metropolitan areas	6.3	5.3	4.3	4.8	5.8	5.4	5.1	4.6	5.4	5.7
Chile										
Metropolitan region	11.7	17.2	9.2	9.3	7.0	6.2	8.3	7.4	7.0	7.1
Colombia										
Seven metropolitan areas	10.0	13.9	10.5	10.2	10.2	8.6	8.9	8.8	11.2	12.4
Costa Rica										
Total urban	6.0	6.7	5.4	6.0	4.3	4.0	4.3	5.7	6.6	5.9
Cuba										
Total nationwide				7.7	6.1	6.2	6.7	7.9	6.0	6.5
Ecuador										
Total urban	5.7	10.4	6.1	8.5	8.9	8.9	7.8	7.7	10.4	9.3
El Salvador										
Total urban			10.0	7.9	8.2	8.1	7.0	7.0	7.5	7.5
Guatemala [e]										
Total nationwide	2.2	12.1	6.0	4.0	1.5	2.5	3.3	3.7	4.9	
Honduras										
Total urban	8.8	11.7	7.8	7.4	6.0	7.0	4.0	5.6	6.5	6.4
Jamaica										
Total nationwide				15.4	15.7	16.3	15.4	16.2	16.0	16.5
Mexico										
Urban areas	4.5	4.4	2.7	2.7	2.8	3.4	3.7	6.2	5.5	3.7
Nicaragua										
Total nationwide		3.2	11.1	14.2	17.8	21.8	20.7	16.4	14.8	13.2
Panama										
Metropolitan region	9.9	15.6	20.0	19.3	17.5	15.6	16.0	16.6	16.9	15.3
Paraguay										
Asunción metropolitan area	4.1	5.2	6.6	5.1	5.3	5.1	4.4	5.3	8.2	9.0
Peru										
Lima metropolitan area [8]	7.1	10.1	8.3	5.9	9.4	9.9	8.8	8.4	7.9	8.3
Dominican Republic [d]										
Total nationwide				19.6	20.3	19.9	16.0	15.8	16.5	15.9
Trinidad and Tobago										
Total nationwide [d]				18.5	19.7	19.8	18.4	17.2	16.3	15.0
Uruguay										
Total urban [h]			8.5	8.9	9.0	8.3	9.2	10.3	11.9	11.5
Venezuela										
Total urban	6.6	14.3	11.0	10.1	8.1	6.8	8.9	10.9	12.3	11.9

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. Weighted regional average. For methodological reasons does not include the following countries: Barbados, Cuba, the Dominican Republic, Jamaica, and Trinidad and Tobago. [c] Represents a high and increasing number of urban areas. [d] Includes hidden unemployment. [e] Official estimates. [f] From 1994 on, figures refer to total urban unemployment. [8] From 1995 on, figures refer to total urban unemployment. [h] Figures for 1980 and 1985 refer to unemployment in Montevideo.

Greater problems were encountered in relation to the volume of work for employed persons in 4 of the 10 countries for which information was available. This would appear to be a reflection of the strong pressure exerted by the labour supply, as a result of which some members of the labour force only manage to obtain part-time jobs even though they would like to work full time. In a number of other countries where employment levels were rising sharply, such as Argentina and Mexico, indicators of the presence of an insufficient volume of work for employed persons showed an improvement, although -with the exception of the Dominican Republic and Honduras- they were still quite high relative to the levels reached in the early 1990s.

Indicators of insufficient levels of labour income were also mixed. In five of the eight countries for which information was available, the number of employed persons having incomes below a specified level declined, although only slightly in most cases. In the other three -Bolivia, Costa Rica and Mexico- the percentage of low-income employed persons rose. Despite the overall modest improvement seen in these indicators in 1997, however, the prevalence of low-paying jobs remains a problem, and a portion of the working population therefore has to work longer hours in order to make up for the low level of the hourly wages received.

The other available job-quality indicators reflect two different trends. First, in most of the countries the informal sector has expanded during the 1990s, but in some cases (e.g., Ecuador and Venezuela), the faster pace of economic growth seen in 1997 spurred job creation in medium-sized and large firms, which caused the informal sector's share of total employment to shrink. Second, the deregulation of some aspects of the labour market and the restructuring of many production chains have stimulated the creation of poor-quality jobs that are unstable because of the type of contract involved (i.e., the increasingly frequent use of fixed-term contracts) and/or do not provide social security coverage. Indeed, in Brazil, El Salvador and Mexico, the percentage of jobs whose occupants are not covered by the social security system has been on the rise during the 1990s. This trend was interrupted in 1997 in these countries, but in a number of others job instability has continued to increase. In Argentina, for example, the percentage of wage earners holding permanent contracts had slipped from around 90% at the end of 1996 to 83% by end-1997.

In many countries job creation has become polarized. At one end of the spectrum, the modernization of secondary- and tertiary-sector activities has led to the creation of more jobs for professionals, technicians, administrators and executives and has therefore boosted the recruitment of highly skilled personnel. Consequently, these occupational categories' share of total employment is rising in many countries; in 1997, this trend was observed within a context of robust economic growth in Argentina, Mexico and Chile. At the other extreme, a large percentage of the new jobs being created are in low-skill, low-productivity, low-paying occupations, and between 1990 and 1996 the informal sector's share of total non-agricultural employment swelled from 51.6% to 57.4% at the regional level.[8] In addition, the percentage of wage earners in the private sector working without a contract or on a temporary basis also increased.

7 In 1994, the percentage of employed persons in the urban areas of 12 countries who worked long hours to make up for low wage levels ranged from 3% in Argentina, Brazil and Venezuela to over 8% in Bolivia, Chile and Paraguay (see ECLAC, *Social Panorama of Latin America, 1996 Edition* (LC/G. 1946-P), Santiago, Chile, 1997, pp. 68 *et seq.*, United Nations publication, Sales No: E.97.II.G.4.

8 See International Labour Organization (ILO), *Labour Overview '97*, Lima, Regional Office for Latin America and the Caribbean, December 1997.

9 See International Labour Organization (ILO), *op. cit.*, pp. 34 *et seq.*

Table VII.4

LATIN AMERICA AND THE CARIBBEAN: EMPLOYMENT QUALITY INDICATORS

(As percentages of total employed)

	Insufficient volume of work							
	1990	1991	1992	1993	1994	1995	1996	1997 [a]
Argentina	9.7	8.8	8.8	10.0	11.6	14.5	15.9	15.5
Bolivia [c]						7.0	9.3	4.9
Chile [d]	2.2	1.8	1.5	2.2	2.0	2.0	4.1	5.6
Colombia[6]	14.6	15.0	15.6	13.1	13.2	12.8	16.6	16.9
Costa Rica	11.3	13.1	9.3	9.1	10.6	12.0	14.5	12.8
Honduras [g]	4.4	2.8	2.0	3.3	1.6	1.7	3.0	3.4
Mexico	13.0	13.8	14.5	15.9	15.1	17.3	17.0	14.9
Paraguay '					5.3	6.4	8.6	
Peru[J]						16.9	19.3	19.3
Dominican Republic		5.8	6.4	6.3	5.5	6.3	5.1	5.8
Uruguay		5.2	3.8	3.4	4.1	5.7	6.8	

Note: Individuals having an insufficient volume of work are defined as those who work fewer hours per day or fewer days per week than normal or desired. The precise definition varies from country to country.

[a] Preliminary figures. Employed persons working fewer than 35 hours per week for reasons beyond their control who would like to work more hours; Greater Buenos Aires. [c] Employed persons working fewer than eight hours per day; departmental capitals. Employed persons working fewer than 35 hours per week who would like to work more; nationwide total, third quarter of each year. The figures shown for the years up to and including 1995 are not strictly comparable with those for 1996 and thereafter due to changes in the sample used. [e] Employed persons working fewer than 32 hours, working 32 hours or more but earning an insufficient income, or working 32 hours or more at a skill level below the level for which they are qualified; seven metropolitan areas. Employed persons working fewer than 47 hours per week who would like to work more; nationwide total. [g] Employed persons working fewer than 36 hours per week who would like to work more; all urban areas. [h] Employed persons working fewer than 35 hours per week on a regular basis or for market-related reasons; covers a large and increasing number or urban areas. ' Employed persons working fewer than 30 hours per week who would like to work more; all urban areas. [J] Employed persons working fewer than 35 hours per week who would like to work more; all urban areas. [k] Employed persons working fewer than 40 hours per week who would like to work more; nationwide total. Employed persons working fewer than 40 hours per week who would like to work more and non-wage-earning employed who would like to work more, even if they are already working 40 hours or more; all urban areas.

Table VII.4 (continued)

	Insufficient income							
	1990	1991	1992	1993	1994	1995	1996	1997 [a]
Bolivia						26.2	23.3	24.3
Brazil[c]	12.2	11.2	14.6	14.8	15.1	8.2	9.1	8.6
Colombia		19.2	24.0	22.8	25.2	19.1	22.3	20.3
Costa Rica[e]	11.1	11.2	15.6	10.8	9.9	8.1	12.7	13.9
Honduras	25.1	27.3	23.9	25.2	20.3	17.5	19.5	18.9
Mexico [g]	12.2	9.4	8.3	9.4	8.0	10.9	12.7	13.3
Paraguay [h]					12.3	12.7	15.9	
Peru'						29.1	26.6	26.3
Dominican Republic[J]		23.4	20.5	18.3	14.7	18.5	18.3	12.0

Note: Individuals having an insufficient income are defined as those who work what is considered to be a normal workday and yet earn less than a specified minimum sum. The precise definition varies from country to country.

[a] Preliminary figures. Employed persons working in departmental capitals who earn less than what the basic food basket costs (does not include unpaid workers, unsalaried apprentices or domestic servants). [c] Employed persons having no income or whose earnings are less than the minimum wage, in six metropolitan areas. Employed persons whose earnings are less than or equal to the minimum wage, as of December of each year; seven metropolitan areas. [e] Employed persons working 47 hours per week or more whose earnings are less than the minimum wage; nationwide total. Employed persons working 36 hours per week or more whose earnings are less than the minimum wage; all urban areas. [g] Employed persons whose earnings are less than the minimum wage; covers a large and increasing number of urban areas. Wage earners whose incomes are below the minimum wage; all urban areas. ' Employed persons working 35 hours per week or more whose earnings are less than what the basic food basket costs per income-earner; all urban areas. [J] Employed persons working 40 hours per week or more whose earnings are less than the minimum wage; nationwide total.

Table VII.4 (conclusion)

	Other employment quality indicators							
	1990	1991	1992	1993	1994	1995	1996	1997 [a]
Brazil [b]		28.0	30.4	31.2	32.5	33.3	34.7	34.8
Colombia[c]		18.2	22.1	17.4	17.3	19.1	21.3	21.0
Ecuador	53.0	50.2	52.6	52.3	50.1	48.6	48.4	44.9
El Salvador[e]					59.1	61.6	62.1	61.3
Mexico	43.4	43.2	44.1	45.6	46.4	49.0	49.6	49.6
Uruguay [8]		15.1	15.7	15.2	15.3	15.1	15.0	
Venezuela	41.5	40.5	39.6	40.6	48.8	48.2	48.7	47.7

Source: ECLAC, on the basis of official figures.
Note: The employment quality indicators refer to job stability and coverage under labour laws.
[a] Preliminary figures. Wage earners not covered by labour or social legislation, as a percentage of all wage earners; six metropolitan areas. [c] Persons employed on a temporary basis, as a percentage of all employed persons, as of December of each year; seven metropolitan areas. Gross underemployment (urban informal sector excluding domestic service and agriculture, plus underemployment in the modern sector of the economy); all urban areas. [e] Employed persons not covered by the insurance scheme of the Salvadoran Social Security Institute; all urban areas. Employed persons with no benefits, as a percentage of all employed persons; covers a large and increasing number or urban areas. [g] Private-sector wage earners not covered by labour laws and employed persons seeking other employment because they lack job security or because they are unpaid family workers; all urban areas. Employed persons working in the informal sector; nationwide total, second half of each year.

6. Wages

In most of the countries, the achievement of a fairly high rate of job creation was not matched by an upturn in wages. In fact, in 7 out of 13 cases, real mean wages were flat, showing variations of no more than 1% (see table VII.5). As a result, a greater convergence of average wage levels has been seen than in earlier years. The fact that sharp increases or decreases were registered in so few cases is a reflection of the widespread trend towards lower levels of inflation.

Only five countries reported wage increases of over 2%, and in two of these cases the slowdown in inflation was a contributing factor in the improvement of real wage income. The largest increase was in Venezuela, where, with inflation still high but abating, wages regained part of the ground lost in earlier years, although they still fell far short of their 1990 level. The considerable upswing in real mean wages in Bolivia was largely due to an unexpected drop in the country's already low inflation rate at the start of 1997. In Chile, the upward trend in real mean wages seen over the past few years held firm, but in Brazil the upturn in wage levels that began with the implementation of the Real Plan weakened somewhat in 1997 and continued to do so in the early months of 1998. In Ecuador, real wages had been rising steadily for several years now, but slipped backward in 1997 as inflation accelerated.

Rising wages in large countries (Brazil) and sharp increases in others (Venezuela) drove up the weighted average of real wage levels for the group of countries considered by 2.7% and the simple average by 3.0%. The median growth rate, however, was only 0.5%. Thus, both the simple and weighted regional averages were higher than they had been during the two preceding years, but the median was lower.

The tendency of wage levels to converge was also reflected in the variations in real minimum wages, since in 11 of the 18 countries for which information is available, the variation in these wage levels stayed within a range of between -2% and +5% (see table VII.6). This convergence is accounted for by improvements in inflation control and by the implementation of policies directed towards maintaining or achieving moderate increases in real income

Table VII.5

LATIN AMERICA AND THE CARIBBEAN: REAL AVERAGE WAGES

(Average annual indices: 1990 = 100)

	1980	1990	1991	1992	1993	1994	1995	1996	1997 [a]
Argentina	130.0	100.0	101.3	102.7	101.3	102.0	100.9	100.7	100.2
Bolivia [c]		100.0	93.4	97.1	103.6	111.8	112.6	113.8	123.1
Brazil									
Rio de Janeiro	94.0	100.0	79.3	79.5	85.7	87.1	91.8	104.3	108.4
São Paulo	88.6	100.0	88.3	85.3	94.6	98.0	102.0	109.5	112.8
Chile [6]	95.4	100.0	104.9	109.6	113.5	118.8	123.6	128.7	131.8
Colombia	85.0	100.0	97.4	98.6	103.2	104.1	105.4	107.0	109.4
Costa Rica [g]	115.8	100.0	95.4	99.3	109.5	113.6	111.4	109.1	110.0
Ecuador [h]		100.0	104.6	113.5	127.8	139.2	153.0	161.3	157.6
Guatemala [8]	142.5	100.0	93.6	107.6	115.2	115.9	129.8	144.7	
Mexico	128.3	100.0	106.5	114.3	124.5	129.1	111.6	99.2	98.2
Nicaragua '	477.6	100.0	103.2	122.8	114.0	120.0	122.2	119.6	119.4
Paraguay [J]	102.1	100.0	104.7	103.6	104.5	106.1	114.0	117.5	117.0
Peru [k]	309.3	100.0	115.2	111.1	110.2	127.4	116.7	111.2	110.3
Uruguay	108.5	100.0	103.8	106.1	111.2	112.2	109.0	109.7	109.9
Venezuela		100.0	94.2	98.8	90.1	75.9	72.4	55.5	69.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Manufacturing. [c] Private sector in La Paz. Workers covered by social and labour legislation. [e] Up to April 1993, wage earners in sectors other than agriculture; from May 1993 onward, general index of hourly pay. Manual workers in manufacturing. [g] Average earning reported by persons enrolled in the social security system. Non-agricultural enterprises with 10 employees or more. Average wages, not counting payments in kind or other benefits. [J] Asunción. Private-sector manual workers in the Lima metropolitan area Urban non-manual and manual workers; second half of each year.

Table VII.6

LATIN AMERICA AND THE CARIBBEAN: REAL URBAN MINIMUM WAGE

(Average annual indices: 1990 = 100)

	1980	1990	1991	1992	1993	1994	1995	1996	1997 [a]
Argentina	465.9	100.0	259.1	203.7	263.7	363.9	352.0	351.4	349.6
Bolivia		100.0	165.6	164.8	181.2	199.9	196.3	188.5	194.0
Brazil	138.4	100.0	112.8	102.5	113.0	108.0	113.9	118.8	121.8
Chile	114.4	100.0	109.3	114.3	120.0	124.4	130.1	135.6	140.4
Colombia	93.1	100.0	96.7	95.0	97.6	96.0	95.6	94.9	96.7
Costa Rica	82.7	100.0	92.8	94.3	98.3	101.0	98.8	100.7	104.4
Ecuador [b]	288.3	100.0	87.0	87.1	100.0	115.9	137.4	150.7	145.4
El Salvador [c]	287.2	100.0	103.1	104.6	104.6	102.7	103.1	99.4	95.1
Guatemala	207.5	100.0	80.7	72.5	62.8	55.5	50.7	50.2	45.6
Haiti	136.2	100.0	86.4	76.0	61.5	44.4	83.8	70.2	60.5
Honduras	117.6	100.0	96.6	108.7	110.2	94.8	89.6	86.0	91.4
Mexico	252.9	100.0	95.8	90.9	89.4	89.6	78.1	71.1	70.3
Panama	100.8	100.0	98.9	97.4	108.8	107.3	106.6	111.1	109.8
Paraguay [e]	76.4	100.0	95.6	87.1	83.8	86.0	87.3	89.4	93.8
Peru [f]	428.0	100.0	68.0	68.0	47.8	61.9	63.3	65.3	114.7
Dominican Republic	131.7	100.0	97.0	118.0	112.1	119.3	119.9	120.6	119.3
Uruguay	145.0	100.0	89.6	87.4	75.8	67.3	62.0	59.9	58.8
Venezuela [g]	209.1	100.0	86.5	123.3	108.0	121.0	113.3	107.2	91.6

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Minimum living wage, including supplementary allowances. [c] Minimum wage in industry and services in San Salvador. [d] Minimum wage, deflated by the consumer price index for Mexico City. Since 1996, deflated by the CPI for low-income groups. [e] Minimum wage in Asunción. Minimum wage in the Lima metropolitan area for non-agricultural activities. [g] Nationwide minimum wage for non-agricultural activities; from 1992 onward, includes meal and transport allowances.

Table VH.7

LATIN AMERICA AND THE CARIBBEAN: QUARTERLY LABOUR INDICATORS

	1996				1997[a]				1998[a]	
	I	II	III	IV	I	II	III	IV	I	II
					Urban unemployment rate					
Argentina										
Urban areas		17.1		17.4		16.1		13.7		13.2
Brazil										
Six metropolitan areas	5.8	6.0	5.5	4.5	5.6	6.0	5.9	5.3	7.6	8.0
Chile										
Metropolitan region	6.3	7.5	7.8	6.2	6.9	7.5	8.0	5.9	6.0	6.5
Colombia										
Seven metropolitan areas	10.2	11.4	11.9	11.3	12.3	13.3	12.2	12.0	14.5	15.8
Mexico										
Urban areas	6.2	5.6	5.5	4.7	4.3	3.9	3.7	3.1	3.5	3.2
Panama										
Total nationwide			14.3		14.1	13.1	13.2	11.8	13.7	
Uruguay										
Montevideo	12.3	12.8	12.6	11.7	11.6	12.8	12.3	9.8	10.0	9.6
Venezuela										
Total nationwide[c]		11.1		12.4		12.1		10.6	11.6	11.3
					Real average wage (index: 1990=100)					
Argentina	100.9	101.2	100.7	99.9	100.1	100.5	100.1	100.2	99.5	99.4
Brazil [e]										
Rio de Janeiro	100.7	107.4	104.5	104.8	104.5	104.9	109.3	114.8	106.0	110.0
São Paulo	105.5	105.2	110.7	116.7	107.1	108.7	114.7	120.7	113.6	108.0
Chile[f]	128.6	128.1	128.9	129.3	132.2	132.0	131.8	131.2	135.0	135.6
Colombia [8]	105.0	109.5	108.0	105.4	107.4	112.2	110.4	111.3	110.0	
Mexico	97.2	96.5	95.8	107.3	93.5	95.6	96.3	107.4	96.8	98.2
Peru"	115.7	109.5	109.1	110.5	112.1	109.9	109.7	109.6	109.2	
Uruguay	109.7	109.8	109.8	109.5	109.6	109.6	109.8	110.5	111.9	112.2

Source: ECLAC, on the basis of official figures from national sources and the International Labour Organization (ILO).
Preliminary figures. Covers a large and increasing number of urban areas. ' Refers to first and second half-years. Manufacturing. ' Workers covered by social and labour legislation. General index of hourly pay. [8] Manual workers in manufacturing. Private-sector manual workers in the Lima metropolitan area.

levels for low-paid wage earners. While in some countries real minimum wages were boosted by a larger-than-expected reduction in inflation, in others (Ecuador and Venezuela) the ascent of price indexes outdistanced the projections and thus eroded the real value of the minimum wage. There were also cases (El Salvador, Guatemala, Haiti) in which the real minimum wage fell considerably because its nominal level was not adjusted. The largest increases in the real minimum wage were instituted in Peru and Honduras, where these raises were implemented in order to help make up for earlier sharp decreases.

As in the case of mean wages, the simple and weighted averages for the minimum wage rose (by 2.8% and 3.9%, respectively), thus rebounding from the declines observed in 1996. As a result of the cautious approach taken in most of the countries, however, the median variation was -0.8%, which was slightly lower than in the previous two years.

10 Guatemala raised its minimum wage on 1 January 1998.

7. Trends in 1998

In a majority of the countries for which information is available, no major changes in existing trends were observed during the early months of 1998. The worst situation was to be found in Brazil, where employment levels fell and open unemployment climbed to 8% during the first half of the year (see table VII.7). Open unemployment was higher in Colombia as well, reaching 15.8% in June; however in this case, too, pre-existing trends remained in place and employment consequently rose as well, although not as rapidly as the labour supply.

In contrast, trends in the labour markets of a number of other countries have been more favourable. In early 1998 Argentina, Chile, Mexico, Panama and Uruguay all recorded lower levels of unemployment than they had for the corresponding months of 1997, and in each of these cases the improvement was attributable to a faster rate of job creation.

VIII. THE EXTERNAL SECTOR

The trends seen in the external sector in 1996 deepened in 1997. Despite the retreat of foreign capital triggered by the Asian crisis in the second half of the year, for 1997 as a whole a record volume of external capital flowed into the region, making it possible to build up reserves and cover larger current account deficits. These shortfalls were associated with a huge increase in the volume of imports, which far outstripped the sharp upswing in exports that took place as the world economy continued to flourish, even though the outlook was dimmed somewhat by the possible implications of the crisis in Asia.

Given the brisk pace of economic growth in the region, the steep increase registered in the current account deficit in absolute terms was only equivalent to slightly more than one percentage point of GDP, and this aggregate therefore matched the average growth rate of slightly over 3% recorded for the period 1993-1994. Meanwhile, external capital inflows amounted to around 4% of GDP. These inflows included a considerable proportion of medium- and long-term funds, and a large portion of those resources were in the form of foreign direct investment.

Thanks to the ready availability of external capital and the fact that this eased the constraints affecting domestic investment and the external sector, the robust expansion of domestic demand, which to a great extent was led by investment, was associated with a large volume of capital goods imports. Purchases of these and other foreign goods were encouraged by a steady appreciation of the countries' currencies in real terms and an improvement in their terms of trade. The external disturbances generated by the Asian crisis in late 1997, which affected raw material prices (including petroleum) most of all, undermined the confidence that had prevailed up to that time and caused economic agents to adjust their expectations regarding the possibility of a further widening of the current account deficit and the desired level of that deficit.

1. Foreign trade

In the area of foreign trade, in 1997 the region posted one of its best performances of the last two decades. This was attributable primarily to the steep increase in the volume of imports that accompanied the upturn in the region's pace of economic growth, but the strong showing of the region's exports -thanks to the solid progress made by the world economy and favourable price trends in the case of some commodities- was also a contributing factor.

Consequently, despite the improvement in the region's real terms of trade, the widespread tendency towards deepening trade deficits became even more pronounced, and the few countries that did have surpluses registered smaller ones than before. During the second half of the year, the Asian crisis exerted a negative effect on the price trends of various raw materials and dampened demand for the products exported by that region's main Latin American trading partners, thereby accentuating the upward trend in the countries' trade deficits and obliging the most severely affected countries to take steps to curb the growth of imports.

(a) The volume of foreign trade

In 1997 the region's trade in goods and services, as measured by the growth of both exports and imports, increased more than at any other time since the early 1980s (see table VIII.l). In fact, estimates on merchandise trade prepared by the World Trade Organization (WTO) for all the world regions rank Latin America and the Caribbean in first place (a position that East Asia had vacated quite some time before the outbreak of its financial crisis); the difference between the two was particularly striking in the case of imports.

The region's trade performance for 1997 was in line with the long-standing trend towards a more rapid rate of growth for imports than for exports and with a worldwide growth pattern in which trade has been expanding at appreciably faster rates than GDP. In 1997, the region's imports of goods and services rose 19% while its exports climbed by 11%, as compared to regionwide GDP growth of 5% (see figure VIII. 1).

These trends further reinforced the region's trade linkages with the rest of the world, as measured by its export and import coefficients in relation to GDP. The import coefficient maintained its historical upward trend, rising to 0.22, which was more than double its 1980 level. The region's export coefficient, for its part, climbed to nearly 0.26 (in 1980 it had stood at 0.15) after having fallen to under 0.1 in the 1980s as a consequence of the adjustment made necessary by the debt crisis that hit the region during that period (see figure VIII.2).

Consequently, a large number of Latin American economies have come to rely to a great extent on foreign trade in order to sell their products or supply their domestic markets. In 1997, two thirds of the countries recorded imports equivalent to at least one third of GDP. Mexico was one of the countries in that group, while Argentina and Brazil were the least dependent on imports, which were equivalent to around 16% of GDP in both cases. Meanwhile, exports were equivalent to one third of GDP or more in 40% of the countries, including Mexico. Here again, Argentina and Brazil were at the opposite extreme, with exports amounting to just 11% of output.

The fact that the expansion of the region's imports outdistanced its export growth in 1997 was a reflection of the steeper rate of increase registered for domestic demand than for external demand and of the continued appreciation of the Latin American currencies in real terms. These two factors have been at work, to varying extents, since the start of the 1990s and have both exerted the same type of influence. In fact, the only year in which exports expanded faster than imports was 1995, when the region's economies sought to withstand the impact of the Mexican crisis by means of a downward adjustment in domestic demand and, in countries such as Argentina and Mexico, a real depreciation of their currencies.

(i) An import boom

As a result of these forces, imports have been the most dynamic component of trade both in 1997 and in the 1990s as a whole. Their buoyancy can be attributed to a combination of structural factors that have continued to influence the region despite the changes made in economic policy over the past few decades and of factors associated with shorter-term economic circumstances, such as the strong expansion of domestic demand and the widespread appreciation of the region's currencies observed in 1997.

At the regional level, domestic demand rose more steeply in 1997 (by over 7%) than at any other time since the early 1980s. Given the magnitude of this upswing in relation to the region's existing production capacity, which is in turn a function of its investment flows, in absolute terms most of the expansion (58%) was channeled into imports, which increased accordingly. In relative terms, every percentage-point increase in demand translated into a 2.6% rise in imports (see figure VIII.3). This ratio, which reflects the region's high propensity to import, has remained above 2% since 1987 (with the exception of 1995) and was particularly high in the late 1980s and early 1990s, i.e., the period during which the countries

Table Vm.l

LATIN AMERICA AND THE CARIBBEAN: EXPORTS AND IMPORTS OF GOODS '

(Indices: 1990 = 100)

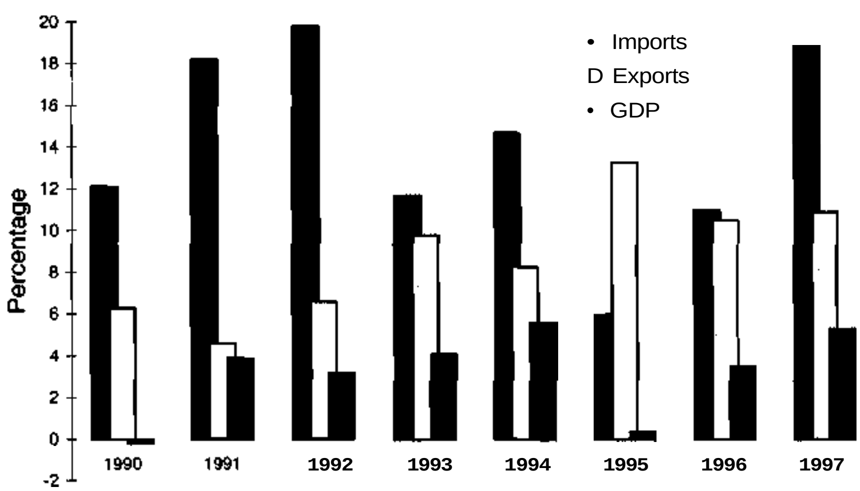
	Exports			Imports		
	Value	Unit value	Volume	Value	Unit value	Volume
1985	71.5	91.0	78.6	60.1	86.5	69.5
1986	61.4	77.7	79.0	61.7	84.1	73.4
1987	70.5	83.4	84.6	70.0	87.9	79.6
1988	81.8	89.9	91.0	81.5	92.6	88.1
1989	90.8	95.4	95.2	88.6	96.5	91.8
1990	100.0	100.0	100.0	100.0	100.0	100.0
1991	100.6	96.5	104.3	117.7	98.8	119.2
1992	107.5	96.4	111.5	143.8	98.8	145.6
1993	118.0	95.6	123.4	160.6	100.0	160.5
1994	137.2	100.9	135.9	190.6	102.2	186.5
1995	166.3	111.2	149.5	213.8	109.1	196.1
1996	186.2	113.2	164.4	236.9	109.8	215.7
1997°	206.9	110.8	186.7	280.7	106.5	263.7

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.

[a] Covers 17 Spanish-speaking countries plus Brazil and Haiti. The indices shown here for unit values and volumes do not necessarily coincide with indices for these variables calculated on the basis of the countries' national accounts due to differences in methodologies and coverage. [c] Preliminary figures.

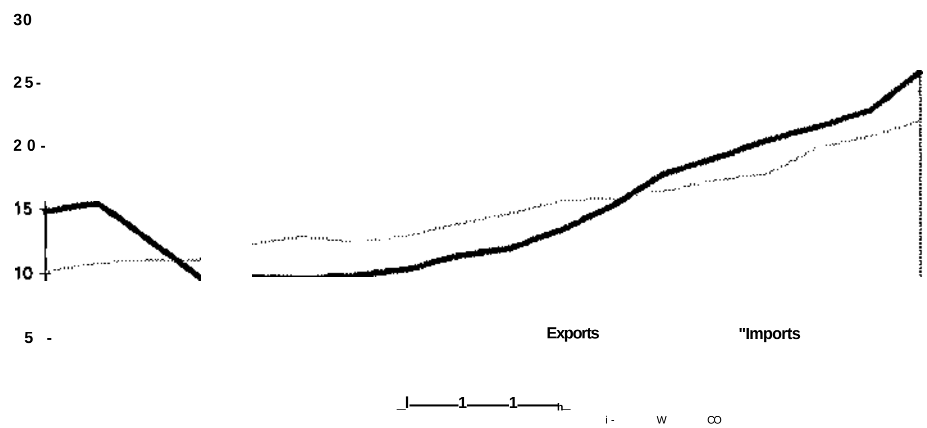
Figure VIII. 1

LATIN AMERICA AND THE CARIBBEAN: VOLUME OF EXTERNAL TRADE AND GDP



Source: ECLAC, on the basis of official figures from national accounts.

Figure Vm.2
LATIN AMERICA: ECONOMIC OPENNESS
(Trade in goods and services as a percentage of GDP)



Source: ECLAC, on the basis of official figures from national accounts.

were implementing structural reform and economic liberalization programmes. Since 1993, this ratio has leveled off at somewhat below 3%.

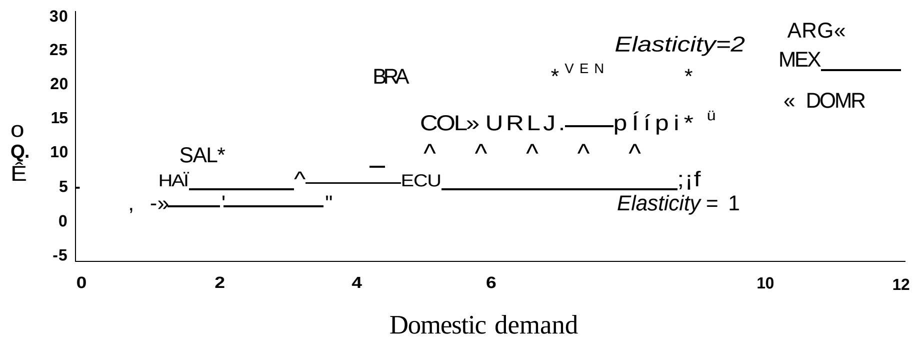
The real appreciation of most of the countries' currencies was one of the factors that helped to keep the region's propensity to import at such a high level in 1997; the influence of this factor was particularly visible in Mexico and Venezuela, which, along with Jamaica, registered the highest rates of appreciation for the year. The effect of this change in currency values on the local prices of imported goods was augmented by the decline in international prices, which amounted to an average of over 2% in 1997.

This short-term circumstance reinforced the effects of long-standing structural features. On the one hand, because of the region's rather limited industrial structure, the reactivation of production and capital formation necessarily entail the purchase of large volumes of intermediate products and capital goods from foreign producers. Thus, because of the vital role played by investment in the expansion of domestic demand in 1997, capital goods imports increased even more steeply, in relative terms, than other types of imports in virtually all the countries of the region.

In addition, it should be noted that, since a large percentage of investment is carried out by foreign firms, the import boom is also linked to the abundant capital inflows received by the region in 1997. This link is not confined to the indirect sort of relationship entailed by the fact that the expansion of the money supply resulting from such capital inflows fuels the demand for imports. There is also a direct linkage with the foreign direct investment that makes up part of the stream of capital entering the region; this component of such capital inflows has also reached record levels, as will be discussed later in the section on the current account and its financing. A sizeable portion of these foreign funds have been used to import the capital goods needed to recapitalize local firms bought by such companies or to fit out new mining projects or production facilities, some of which are themselves oriented towards exports.

The ti-in between imports and production is much more obvious in the case of the *maquila* industry, where, as in the case of transit trade, a direct link also exists between imports and

Figure VIII. 3
VARIATION ES IMPORT VOLUMES AND DOMESTIC DEMAND» 1997
(Percentages) [a]



Source: ECLAC, on the basis of official figures from national accounts.

exports. The expansion of these economic activities therefore boosted imports, except in Paraguay where the same type of linkage accounted for downturns in both imports and exports.

Imports of consumer goods have been stimulated by the ready and growing availability of foreign manufactures in the region following the dismantlement of the import quota systems and the sharp tariff rollbacks carried out during the 1980s. The tariff reductions made in 1997 in some Central American countries have continued to encourage imports (and not only of consumer products); in Brazil, the scheduled rollbacks for the automotive industry sparked a boom in motor vehicle imports. In general, the available supply of imports has also increased in many countries as a result of the expansion and gradual development of local import and distribution networks that provide potential consumers with easier access to such goods.

In view of the characteristics of these products, it would also be reasonable to assume that the demand for these items would increase particularly swiftly. These are, for the most part, durable goods whose income elasticity is greater than that of food products and non-durables. In addition, because they are imports, they are also regarded as "superior goods" in relation to locally-produced articles. In the early years of the decade, consumer goods were the most buoyant component of imports, and although recently the lead has been taken over by capital goods, they still display a great deal of forward momentum.

(ii)A strong export performance

In 1997 external demand was an important factor in the acceleration of economic activity. Although in absolute terms it played a less important role in this regard than domestic demand did, in proportional terms exports expanded more than domestic demand (11% versus 7%). This has been the case since the start of the 1990s (i.e. , once the debt crisis of the 1980s had definitely come to an end) with the sole exception of 1995, when the region's major economies were striving to make the necessary adjustments in the wake of the Mexican crisis.

The fact that exports expanded more than domestic demand did at the regional level was an accurate reflection of the situation in a majority of the countries, even though Brazil and Mexico skewed the average somewhat by virtue of their relative weight in the regional aggregate. In Mexico, export volumes rose much more sharply than domestic demand, despite the appreciation of the currency. The effect of the latter was manifested in the slowdown of external sales observed during the second half of 1996, however. Variations in the exchange rate may generate short-term impacts in economies that tend to be particularly sensitive to price movements, such as Brazil's (where the real exchange rate did not vary to any substantial degree in 1997) and Mexico's (whose exports include a large proportion of manufactures). The impact of the appreciation of local currencies was much less marked in the other countries, where manufactures make up a much smaller proportion of total exports. A prolonged real appreciation can, however, help to perpetuate the existing preponderance of commodity exports, which is why the countries' export performance is, generally speaking, heavily influenced by exogenous supply and demand factors.

Among the relevant factors of supply, weather conditions and other circumstances that affect farming and livestock production continued to figure prominently. In general, these types of factors influenced output in a variety of ways, some positive (as in the cases of Argentina's maize and wheat crops, Brazilian coffee harvests, and soybean production in Brazil and Paraguay) and some negative (Costa Rica's traditional crops, Cuban sugar, Paraguayan cotton and various crops and fishery products in the Caribbean). The effects of El Niño were especially destructive and towards the end of 1997 seriously hurt the production sector in Peru, among other countries. Another exogenous supply-related factor was the break in the Bolivian-Argentine gas pipeline, which reduced Bolivia's gas exports by nearly one fourth.

Although these kinds of factors fall outside the scope of economic policy, other types of measures can still be taken to promote exports. In Brazil, commodity sales were encouraged through the adoption of fiscal and financial measures, such as an exemption from value added tax and the re-introduction of an export credit insurance scheme, while Costa Rica and Panama adopted tax provisions to encourage investment in their customs-free areas as a means of boosting exports. Mention should be made in this connection of the valuable contribution made by the *maquila* sector to the expansion of exports in many Central American and Caribbean countries, especially the Dominican Republic, El Salvador, Guatemala, Haiti and Honduras.

On the demand side, the import measures applied in destination markets also had a considerable impact on certain product lines of importance to some countries. The Central American countries, for example, continue to be heavily influenced by the special arrangements instituted in their main market, the United States. Thus, that country's decision to eliminate its import quotas for clothing gave a boost to Costa Rican sales of wearing apparel; the health and phytosanitary regulations it applied hindered exports of some Guatemalan products; its modification of the quotas for sugar imports allowed Honduras to increase the volume of its exports but had the opposite effect on Belize; and the changes it made in quota levels for rice had the effect of reducing Guyana's access to the United States market. The European Union's new banana import regime (which will have to be modified in accordance with a WTO ruling) has adversely affected Caribbean banana exports and has prompted a reduction in the land area devoted to this crop in Belize, among other countries. By the same token, restrictions placed on cross-border trade by Brazil have hurt re-exports and other unregistered exports from Paraguay.

In a broader sense, the region's export performance depends upon the level of demand in its various target markets. In this respect, an important contributing factor to its strong showing in 1997 was the continued buoyancy of the international economy, which was reflected in a 9% upturn in world trade. The expansion of economic activity was particularly notable in markets of major importance for Latin American exporters, such as the United States (a vital market for Mexico) and the region itself. The

United States economy posted the highest growth rate (3.8%) of the last nine years and was largely unaffected by the Asian crisis in 1997, with the only noticeable impact being an easing of potential pressures for a tighter monetary policy. The situation was much the same in the Canadian economy, and thanks to the fact that a number of European countries (including the United Kingdom, Denmark, Finland, Ireland, the Netherlands and Norway) also kept up a brisk pace of economic growth, the European Union achieved a much higher growth rate (2.6%) than the year before. The Japanese economy, on the other hand, continued to slow (dropping to a growth rate of less than 1% in 1997) and, as a result, lapsed into a recession in 1998. The sharp downturn in the Asian market caused by the weak performance of Japan and of the other countries hit by the financial crisis did not, however, begin to affect the volume of some Latin American countries' exports until 1998.

Another major demand-side source of momentum was the Latin American market itself, thanks to the robust growth of economic activity seen in the countries of the region in 1997. This strength was reflected in a sharp increase in intraregional trade (see table VIII.2). The fastest rates of growth were attained by the Group of Three (Colombia, Mexico and Venezuela), whose trade flows jumped by a third. Trade between the member countries of the Andean Community and Mercosur was up by 23% and trade within each of these two groups climbed by 18%, thereby resuming the upward trends that had been interrupted in 1996 (with the exception of Mercosur, whose internal trade flows have been mounting steadily for a full decade now). The soaring levels of Brazil's and Argentina's imports included a large proportion of manufactures, particularly within the automotive industry. Mexico stepped up its commercial transactions with Chile and Peru (37% and 22%, respectively), and trade among the Central American countries was also substantially higher.

The solid progress made by the various economic areas was not only a boon to exporters in supplier countries; it also had a positive effect on the tourism industry, whose steady development has made it a highly important sector for the region. In keeping with the geographic distribution of world and regional growth, the most vigorous rates of expansion in relative terms were registered in the vicinity of North America (with the exception of Mexico). The growth rate in tourist arrivals for the countries of the Central American isthmus sped up to 11%. In the Caribbean, which received 6% more visitors than the year before, the largest increase was in Cuba (where arrivals were up by 15%), followed by the Dominican Republic, with a growth rate of 14%. The number of tourists visiting the English-speaking Caribbean rose by 4%, but arrivals were distributed quite unevenly among the various destinations within that area. Another new development in 1997 was the upswing in travel within Mercosur, which was largely responsible for the strong performance of the South American countries as a whole (where the number of tourists jumped by over 7%).

(b) The value of foreign trade

In 1997, the region's foreign trade in goods and services rose somewhat less in value than in volume since, overall, the prices of the products it buys and sells tended to weaken. Export earnings were up by over 10%, but the sum paid out for imports climbed by nearly 18% (see figure VIII.4). Consequently, for a majority of the countries the gap between earnings and outlays widened, reaching an average level of 1.6% of GDP. For the region as a whole, the shortfall was well over US$ 30 billion, which

1 This and other figures in this section have been taken from the International Monetary Fund, *World Economic Outlook,* Washington D.C., 1998.

2 The following figures refer to the value of trade, since figures on the volume of trade flows were not available; see the Latin American Integration Association (LAIA), *Evolución del proceso de integración regional durante 1997* (ALADI/SEC/Estudio 113), Montevideo, 28 May 1998.

3 The terms "visitors" and "tourists" are used to denote the number of arrivals to a given country. These data have been obtained from the World Tourism Organization, *Datos esenciales,* Madrid, 1998, and national sources.

Table VIII.2

LATIN AMERICA AND THE CARIBBEAN: INTRAREGIONAL AND TOTAL EXPORTS

(Billions of dollars and percentage share)

	1992	1993	1994	1995	1996	1997 [a]
Mercosur						
Intrasubregional	7.2	10.0	12.0	14.4	17.0	20.0
World	50.5	54.2	62.1	70.3	75.0	82.3
Mercosur/world (in %)	14.3	18.5	19.3	20.5	22.7	24.3
Andean Group						
Intrasubregional	2.2	2.9	3.5	4.8	4.7	5.4
World	28.3	29.8	34.8	40.2	44.7	48.2
Andean Group/world (in %)	7.8	9.7	10.1	11.9	10.5	11.2
LAIA						
Intrazonal	19.4	23.7	28.4	34.8	37.9	44.2
World	134.9	145.2	170.3	206.3	231.6	257.5
LAIA/world (in %)	14.4	16.3	16.7	16.9	16.4	17.2
CACM						
Intrazonal	1.0	1.1	1.2	1.5	1.6	1.6
World	4.6	5.1	5.5	6.9	7.3	8.2
CACM/world (in %)	21.7	21.6	21.8	21.1	21.2	19.6
CARICOM [b]						
Intrazonal	0.2	0.3	0.5	0.7	0.8	
World	3.7	3.7	3.7	4.5	4.6	
CARICOM/world (in %)	6.1	7.9	14.0	15.4	16.7	
Latin America and the Caribbean [c]						
Intraregional	24.5	29.3	35.2	42.8	46.5	
World	146.1	156.4	177.3	216.1	242.0	
Region/world (in %)	16.8	18.7	19.8	19.8	19.2	

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. Includes Barbados, Guyana, Jamaica, and Trinidad and Tobago. [c] Includes LAIA, CACM, Barbados, Guyana, Jamaica, Trinidad and Tobago, Bahamas, Belize, Haiti, Panama, Dominican Republic and Suriname.

was almost four times as much as the preceding year's deficit.

Ecuador and Venezuela were the only two countries whose export earnings covered their expenditures on imports, and in both cases the surplus was much smaller than in 1996. Mexico, which had been the third member of this select group in earlier years, balanced its accounts in 1997, but the rest of the countries posted deficits of varying sizes. In terms of GDP, these deficits exceeded 4% only in Bolivia, Paraguay and some of the Central American and Caribbean countries (El Salvador, Guatemala, Haiti, Honduras and Nicaragua).

The region's overall trade deficit was due more to the net result of service transactions than to its merchandise trade, however, as the deficit on the services account topped US$ 17 billion, as compared to less than US$ 13 billion on the merchandise trade account. The deterioration in the latter account was more pronounced, however, since it had previously yielded a surplus. The fact that, in terms of volume, exports rose less sharply than imports was the main cause of this turnabout, since the terms of trade improved somewhat.

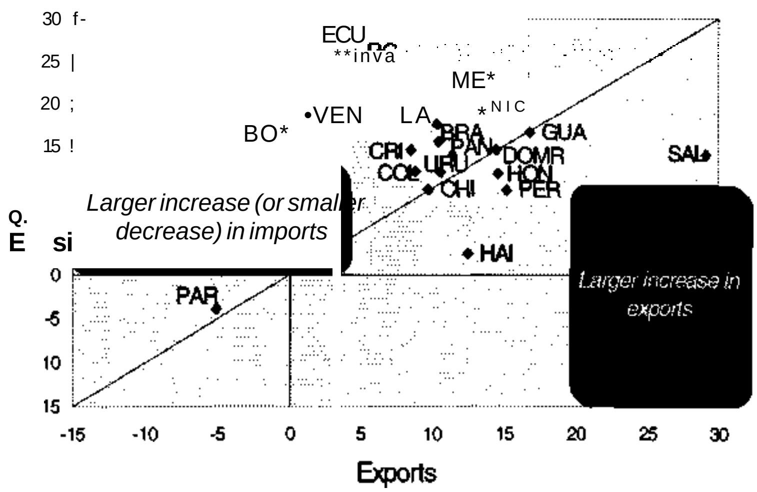
(i) Generally favourable terms of trade

The dynamism of the world economy in 1997 heiped to strengthen the prices of the commodities that make up the bulk of almost all

Figure Vm.4

VARIATIONS IN THE VALUE OF TRADE IN GOODS AND SERVICES, 1996-1997

(Percentages)



Source: ECLAC, on the basis of official figures.

the Latin American and Caribbean countries' exports. The situation took a turn for the worse in the second half of the year with the outbreak of the Asian crisis, however, as it drove down the prices of certain products, particularly those for which a large part of world demand is generated by the Asian countries (such as minerals and metals, including petroleum, and some agricultural raw materials). As a result of this combination of demand-side forces and of the various factors influencing the supply of each product -including those that generate the cycles characteristic of these markets- price trends were quite mixed.

A comparison of mean price levels in dollar terms for 1996 and 1997 reveals a number of price increases, especially in the case of food products, which were the least affected by the Asian crisis during the second half of 1997. On the other hand, the prices of many raw materials were lower than the year before. The extent to which the Asian crisis was responsible for these decreases differed from case to case. It was probably the main cause of the prices declines recorded for copper, nickel, natural rubber, wool, cowhide and rice, and was an important factor in the descent of petroleum, wood and lead prices.

Of these last products, petroleum exerts a particularly strong influence because of its relative weight in the exports of some countries and in the imports of many others. In 1997, the year-on-year slippage in crude oil prices amounted to around 5%, on average. The steepest drop came in the first quarter; prices then leveled off for the next two quarters, but then began to slide again in October as demand in the

4 Some of the region's most important products for which prices increases were recorded were bananas, beef, cocoa, coffee, fishmeal and shrimp, along with aluminium and zinc. Products whose prices declined include cotton, cowhides, maize, soybeans, sugar, wheat, wood, wool and numerous minerals, including petroleum.

5 See International Monetary Fund, *op. cit.*

Asian countries sagged; demand was also weak in the northern hemisphere, which had a relatively mild winter (perhaps as a consequence of El Niño). The effects of these factors were compounded by the fact that the OPEC and other oil-exporting countries increased their production levels.

The declines in copper and wheat prices -two other products that play a very important role in Latin American trade- illustrate the two opposite types of influence exerted by the Asian crisis. The downward spiral (33%) of copper prices in the second half of 1997 was primarily due to the contraction of demand in the Asian countries, which outweighed the rapid pace of consumption in the United States and Europe. On the other hand, the crisis played virtually no part in the steep drop in wheat and other grain prices (with the exception of rice), which was instead ascribable to the increase in output that came in response to high price levels in 1995 and 1996 and to sluggish world demand.

The downward trend that took shape in the second half of 1997 carried over into 1998, and the prices of these products thus continued to sink. In March 1998 and again in June, the major oil-exporting nations agreed to reduce the level of supply being offered on the world market in an effort to halt the slide in crude oil prices. Nevertheless, during the first half of 1998 oil prices fell another 28%. The decrease in copper prices, on the other hand, only added a further 6% to the steep drop registered in 1997.

The prices of manufactures (which represent a smaller portion of Latin America's exports but account for the lion's share of its imports) were fairly flat in 1997 in both developed and developing countries. As a result of the success of anti-inflationary measures in developed countries, the price rises for manufactures were the smallest to be observed in several decades. Consequently, the price index for internationally traded manufactures showed a year-on-year decrease of 9%. This was partly due to the appreciation of the United States dollar, since in terms of special drawing rights (SDRs), the drop was only 4%. The same exchange-rate effect was in evidence in the case of commodities, inasmuch as the IMF commodity price index (excluding petroleum) slipped by 4% when measured in dollars but climbed nearly 2% when expressed in terms of SDRs.

These uneven price trends were reflected in the unit values of the exports sold by the countries of the region, which differed according to the product mix involved in each case. Most of the countries' exports fetched higher prices, however. The few exceptions (Argentina, Chile, Mexico and Uruguay) were primarily attributable to the sagging prices of petroleum, grain, copper, leather and manufactures. Argentina and Chile were hit the hardest, as the unit value of their exports fell by 10%. The Central American countries, on the other hand, reaped the benefits of higher coffee and banana prices, and in most cases the unit values of their exports thus climbed by between 3% and 9%.

Lower prices for manufactures, petroleum and grain -all of which are major components of the region's imports-translated into an average decrease of 3% in the cost of the region's imports as a whole. The net effect of this decrease and the trend in the unit value of the region's exports, which fell by an overall average of 2%, was a widely distributed improvement in the terms of trade (see table VIII.3). The only countries to record a deterioration in the ratio between their export and import prices were Argentina, Mexico and Venezuela. Thus, generally speaking, the movement in this variable was just the reverse of what it had been the year before.

(ii) A deterioration in the merchandise trade balance

In all the countries except Paraguay, the decline in import prices was not large enough to offset the strong upswing in the volume of imports, and import spending consequently rose, in most cases quite sharply. There were very few countries in which the percentage increase was in the single digits, and in Argentina, Ecuador, Mexico, Nicaragua and Venezuela it was over 20%.

6 See International Monetary Fund, *op. cit.*

On the other hand, in all the countries except Paraguay and Bolivia, the expansion of export volumes either combined with improved prices or offset lower price levels, with the result that export earnings rose. In a majority of the cases, the increase was in or near the double-digit range but under 20%, with the exception of two countries (El Salvador and Haiti, both of which registered improvements of over 30%).

The increased expenditure on imports was only partially covered by the countries' higher export earnings, and the merchandise trade balance consequently deteriorated in most cases. For the region as a whole, the surpluses of the preceding two years gave way to a deficit of approximately US$ 13.3 billion. Trends in oil prices are usually a crucial factor in producing either a surplus or deficit on this account (and, to a large extent, in determining its size) because of the decisive influence exerted by the size of Venezuela's merchandise trade surplus, but in 1997 the region posted a deficit even though Venezuela recorded an ample surplus of some US$ 11.6 billion on this account.

Ecuador, Mexico and Venezuela were the only countries whose export earnings covered their entire import bill; Argentina had previously belonged to this select group as well, but ceased to do so in 1997. Ecuador and Mexico seemed to be on the verge of following suit, as oil prices continued to slump. For its part, Mexico had routinely recorded deficits on this account during the 1990s until it managed to reverse that trend (as had Argentina) thanks to the adjustment made in the wake of the financial crisis of late 1994.

In fact, Mexico's merchandise trade surplus was less than one tenth the size of its 1996 surplus, and by July 1997 it had already begun to

Table VIÏÏ.3

LATIN AMERICA AND THE CARD3BEAN: TERMS OF TRADE FOR GOODS, FOB/FOB '

(Indices: 1990 = 100)

	Value			Unit value			Volume		
	1995	1996	1997[b]	1995	1996	1997[b]	1995	1996	1997[b]
Latin America and the Caribbean	**21.3**	**11.9**	**11.1**	**10.2**	1.8	-2.1	**10.0**	**10.0**	**13.6**
Argentina	32.4	13.6	5.9	10.1	7.5	-10.0	20.3	5.7	17.7
Bolivia	5.7	3.0	-2.3	4.1	-11.5	-1.0	1.6	16.4	-1.3
Brazil	5.5	2.7	11.0	12.4	-0.9	1.7	-6.2	3.6	9.1
Chile	38.1	-3.9	9.9	23.9	-19.0	-0.8	11.4	18.7	10.7
Colombia	16.8	4.2	9.7	16.0	0.8	1.5	0.7	3.4	8.0
Costa Rica	16.9	10.6	7.7	10.0	-0.5	4.0	6.2	11.2	3.5
Ecuador	14.8	11.1	6.4	5.9	7.5	1.0	8.3	3.3	5.4
El Salvador	32.6	7.7	35.1	17.1	-0.7	8.8	13.3	8.5	24.2
Guatemala	27.9	3.7	16.4	16.5	-8.2	6.0	9.8	13.0	9.9
Haiti	27.4	7.4	30.6	10.0	-4.1	6.0	15.7	11.9	23.2
Honduras	27.9	11.4	13.3	12.5	-9.0	7.1	13.7	22.4	5.9
Mexico	30.7	20.7	15.0	2.9	3.0	-3.0	27.0	17.1	18.6
Nicaragua	49.9	27.4	11.3	17.0	-6.5	2.5	28.1	36.2	8.6
Panama	1.0	-3.5	13.4	2.1	-0.2	1.9	-1.0	-3.4	11.2
Paraguay	33.4	-6.4	-4.5	10.4	2.3	3.0	20.9	-8.5	-7.3
Peru	21.6	5.5	14.5	12.7	0.4	1.5	7.9	5.1	12.8
Dominican Republic	8.7	14.8	14.5	14.5	-0.8	1.3	-5.1	15.8	13.0
Uruguay	12.0	14.0	13.6	10.8	-2.7	-2.0	1.1	17.2	15.9
Venezuela	18.4	24.2	1.2	12.2	16.3	-10.0	5.6	6.7	12.4

Source: ECLAC, on the basis of figures from national sources.

[a] The unit value indices used as a basis for the calculation of the indices shown here do not necessarily coincide with the indices derived from the countries' national accounts due to differences in methodologies and coverage. Preliminary figures.

post deficits on its monthly trade account for the first time since January 1995. This trend deepened in 1998, when the value of oil exports plunged 33% in a single quarter, while its exports of manufactures and its imports maintained their growth rates. As of the end of the first quarter of 1998, Mexico's merchandise trade balance showed a deficit of nearly US$ 2.2 billion. The situation was much the same in Ecuador, whose trade deficit for that quarter was unusually large (US$ 64 million) as the impact of the drop in oil prices was heightened by the disastrous effects of El Niño in that country.

In 1998, unfavourable price trends were compounded by the slump in exports which, as a consequence of the Asian crisis, began to make itself felt quite clearly, at least in Brazil and Chile. As a result of Chile's greater exposure to any changes in trade flows with Asia, that country's earnings from copper and other traditional exports, such as forestry products, were lower, and the slowdown in import growth caused by the cooling of domestic expenditure was not pronounced enough to halt the expansion of the trade deficit. In Brazil, on the other hand, which is another of the countries that has been most seriously affected by the Asian crisis, the trade deficit was diminishing thanks to the fact that imports reacted sharply to the tight fiscal and monetary measures adopted in 1997, falling by 2% in the first four months of 1998. During this same period, the growth rate for exports slipped to less than 8%, while sales to the hardest-hit Asian countries plummeted by 43%.

(iii)Trade in services

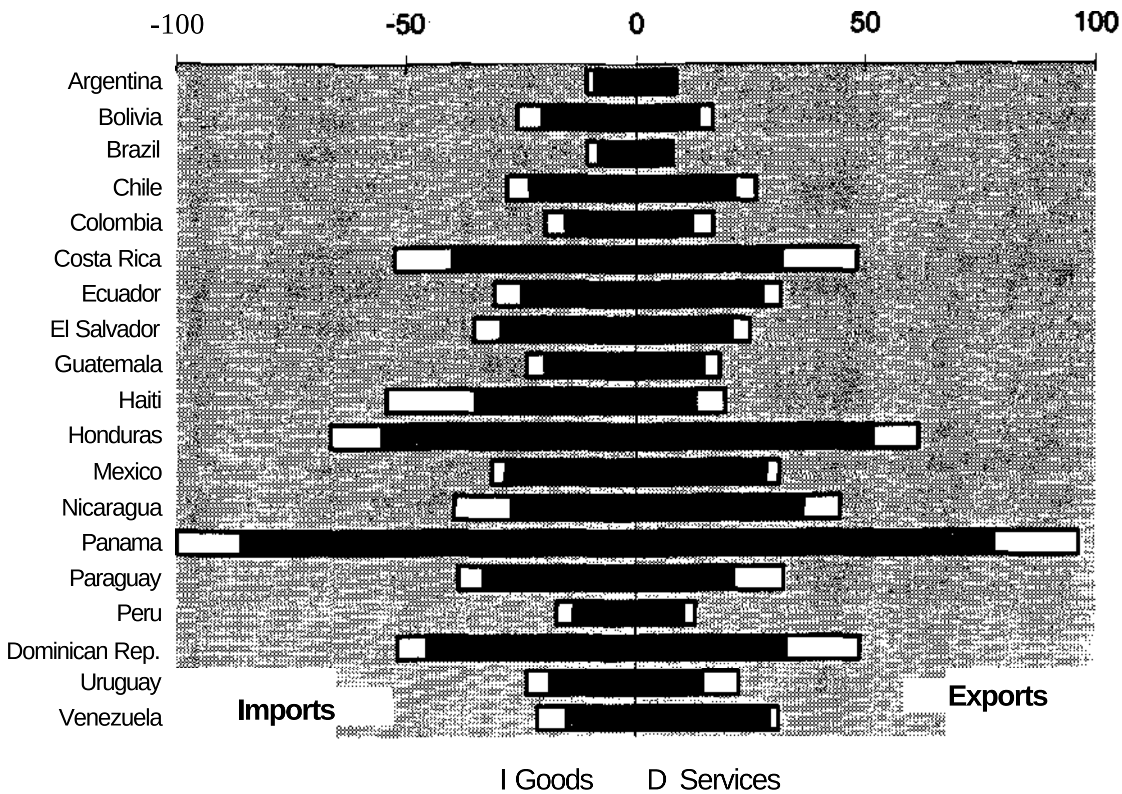
Most of the countries run a deficit on their services trade account, and its effect on the current account balance is therefore generally negative, although these deficits are usually smaller than those recorded for merchandise trade; in fact, the former were similar to or larger than the latter only in the cases of Argentina and Brazil. In Costa Rica, Dominican Republic, Panama, Paraguay and Uruguay, on the other hand, trade in services yielded a surplus and thus helped to cover part of these countries' merchandise trade deficits.

Payments for services are generally linked to merchandise trade, since insurance and freight charges for the transport of cargo make up the largest category of trade in services. All the countries except Panama and Colombia traditionally run a deficit under this heading, which attests to the region's widespread dependence on foreign fleets and services for the transport of cargo. Colombia, which has a fairly large merchant fleet, is an exception to this rule, while Panama earns a considerable amount from the provision of services in connection with shipping and canal toll fees. In 1997, the boom in merchandise trade was reflected in an increase in payments for transport services in all the countries except Paraguay (the only country in which merchandise trade was depressed). The increase was in the double digits in most countries, and the trend of total payments for services was along the same lines.

Tourism is the main source of the earnings entered on the services account and constitutes a major export item in quite a few countries; in 1997 the positive trend in such earnings continued, thanks to the increase in this type of travel, as mentioned earlier. The upswing in this item in the Central American countries (with the exception of El Salvador) ranged between 7% in Costa Rica (which relies heavily on this source of income) and 37% in Nicaragua. The higher level of tourism income in Costa Rica and the drop in such earnings in El Salvador and Haiti were presumably associated with the amount of foreign exchange brought into the countries by those of their nationals who reside elsewhere (chiefly in the United States).

Costa Rica is one of the countries in which earnings from tourism usually account for at least a third of total exports. This is also the case in the Dominican Republic, where this item jumped by 18%, and Uruguay, whose income under this heading was up by 6% thanks to an increase in the number of tourists (especially from Argentina), as travel within this area was boosted by the buoyancy of the relevant economies. Argentina, Brazil and Chile also benefited a great deal from this trend, which translated into double-digit upswings in revenues although, by the same token, outlays under the same heading

Figure VIE.5
VALUE OF TRADE AS A PERCENTAGE OF GDP, 1997
(Based on figures in dollars at current prices))



Source: ECLAC, on the basis of official figures.

also rose substantially. Tourism continued to grow in Peru, and both income and expenditure in this category were higher.

In Colombia and Mexico tourism revenues climbed by about 5% and 9%, respectively, despite the fact that fewer tourists visited these countries owing to deepening concerns about public safety. In Paraguay, on the other hand, a drop of nearly 10% in the number of visitors (owing to the measures applied by Brazil to curb cross-border trade) drove down revenues on the travel account by around 13%.

2. The current account balance and its financing

The deficit on the region's current account rose steeply, jumping from US$ 37 billion in 1996 to US$ 63 billion in 1997. This meant that it rose from 2% of GDP to 3.2% during that period, which was similar to the figure recorded for 1993-1994. This expansion is mainly attributable to the sharp downswing in the trade balance for goods and services. Since the supply of external financing was plentiful, however, the region was able not only to cover that deficit but also to add to its level of reserve assets for the second year running (see table VIH.4).

Except in the cases of the Dominican Republic, El Salvador, Honduras and Peru, the Latin American and Caribbean countries' current account balances were less favourable than they had been in 1996. El Salvador and Venezuela were the only countries to post a surplus in 1997. Bolivia, Brazil, Costa Rica and Panama all registered considerably larger deficits, while in Bolivia, Chile, Colombia, Paraguay and Peru the deficit on this account was over 5% of GDP for the second year in a row (see figure VIII.6; this figure does not include Nicaragua, which has had a deficit of over 10% of GDP at least since 1980).

(a)Factor income and current transfers

As in 1996, interest payments and profit remittances totalled 2.4% of GDP. While this ratio did not exhibit any major variations in 1997, it is important to note that in Chile, Colombia, Mexico and especially Ecuador, factor services remained above 3% of GDP and represented over one half of the deficit entered on the balance-of-payments current account for the year. The region's gross interest payments rose only slightly (to US$ 40 billion) thanks to the stability of international interest rates; in contrast, profit remittances climbed steeply, reaching the equivalent of 6.5% of its exports of goods and services. Such remittances have been trending upward in Argentina, Brazil, Chile, Colombia and Mexico, which are precisely the countries that have seen the swiftest increase in foreign direct investment since the start of the 1990s (see table VIII.5).

Current transfers received by the region, mainly from Latin Americans and Caribbeans residing abroad, continued to help finance the current account (especially in Central America and the Caribbean), providing a total of US$ 14.7 billion for the region as a whole in 1997. Measured in terms of GDP, these financial flows represented very significant sums in El Salvador (12%), Haiti (14%), and the Dominican Republic (9%). These resources turned El Salvador's deficit into a surplus and greatly reduced the level of Haiti's shortfall, while in the Dominican Republic they provided a large part of the financing for factor payments.

(b)Capital flows and international reserves

(i) General features

In 1997 the region's net capital inflows totalled US$ 80 billion, or 4% of GDP (see table VIII.6). Most of the economies in the region saw an increase in such inflows, and a number of them were also able to build up their reserve assets. Among the countries witnessing the strongest recoveries, mention should be made of Argentina, Mexico and Nicaragua, where the level of this variable trebled, while in Chile, Colombia and Peru the level of inflows remained high. In some countries the level of external finance fell sharply; this was the case, for example, in Brazil, which consequently had to draw down its reserves by US$ 8 billion. The countries receiving the highest levels of capital inflows, measured in terms of GDP, were Nicaragua (35%); Bolivia, Chile, Panama and Peru (around 10%); and Colombia, Costa Rica, Honduras and Paraguay (between 5% and 6%) (see table VIII.4).

Despite the turbulence created by the Asian crisis, the upward trend observed since 1995 in the proportion of total financial flows represented by medium- and long-term capital became much stronger in a majority of the Latin American and Caribbean economies in 1997. This has enabled the region's major economies to cope much more successfully with the bouts of financial volatility that have been triggered by the Asian crisis since October 1997.

Foreign direct investment -the least volatile component of medium- and long-term flows- provided a significant portion of the financing for a number of Latin American and Caribbean countries' current account deficits for the second year in a row. Bonds were an important source of financing in some of the region's economies as well. Bank lending remained at moderate levels, and most such loans were provided by banking consortia. Equity investment and other types of short-term capital continued to represent a fairly small proportion of capital inflows in most cases. Some countries of the region moved

Table Vffl.4

LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS

(As percentages of gross domestic product)[a]

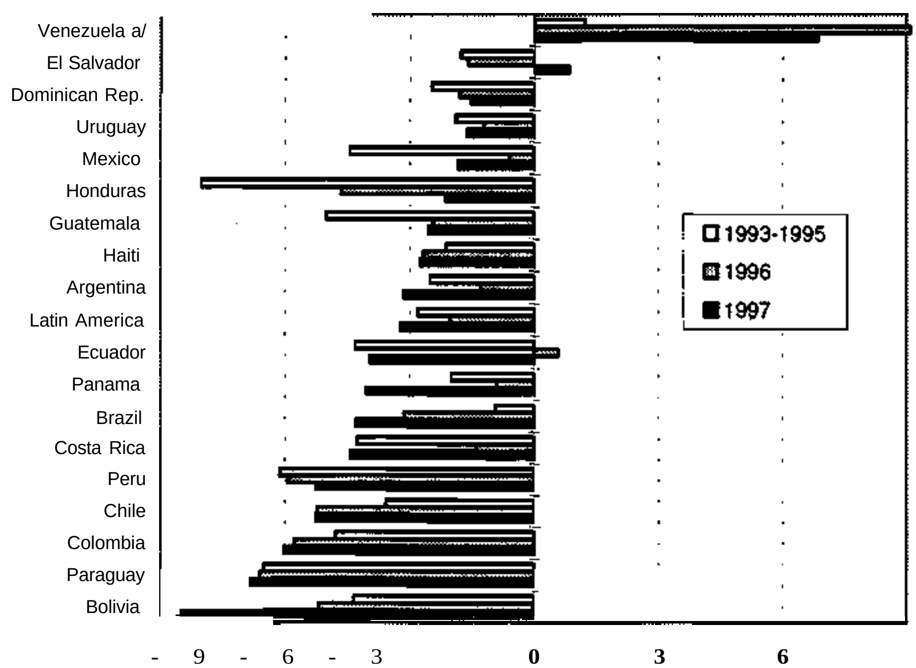
	Balance of goods and services		Balance on current account		Balance on capital and financial accounts"		Overall balance	
	1996	1997 [e]	1996	1997 [e]	1996	1997 [e]	1996	1997 [e]
Latin America and the Caribbean	-0.5	-1.6	-2.0	*-32*	3.5	4.1	1.5	**0.8**
Argentina	-0.3	-1.9	-1.3	-3.1	2.4	4.1	1.1	1.0
Bolivia	-5.6	-8.7	-5.2	-8.5	9.3	10.0	4.2	1.5
Brazil	-1.9	-2.5	-3.1	-4.3	4.3	3.3	1.1	-1.0
Chile	-2.0	-2.1	-5.2	-5.3	8.7	9.4	3.5	**4.1**
Colombia	-2.5	-3.0	-5.8	-6.0	7.5	6.0	1.7	0.0
Costa Rica	-1.1	-3.7	-1.4	-4.4	0.5	5.8	-0.9	1.3
Ecuador	6.3	0.9	0.6	-4.0	-1.3	3.4	-0.7	-0.5
El Salvador	-12.8	-10.3	-1.6	0.8	3.2	2.3	1.6	3.2
Guatemala	-4.8	-5.0	-2.5	-2.6	3.6	4.2	1.1	1.6
Haiti	-19.1	-16.5	-2.7	-2.8	0.9	3.3	-1.8	0.6
Honduras	-5.1	-3.7	-4.6	-2.1	7.2	6.6	2.5	4.4
Mexico	2.1	0.0	-0.6	-1.8	1.3	4.5	0.7	2.6
Nicaragua	-25.2	-31.8	-35.7	-35.1	11.0	37.0	-24.7	2.0
Panama	-1.3	-3.6	-0.9	-4.0	4.4	10.8	3.5	6.8
Paraguay	-7.7	-7.8	-6.6	-6.8	6.1	4.6	-0.5	-2.2
Peru	-4.4	-3.9	-5.9	-5.2	7.5	9.0	1.6	3.8
Dominican Republic	-2.5	-2.5	-1.8	-1.5	1.5	3.1	-0.3	1.6
Uruguay	-0.7	-1.0	-1.2	-1.6	2.0	3.3	0.8	1.7
Venezuela	14.8	9.1	12.6	6.9	-2.6	-3.2	10.0	3.7

Source: ECLAC, on the basis of figures from the International Monetary Fund and official sources.
[a] Estimates based on figures expressed in dollars at current prices. Includes errors and omissions. " Preliminary figures.

Figure Vin.6

LATIN AMERICA AND THE CARIBBEAN: CURRENT ACCOUNT BALANCE

(As percentage of GDP)



Source: ECLAC, on the basis of figures from the International Monetary Fund and official sources.
[a] In 1996 the surplus amounted 12.9% of GDP.

Table Vffl.5
LATIN AMERICA AND THE CARD3BEAN: REMITTANCES OF PROFITS AND DIVIDENDS '
(Millions of dollars)

	1980	1990	1991	1992	1993	1994	1995	1996	1997[b]
Latin America and the Caribbean	**4 621**	**6 892**	**6 946**	**7 850**	**10 022**	**12 878**	**15 349**	**15 762**	**20 874**
Argentina	605	637	807	1 133	1678	1821	1893	1661	2 349
Brazil	955	1892	1053	824	1979	2 315	3 884	3 841	6659
Chile	86	387	875	1033	947	1870	2 199	2 241	2 620
Colombia	110	776	716	943	1022	1349	1729	2 069	2 121
Mexico	1366	2 304	2 492	2312	2512	3 627	3 542	4 193	4 914
Peru	256	15	36	159	132	187	350	332	572
Venezuela	322	224	228	507	574	514	429	441	603
12 other countries	921	657	739	939	1 178	1 195	1323	984	1036

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.
" Includes reinvestment of profits. Preliminary figures.

Table Vffl.6
LATIN AMERICA AND THE CARD3BEAN: CAPITAL ACCOUNT INDICATORS
(Percentages)

	1990	1991	1992	1993	1994	1995	1996	1997
Current account balance/GDP *	-0.2	-1.5	-2.7	-3.2	-3.1	-2.1	-2.0	-3.2
Capital account balance/GDP " [b]	-0.7	1.9	3.8	4.3	2.5	1.7°	3.5	4.1
Overall balance/GDP	-0.9	0.4	1.0	1.1	-0.7	-0.4	1.5	0.8
Capital inflows to Latin America/ capital inflows to developing countries	-8.0	18.9	32.9	28.6	18.9	11.7	22.5	26.5
LIBOR (nominal)	8.3	6.0	3.9	3.4	5.1	6.1	5.6	5.8
LIBOR (real)	3.2	1.3	0.8	0.6	2.7	3.5	3.2	3.7
Yield on United States government bonds	8.6	7.9	7.0	5.8	7.1	6.6	6.4	6.4

Source: ECLAC, on the basis of official figures and data from the International Monetary Fund and the World Bank.
" Coefficients have been estimated on the basis of figures expressed in dollars at current prices. The figures on capital inflows include errors and omissions. [c]In addition, Latin America received US$ 29 billion in exceptional financing. [d] Net flows of long-term resources.

ahead with the implementation of mechanisms designed to discourage excessive inflows of short-term and, especially, speculative capital; these mechanisms took the form of reserve requirements in Chile and Colombia and of graduated taxes on financial operations in Brazil.

The region's position in terms of external financing in 1997 can be divided into two different phases. During the first, which was marked by an abundant supply of such resources and narrowing spreads over the reference rate, the situation was a highly positive one in terms of nearly all the various types of capital inflows.

In June 1998 the Central Bank lowered the reserve requirement from 30% to 1

This phase came to an end in September 1997. During the second phase, which began in October, reference interest rates were stable, but financing became more expensive as the Asian crisis deepened. This began to affect some of the financial flows to Latin American economies suffering from major internal and/or external imbalances, thus making it necessary for them to adopt economic policy measures (primarily in the monetary, fiscal and commercial areas of the economy) in the fourth quarter of 1997 and the early months of 1998.

The Asian crisis, which had begun to grow more serious in July 1997, started to make its effect felt on capital flows to the region in October of that year, and investors began to pull out of some countries. In terms of magnitude, the most severely affected components between October 1997 and early 1998 were equity investment, bond issues and other short-term capital. The hardest-hit countries during this period were Brazil, Chile, Colombia and Venezuela, where speculative attacks and withdrawals of funds were partly attributable to the presence of speculative capital in connection with investments on their local stock exchanges. A total of US$ 5.075 billion in short-term capital flowed out of Brazil in the fourth quarter of 1997 ; Chile built up a US$ 1.8 billion deficit on its balance of payments between December 1997 and January 1998; US$ 850 million was withdrawn from Venezuela in the fourth quarter of 1997; and by February 1998, Colombia's international reserves were US$ 560 million lower than they had been at the end of 1997.

A number of Governments and business enterprises postponed international bond issues as well. In November 1997, the spreads on debt paper traded on the secondary market began to widen sharply, reaching more than 500 basis points in the cases of Argentina and Brazil. In some other Latin American countries, however, the Asian crisis had little or no impact in the fourth quarter of 1997 and early 1998.[9]

(ii)The structure of capital flows

- Foreign direct investment (FDI)

In 1997 Latin America's inflows of foreign direct investment reached an all-time record of US$ 55 billion. This was largely the result of unprecedented levels of investment activity in Argentina, Brazil, Colombia, Mexico and Venezuela (see table VIII.7). Around 20% of the region's FDI corresponded to privatization operations involving foreign capital, with sales of State assets being conducted on an especially large scale in Brazil and Colombia. Mergers and the acquisition of private firms by foreign investors also played a highly important role. Foreign direct investment was also more geographically diversified in 1997, making it possible for more than half of the Latin American and Caribbean economies to cover a large part of their current account deficits with FDI. Thanks to the striking increase in these levels, the region's share of total FDI flows to developing countries swelled from 30% to 45%.'[l]

Although FDI still appears to be concentrated in commodity-related activities, increasing amounts of such funds are being channeled into manufacturing, telecommunications, business and financial services, and infrastructure projects. Intraregional investment also continued to mount; meanwhile, the share of investment funds coming from the United States held steady, but the share accounted for by the countries of the European Union increased. As for outward FDI, Chilean firms invested a record US$ 2 billion in other countries in 1997, and foreign investments by Brazilian and Venezuelan residents also reached significant levels; in the case of the other countries of the region, these flows increased at a fairly sedate pace.

8 See chapters I and n.

9 See ECLAC, *Impact of the Asian Crisis on Latin America* (LC/G.2026), Santiago, Chile, May 1998.

10 See ECLAC, *La inversión extranjera en LATIN AMERICA. Informe 1997* (LC/G.12985-P), Santiago, Chile, March 1998. United Nations publication, Sales No: S.97.II.G.14.

11 According to information compiled by the World Bank, in 1997 a total of US$ 120 billion in foreign direct investment was received by developing countries, which was quite similar to the figure for 1996.

Table Vin.7

LATIN AMERICA AND THE CARIBBEAN: NET FOREIGN DIRECT INVESTMENT[a,b]

(Millions of dollars)

	1980	1990	1991	1992	1993	1994	1995	1996	1997[c]
Latin America and the Caribbean	**5 735**	**6 760**	**11031**	**13 229**	**10 932**	**21451**	**26 900**	**35 886**	**55 339**
Argentina	788	1836	2 439	4 019	3 262	2 982	4 628	4 885	6 298
Bolivia	46	66	94	120	122	128	372	472	558
Brazil	1544	324	89	1924	801	2 035	3 475	9 123	18 601
Chile	213	653	697	433	600	1672	2 220	3 561	3 467
Colombia	51	485	433	679	719	1515	1943	3 208	5172
Costa Rica	48	161	172	222	245	293	390	422	446
Ecuador	70	126	160	178	469	531	470	447	577
El Salvador	6	2	25	15	16	23	38	25	
Guatemala	111	48	91	94	143	65	75	77	82
Haiti	13	8	14	-2	-2	-3	7	4	5
Honduras	6	44	52	48	52	42	69	90	114
Mexico	2 090	2 549	4762	4 393	4 389	10972	9 526	8169	12 101
Nicaragua				15	39	40	70	85	162
Panama	252	132	41	139	156	354	179	238	1030
Paraguay	32	76	84	137	119	164	157	105	191
Peru	27	41	-7	136	670	3 083	2 048	3 242	2 030
Dominican Republic	93	133	145	180	214	348	389	358	405
Uruguay	290		32	58	102	155	157	137	160
Venezuela	55	76	1728	473	-514	136	686	1595	4 346

Source: ECLAC, on the basis of figures from the International Monetary Fund and from national sources.

" Refers to direct investment in the reporting economy minus direct investment abroad by residents. Includes reinvested eamings. For some countries this information is not available. In accordance with the fifth edition of the IMF *Balance of Payments Manual,* all transactions between non-financial direct-investment enterprises and their parent companies and affiliates are included in direct investment. [c] Preliminary figures.

- *International bond issues*

As in the past, a limited number of economies -notably Argentina, Brazil and Mexico- accounted for the bulk of the region's debt issues on international markets. Most of these financing operations were undertaken by central governments (see box VIII. 1), with a smaller proportion corresponding to business enterprises. In 1997, the net amount of financing obtained via bond issues totalled US$ 25 billion.

The region's international bond issues in 1997 were notable for the fact that their average maturity doubled and the spreads over the relevant reference interest rates narrowed to around 300 basis points (see table VIII.8); 60% of placements were in United States dollars and the remainder in an assortment of European currencies and the Japanese yen. In the fourth quarter of 1997, however, the turbulence generated by the crisis sweeping over many Asian economies caused the terms and conditions for these bond issues to deteriorate considerably; the situation then began to improve through April 1998 but began to worsen once again in May.

- *Equity investment*

Foreign equity investment held fairly steady at US$ 11 billion, which was quite similar to the total for 1996. This type of investment is still concentrated in a few countries of the region, especially Brazil (which received more than half of the total in 1997), Argentina, Chile, Mexico and, to a lesser extent, Colombia and Peru. The level of American Depository Receipts (ADRs) climbed to US$ 5.1 billion, which was an improvement over the depressed levels of 1995 and 1996 but still below the peak level reached in 1993. Net equity investment flows showed a tendency to expand during the first half of the year, especially in some countries, in part because of the stimulus provided by bullish stock markets, which exhibited a great deal of strength with an upswing of 40% up to September 1997 (see figure VIII.7). During the fourth quarter of 1997 and the early months of 1998, however, equity investment in the region slackened in response to the sharp downturns in quotations on Latin American exchanges that were triggered, in large part, by the Asian stock market crash of late October 1997 (see table VIII.9). The impact of the Asian crisis on investment flows during this period was most intense in Brazil, Chile and Venezuela.

- *Bank lending*

Although net bank lending to the region has gradually been rising since 1995, the total amount of such loans has nonetheless been quite moderate and has tended to be concentrated in a few countries (and mainly in the private sector). The economies receiving the lion's share of such flows in 1997 were Argentina, Brazil, Chile and, to a lesser extent, Ecuador and Peru. As of the end of 1997, international commercial bank claims on Latin America totalled US$ 305

Box VIE 1

MAJOR INTERNATIONAL BOND ISSUES[8] PLACED BY LATO? AMERICAN GOVERNMENTS IN 1997

Country	Amount (in millions of dollars)	Spread at time of placement[b]	Coupon {%))	Term (in years)
Argentina	2 250	305	9.8	30
Brazil	3000	395	10.1	30
Colombia	750	130	7.6	10
Colombia	250	170	8.4	30
Ecuador	350	470	11.3	5
Mexico	1000	335	9.9	10
Panama	700	250	8.9	30
Venezuela	4 400	325	9.3	30

Source: ECLÀC, on the basis of World Bank figures.

[a] Largest issues placed by Governments of the regjo betwee» January and September 1997. AU the issues shown are denominated in dollars and carry fixed interest rates.

Difference between the yields of the bonds issued and the yield of United States Treasury bonds of a similar term (100 basis points equals 1%).

During 1997 the Governments of Argentina and Mexico continued to pursue their policies of obtaining longer maturities for new commitments and lower interest rates. The Governments of Brazil and Venezuela also were very active in international bond markets during the year. Until September 1997, the trend towards longer maturities that had emerged in 1996 held firm, and some large issues were placed for terms of between 10 and 30 years. However, even though spreads over nominal interest rates narrowed, in real terms the spreads were still very large for most of the issues placed by Governments of the region.

The Governments of Argentina, Brazil, Ecuador, Panama and Venezuela used a sizeable portion of these resources to retire Brady bonds corresponding to US$ 14.8 billion of debt in gross terms, thereby releasing the collateral on those bonds. The restructuring of this debt reduced it by US$ 2.5 billion.

Table Vra.8

LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISSUES'

	1995	1996	1997	1997				1998
				Quarter I	Quarter II	Quarter m	Quarter IV[b]	Quarter I[e]
				Maturity (years)				
Region	3.7	7.8	**15.4**	**14.4**	**13.6**	**18.6**	7.6	6.9
Argentina	4.7	9.2	13.5	14.0	7.5	16.8	4.5	9.3[d]
Brazil	2.7	6.5	16.5	8.2	23.5	7.9	9.2[e]	4.6[e]
Chile	8.0	7.3	35.6	54.9	-	9.3	-	-
Colombia	9.7	6.9	15.0	15.0	-	-	5.0	6.5
Ecuador	-	-	5.0	-	5.0	-	-	-
Mexico	2.4	7.4	9.4	10.0	7.8	12.3	-	8.7
Panama	-	-	19.6	5.0	-	30.0	-	-
Uruguay	-	-	30.0	-	-	30.0	-	-
Venezuela	3.8	7.0	30.0		14.8	30.0		
				Spread [f]				
Region	**...**	**370**	**285**	**271**	**308**	**286**	**450**	**400**
Argentina		383	298	340	264	278	355	416
Brazil		358	327	227	353	335	515	443
Chile		86	96	103	-	88	-	-
Colombia		188	140	140	-	-	155	290
Ecuador	-	-	470	-	470	-	-	-
Mexico		393	263	298	257	262	-	313
Panama	-	-	219	175	-	250	-	-
Uruguay	-	-	135	-	-	135	-	-
Venezuela		440	325	-	159	325	-	-

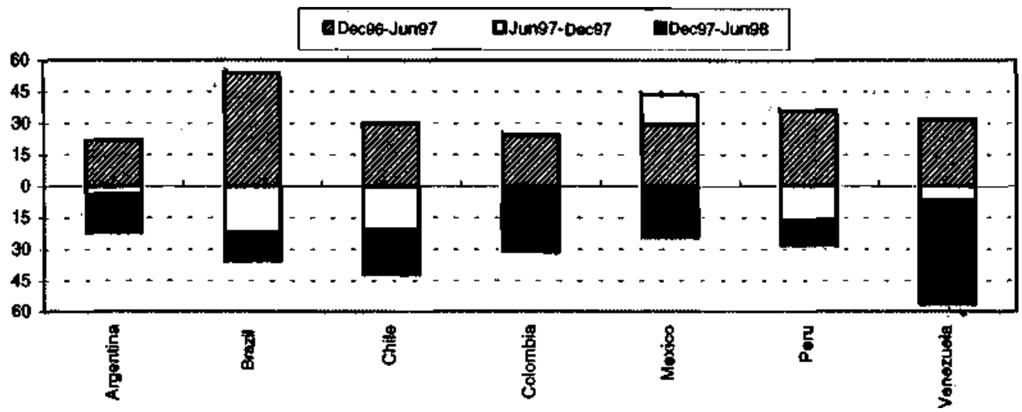
Source: Up to the third quarter of 1997: ECLAC, on the basis of figures published in World Bank, *World Debt Tablesl996,* Washington, D.C., and *Financial Flows and the Developing Countries,* Washington, D.C., (various issues); from the fourth quarter of 1997 on: ECLAC, on the basis of official figures.

" Up to the third quarter of 1997, includes issues over US$ 150 million. [b] Includes issues made after the crash of the Hong Kong (China) stock exchange on 27 October 1997 only. Preliminary estimates. Does not include a US$ 500 million expansion of the global bond having a term of 29.5 years. Includes Euronotes and certificates of deposit. Refers to the differential between the yields of the bonds issued and the yield of United States Treasury bonds having comparable terms (100 basis points equals 1%).

billion. Information compiled by the Bank for International Settlements indicates that bank lending to the region proceeded at a good pace until the third quarter of 1997. In the fourth quarter of 1997 and the early months of 1998, however, the serious difficulties facing the banking system in Asia drove down the level of bank loans to the region.[12] After October 1997 a deterioration was also seen in the terms of bank loans; this was particularly apparent in the widening spreads over reference interest rates. Short-term loans continued to represent a moderate proportion of total capital inflows to the majority of the countries in the region, and most

12 In November 1997 Argentina attempted to secure a syndicated loan from international banks, but talks on the subject were later suspended. In January 1998, Argentina's primarily foreign-owned banking system extended a 2 billion peso loan with a 3-year maturity to the Government.

Figure Vm.7
VARIATION IN STOCK EXCHANGE INDEXES
(Based in indexes denominated in dollars)



Source: ECLAC.on the basis of figures from the International Finance Corporation.

of these funds were used for foreign trade operations.

(iii)Net resource transfers

Since net capital inflows once again exceeded remittances of profits and interest payments, the net transfer of financial resources to Latin America and the Caribbean remained positive, as has been the case since 1991. In 1997, net transfers totalled US$ 31.6 billion (see table VIII. 10). This situation was quite widespread, with Ecuador, the Dominican Republic and Venezuela being the only countries in which the direction of net transfers was outward. In absolute terms, the highest levels were seen in Argentina, Brazil, Chile and Mexico. When measured in relation to exports of goods and services, the countries receiving the largest proportions of such transfers were Nicaragua (78%), Bolivia and Peru (42%) and Argentina (32%).

(iv) External debt

In 1997 the region's foreign debt rose by 3% to US$ 643 billion, or 33% of GDP. In over half of all Latin American and Caribbean countries, the level of external liabilities changed very little. Peru and Trinidad and Tobago sharply reduced their nominal external debt, in the first case thanks to debt restructuring operations and, in the second, to a high net level of amortization payments. In contrast, the external debts of Argentina, Brazil and especially Chile rose sharply, mainly because of increased borrowing by the private sector. Despite the sizeable reduction in government debt in some countries, particularly Mexico, public-sector debt continued to represent around 60% of the region's total debt.

A number of Governments continued to pursue a prudent policy aimed at improving the maturity profile of their public external debt while at the same time taking steps to reduce its financial cost. In order to accomplish this, for the most part they turned to international bond markets, taking advantage of their liquidity and the more favourable terms that were available up to September 1997. Some countries used the very large sums they obtained on these markets to pay off short-term debts, while others used them to buy back Brady bonds. Brazil and Venezuela floated the largest issues of government bonds in the region in 1997 (see box VIII. 1).

Peru and Bolivia made noteworthy progress in the renegotiation of their external debts. In March 1997, the Government of Peru successfully concluded an agreement for the restructuring of US$ 8 billion of commercial foreign debt

Table Vffl.9

LATIN AMERICA AND THE CARIBBEAN: STOCK EXCHANGE INDEXES, IN DOLLARS [a]

(Indices: June 1997 = 100)

	1990	1991	1992	1993	1994	1995	1996	1997	1998[b]
itin America	**22.7**	**49.0**	**51.0**	**77.4**	**76.2**	**62.5**	**72.5**	**90.6**	**72.0**
Argentina	14.2	70.0	50.7	84.9	63.6	69.1	82.1	96.3	78.7
Brazil	8.2	20.2	20.0	38.2	64.0	49.8	64.9	78.3	67.4
Chile	24.6	46.7	52.4	67.8	95.8	93.0	77.0	79.6	62.5
Colombia	16.6	45.5	62.0	81.6	103.5	77.1	80.5	99.9	69.0
Mexico	43.7	88.5	106.2	156.0	91.1	66.5	77.3	114.1	86.1
Peru	0.0	0.0	32.6	43.9	66.8	73.1	73.6	83.8	73.7
Venezuela	89.1	128.0	73.3	65.6	47.8	32.7	75.7	93.3	46.8

Source: ECLAC, on the basis of figures from the International Finance Corporation.
[a] Year-end figures. Figures as of the end of June.

Table Vm. 10

LATIN AMERICA AND THE CARIBBEAN: NET RESOURCE TRANSFERS [a]

(Millions of dollars)

	1980	1990	1991	1992	1993	1994	1995	1996	1997[b]
Latin America and e Caribbean	**10 966**	**-17 366**	**4183**	**25 816**	**30 873**	7 **279**	**17 122**	**20156**	**31641**
Argentina	664	-5 830	-1573	6 152	9 257	7 399	-497	4 314	**8** 996
Bolivia	-319	-19	24	258	339	19	234	460	541
Brazil	2319	-7 345	-8 612	530	-1714	-896	19 759	20 351	**9** 522
Chile	2 240	868	-780	1421	1070	2 004	-589	2 056	**4** 268
Colombia	868	-2 034	-2 394	-1629	659	1063	1960	3 106	**2** 227
Costa Rica	-545	64	341	356	335	51	111	-120	348
Ecuador	299	-839	-557	-1055	-132	-151	-761	-1245	-327
El Salvador	-161	294	22	190	118	37	383	241	180
Guatemala	-139	-5	632	513	704	671	210	352	559
Haiti	55	-35	12	37	64	-6	184	13	106
Honduras	103	-30	34	108	-4	151	51	104	159
Mexico	4 829	2 396	14 777	16 406	18 427	-1808	-2 122	-9 836	**5** 170
Nicaragua	80	161	212	340	136	344	352	477	713
Panama	-64	-115	-23	-816	-639	-103	94	271	957
Paraguay	422	377	617	225	456	1035	622	662	497
Peru	-157	-111	979	1 164	1411	3 894	3 251	3 910	**3** 552
Dominican Republic	403	-19	322	450	22	-1 109	-428	-838	-928
Uruguay	705	-467	-161	8	230	294	147	163	434
Venezuela	-636	-4 677	311	1 158	134	-5 610	-5 839	-4 285	**-5** 333

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.
[a] The net transfer of resource is equal to net capital inflows (including involuntary flows and errors and omissions) minus the balance on the factor income account (net payments of profits and interest). In this table, negative figures indicate outward transfers of resources. Preliminary figures.

Table VIH. **11**

LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL INTEREST TO EXPORTS OF GOODS AND SERVICES [a]

(Percentages)

	1991	1992	1993	1994	1995	1996	1997[b]
Latin America and the Caribbean	**21.6**	**18.7**	**18.2**	**16.8**	**16.5**	**15.3**	**14.5**
Argentina	36.1	23.1	21.3	24.3	24.0	23.2	25.6
Bolivia	29.2	23.2	21.3	14.8	16.8	16.3	16.7
Brazil	27.2	20.8	21.8	17.9	20.5	23.4	23.9
Chile	14.7	11.3	10.3	8.2	7.3	7.0	6.9
Colombia	16.4	14.6	12.3	12.9	13.6	14.4	14.8
Costa Rica	10.1	8.7	8.1	6.4	6.2	5.6	5.5
Ecuador	31.3	24.1	23.2	20.7	17.2	17.6	16.6
El Salvador	12.6	10.5	10.3	6.3	5.6	6.0	5.6
Guatemala	7.1	8.8	6.2	5.8	4.8	6.1	4.7
Haiti	7.7	5.6	8.4	6.5	11.1	4.0	4.2
Honduras	21.1	25.9	15.5	15.5	13.2	11.4	8.9
Mexico	18.0	17.5	18.3	17.0	15.2	12.6	10.2
Nicaragua	110.3	158.6	115.6	102.1	54.5	35.8	21.7
Paraguay	4.7	8.5	3.1	2.4	19	2.1	2.4
Peru	36.7	37.3	38.8	35.4	33.2	25.5	19.8
Dominican Republic [c]	8.6	9.1	5.9	4.7	4.9	3.8	3.0
Uruguay	21.2	15.7	14.4	14.9	18.0	15.1	15.9
Venezuela	15.5	18.3	17.0	17.0	16.1	11.2	12.8

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.
In some countries includes interest on portfolio investments. Preliminary figures. From 1993 on, *maquila* exports are included under "exports of goods".

(including both principal and interest arrears).[13] In the case of Bolivia, in 1997 the World Bank approved a debt relief programme for the country under the terms of the Heavily Indebted Poor Countries (fflPC) Debt Initiative. Honduras and Nicaragua, which have made great strides but nonetheless continue to exhibit highly worrisome debt indicators, could be eligible for this type of debt relief programme in 1998.

The great majority of the countries in the region saw a further improvement in their external debt/exports and interest payments/ exports coefficients in 1997. In some cases, however, these indicators continued to be a cause of concern (see tables VIII. 11 and VIII. 12).

Short-term debt continued to represent about 18% of the region's total debt in 1997. At the individual country level, this coefficient was near or below 25% in all cases with the exception of Paraguay (35%). Among those countries having a fairly high level of short-term external debt in absolute terms, as of mid-1997 the coefficients for these liabilities when measured as a percentage of international reserves were 126% for Mexico, 108% for Argentina, 69% for Brazil, 57% for Colombia and 44% for Chile, thus comparing favourably with the figures for the Republic of Korea (300%) and Indonesia (160%) during that same period.

13 For further information on the terms of this agreement, see ECLAC, *Economic Survey of Latin America and the Caribbean, 1996-1997* (LC/G.1968-P), Santiago, Chile, September 1997, p. 138. United Nations publication, Sales No: E.97.II.G.2.

14 See the section on Bolivia in this edition of the *Survey*. In 1996 a similar programme was approved for Guyana.

15 World Bank, *Global Development Finance, 1997,* Washington, D.C.

Table VHL12

LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL DISBURSED EXTERNAL DEBT TO EXPORTS OF GOODS AND SERVICES

(Percentages)

	1991	1992	1993	1994	1995	1996	1997"
Latin America and le Caribbean	2705	**262.1**	263.6	**2423**	**2223**	**2063**	**191.9**
Argentina	406.0	402.4	435.4	428.8	374.9	368.8	383.8
Bolivia	390.4	466.1	423.5	358.0	368.0	342.2	333.0
Brazil	354.4	340.9	334.3	302.6	307.3	326.7	320.1
Chile	155.5	153.4	167.9	152.1	113.0	122.4	129.9
Colombia	190.5	186.9	190.4	181.6	181.3	200.2	197.9
Costa Rica	182.3	154.7	131.7	115.1	102.6	81.8	73.8
Ecuador	376.3	344.2	367.5	318.5	265.1	253.8	253.7
El Salvador	234.1	239.7	174.7	126.2	114.3	112.9	92.6
Guatemala	142.3	118.7	103.1	94.5	75.2	74.9	65.8
Haiti	237.2	590.3	562.7	670.5	372.6	355.6	354.7
Honduras	338.8	344.7	318.0	295.0	244.7	215.8	187.0
Mexico	226.9	210.0	212.6	196.4	184.1	147.2	123.0
Nicaragua	3049.4	3367.0	3237.2	2584.0	1599.4	755.1	656.6
Panama	68.7	56.2	52.2	49.4	51.8	68.3	61.0
Paraguay	80.9	65.6	41.2	36.1	29.0	31.3	35.4
Peru	491.2	476.1	631.5	536.8	495.6	461.5	337.8
Dominican Republic [b]	248.5	230.9	98.4	77.3	71.8	60.4	48.9
Uruguay	188.1	157.2	155.5	152.7	148.1	139.5	132.0
Venezuela	219.7	247.8	250.5	232.8	187.7	138.7	128.7

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.

Note: A table on the external debt in which the data are expressed in absolute terms is included on the diskettes that accompany this publication.

* Preliminary figures. [b] From 1993 on, *maquila* exports are included under "exports of goods".

SECOND PART

COUNTRIES

ARGENTINA

1. General trends

Economic activity expanded significantly in 1997 and unemployment fell, although it continued at high levels. Increased domestic demand had no effect on prices, which remained practically stable. The current account deficit hovered around 3% of GDP, but was financed without problems because of large capital inflows. This economic momentum continued well into 1998, until the current account gap widened as the merchandise trade imbalance was aggravated by a fall in cereal and petroleum prices, weaker demand in Brazil and a continuing high level of imports.

The increase in GDP of more than 8% in 1997, following the previous year's recovery, meant that cumulative growth in output since the beginning of the decade was nearly 50%. Within aggregate demand, there was a noteworthy rise in investment, while consumption increased significantly, although at a slower rate than GDP. The economic acceleration generated a considerable amount of employment; however, most of the new hiring was not on a regular indefinite-term contractual basis. The value of exports increased by around 6%, while imports showed strong growth, resulting in a considerable trade deficit. 1997 saw large inflows of capital from expanded foreign direct investment and from increased private-sector issues of securities. For its part, the Government undertook a large volume of external financing operations, but the net balance was lower than in the previous year.

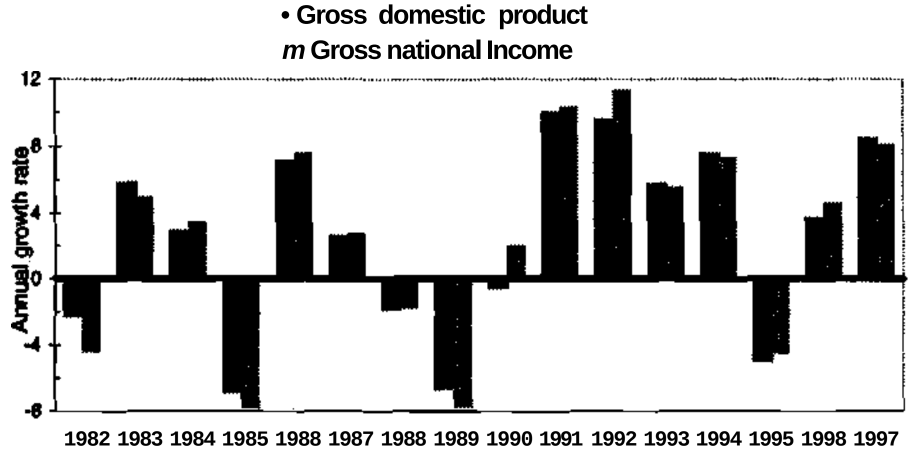
The positive trends of the previous year were consolidated in 1997. Cautious behaviour and its effects on portfolio decisions and willingness to spend, following the sharp contraction in output and revenue of the mid-1990s, gradually began to diminish. The supply of foreign credit regained fluidity and local financial markets revived thanks to the improved international situation and perceptions that the economy, and in particular the monetary and exchange rate systems, had managed to withstand strong turbulence.

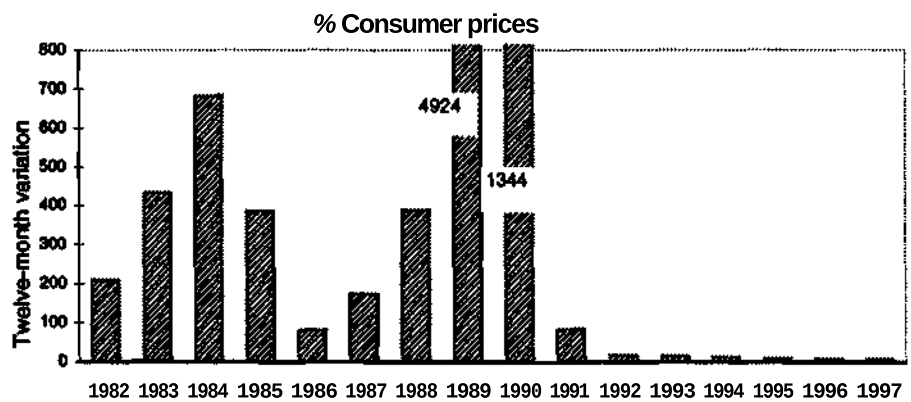
Until well into 1997, the financial markets reflected the growing availability of funds, with rises in the price of assets, interest rate reductions and increases in the volume of resources channeled through the banks. The marked recovery in output generated expectations which stimulated spending and investment decisions. A sharp increase in construction and in purchases of equipment raised capital formation to a historically high level. This occurred in a context of heightened activity with respect to changes in the ownership and control of enterprises, in which foreign firms were increasingly involved, especially in sectors such as banking.

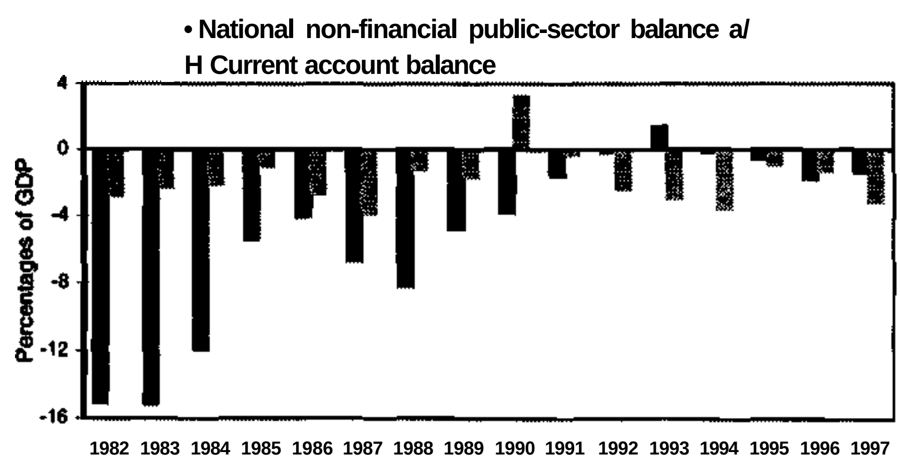
The growth in output was generalized, extending to various sectors linked to external trade. Changes in cultivation methods and techniques resulted in improved grain harvests. Although on aggregate the volume of exports expanded, the rate of increase slowed during the period under review, while the trade deficit widened considerably.

Macroeconomic policy sought to reduce the fiscal deficit and reinforce prudential measures

Figure 1
ARGENTINA: MAIN ECONOMIC INDICATORS







Source: ECLAC, on the basis of official figures

* Does not include provinces or municipalities.

for the financial system. In the light of rising tax revenue, the need to finance the national public sector decreased, as planned. Debt issues were well received, with the result that the Government attracted resources in excess of its immediate requirements. The Central Bank increased the liquidity requirements for banks. In addition, a contingency credit mechanism was established with foreign institutions, enabling the Central Bank to have access to a significant amount of resources should it consider this to be necessary.

The mid-year crisis in several Asian economies had no marked repercussions initially. Nevertheless, as the wave of distrust spread to other parts of the Asian region, there was a sharp drop in domestic bond and share prices towards the end of October. The international reserves also declined, while bank rates and the differentials between yields in pesos and dollars increased, although the total volume of deposits and loans continued to grow. However, the effects of the upheaval did not become entrenched. Although some of them persisted, after a few weeks there was noticeably less pressure on financial markets and securities prices rebounded. Furthermore, during the fourth quarter, capital inflows reached fairly high levels and there was a considerable increase in reserves.

For a while, financial volatility threatened to make credit more expensive and to put a brake on spending; there were even signs of industrial demand and manufacturing output weakening. However, GDP picked up appreciable momentum in the fourth quarter of 1997. During the first few months of 1998, with sustained domestic demand, the economic indicators improved significantly over those for one year earlier. Nevertheless, as the year progressed signs of a slow-down began to appear. First-quarter exports were affected by falling prices and were down compared with the same period in 1997.

2. Economic policy

Economic policy in 1997 was based on a positive interpretation of how the main variables were performing. The authorities also envisaged reforms to correct the distortions they had detected in several tax and regulatory instruments. One of the main macroeconomic objectives established for the year was to reduce the national public-sector deficit (1.8% of GDP the previous year) to 1.4% of GDP, including the effects of transferring various provincial pension funds to national jurisdiction. This goal, part of the stand-by agreement with the International Monetary Fund (IMF), was met by increased tax collection.

During the year, the Government held talks with IMF concerning a multi-annual agreement on facilities. This agreement, finalized in February 1998, stipulates a gradual reduction of the public-sector deficit to almost zero level in the year 2000, on the basis of increasing revenues and a reduction in primary expenditure as a ratio of GDP. Reducing the external current account deficit to less than 4% of GDP, while maintaining the merchandise trade deficit at a similar level to that of the previous year, was established as a goal for 1998.

During the first few months of 1998, the external current account deficit accumulated over a one-year period exceeded US$ 5 billion, giving rise to debate on prospects for the trade balance and whether action should be taken to contain domestic spending. However, the fiscal deficit in the first quarter was within the limits foreseen and the authorities did not find it necessary to adopt special measures to adjust macroeconomic trends, other than emphasizing their determination to maintain strict control over public-sector finances. In this respect the Government indicated that it was on the alert with respect to tax collection, which was not keeping up with projections.

(a) Fiscal policy

In the area of fiscal management in 1997, there was increased activity, strong demand for public debt (except in the latter part of the year when the effects of the Asian crisis were being felt) and demands deriving from the electoral agenda in a

Table 1
ARGENTINA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
					Growth rate;[i]				
Growth and investment									
Gross domestic product	-6.6	-0.5	10.0	9.5	5.7	7.5	-5.0	3.6	8.4
Per capita gross domestic product	-7.9	-1.9	8.5	8.1	4.3	6.1	-6.2	2.3	7.0
Gross national income	-7.8	2.0	10.4	11.4	5.5	7.3	-4.5	4.6	8.1
Gross domestic product, by sector									
Goods	-9.9	-1.8	9.9	9.1	5.9	7.2	-5.2	4.3	9.9
Basic services	-2.0	-0.6	8.5	11.8	6.7	9.6	1.6	5.5	6.5
Other services	-5.0	-2.2	10.2	9.8	6.4	9.4	-3.3	4.3	6.7
					Percentages				
Contribution to growth of GDP[c]									
Consumption	-3.5	0.4	10.1	7.6	3.4	3.5	-4.1	3.2	4.9
Gross fixed investment	-4.2	-2.6	3.7	6.7	3.3	4.9	-4.2	1.9	6.5
Exports	0.2	1.8	-0.6	0.0	0.3	1.3	1.6	0.7	0.9
Imports	0.8	-0.1	-3.2	-4.8	-1.3	-2.2	1.7	-2.2	-3.8
					Percentages of GDP[b]				
Gross fixed investment	16.4	13.9	16.0	20.7	22.7	25.8	22.7	23.7	27.9
National savings	15.5	17.2	15.6	17.5	18.5	20.7	21.3	21.9	23.2
External savings	0.9	-3.2	0.4	3.3	4.2	5.0	1.4	1.8	4.7
					Percentages				
Employment and wages									
Labour force participation rate	39.8	39.1	39.5	40.0	41.3	41.0	42.0	41.5	42.2
Open unemployment rate[e]	7.7	7.4	6.5	7.0	9.6	11.5	17.5	17.2	14.9
Real average wage (index: 1990 = 100)[f]	95.5	100.0	101.3	102.7	101.3	102.0	100.9	100.7	100.2
					Growth rates				
Prices (December-December)									
Consumer prices	4 924	1344	84.0	17.6	7.4	3.9	1.6	0.1	0.3
Wholesale prices	5 386	798	56.7	3.2	0.1	5.8	6.0	2.1	-0.9
External sector									
Terms of trade (index: 1990=100)[b]	100.4	100.0	101.7	109.0	109.4	108.3	109.4	119.0	112.0
Nominal exchange rate (pesos per dollar)[8]	0.04	0.5	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Real effective exchange rate for imports (index: 1990=100)	169.7	100.0	71.0	62.8	57.6	57.2	61.0	62.1	60.3
					Millions of dollars				
Balance of payments									
Current account	-1 305	4 552	-647	-5 462	-7 672	-10118	-2 768	-3 787	-10 119
Trade balance (goods and services)	5 109	7 954	2 820	-3 707	-5 156	-7 179	16	-873	-6 264
Exports	11 766	14 800	14 386	14 689	15 571	18 438	23 824	27 037	28 494
Imports	6 657	6 846	11 566	18 396	20 727	25 617	23 808	27 910	34 758
Capital and financial account[h]	-8 332	-5 169	-159	7 578	9 862	9 264	586	7 025	13 282
Overall balance	-9 637	-617	-806	2 116	2 190	-854	-2 182	3 238	3 163
Variation in reserve assets (- indicates an increase)	1 826	-3 121	-2 040	-3 106	-4 512	-541	49	-3 775	-3 082
					Percentages				
External debt									
Gross debt (as a percentage of GDP)			30.8	25.8	26.3	28.0	31.9	33.5	33.9
Net interest (as a percentage of exports) '	48.9	25.4	24.0	-2.5	-0.4	-5.6	-7.9	-5.8	-7.5

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
				Percentages of GDP					
Non-financial national public sector									
Current revenue[J]	12.7	13.3	15.0	17.4	20.0	17.9	17.4	15.8	16.7
Current expenditure	13.9	15.4	16.2	16.8	17.3	16.9	17.3	16.6	17.1
Saving	-1.2	**-2.1**	**-1.2**	**0.6**	2.6	0.9	0.1	-0.8	-0.4
Capital expenditure (net)	2.6	**1.7**	**0.4**	**0.7**	1.2	1.1	0.6	0.9	0.9
Financial balance	-4.8	**-3.8**	**-1.6**	**-0.1**	1.4	-0.2	-0.6	-1.8	-1.4
				Growth rates					
Money and credit									
Monetary balances of banking system									
Net domestic credit	8 013	230	152	15.0	33.8	27.3	5.6	12.6	20.5
To public sector	14 888	220	56	-21.6	-61.2	-9.6	112.8	13.0	-10.6
To private sector	5 608	735	112	53.5	23.7	20.1	-1.3	6.4	10.3
Money (Ml)	4 103	1071	144	51.5	35.0	12.6	1.3	11.2	8.6
Local currency savings and time deposits	214	4 719	65	73.9	51.3	9.1	-10.5	19.3	35.5
M2	1 105	1 803	104	60.7	43.3	10.1	-4.2	14.7	20.7
Dollar deposits		473	269	64.6	60.7	25.6	-0.4	23.0	33.1
				Annual rates					
Real interest rates (annualized)									
Deposit rate		-25.2	-10.4	-3.8	3.4	4.3	10.6	7.6	6.6
Lending rate		81.9	43.6	12.5	14.3	17.2	23.5	19.5	13.6
Equivalent interest rate in foreign currency		138.0	-8.8	13.1	10.1	8.2	12.4	7.6	7.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentages of GDP. [d] Includes changes in stocks. [e] Percentages of the total population; urban areas. [f] Percentages of the economically active population (EAP); urban areas. [8] Corresponds to the exchange rate for imports. [h] Capital pending classification according to the methodology used in the fifth edition of the *Balance of Payments Manual.* Includes the banking sector and the non-financial public and private sectors. Includes Errors and omissions. 'Refers to net interest as shown on the balance of payments, divided by exports of goods and services. ' Includes the national administration, the national social security system and public-sector enterprises. Relates to final budget figures. 'Interest rates on deposits, deflated by the variation in the exchange rate.

Table 2

ARGENTINA: MAIN QUARTERLY INDICATORS

	1995				1996				1997[a]				1998[a]	
	I	II	III	IV	I	11	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)	2.7	-5.2	-8.1	-7.0	-3.2	4.8	6.7	8.8	8.0	8.3	9.9	8.2	6.9	
Consumer prices (12-month variation, %)	4.3	3.6	2.2	1.6	0.4		0.2	0.1	0.9	0.8	0.6	0.3	0.8	1.1
Exports (millions of dollars)	4 536	6317	5 273	4 837	4 738	6 606	6 439	6 029	5 774	7 205	6 903	6 335	5 645	7 604
Imports (millions of dollars)	5 238	4 780	4917	5 186	4 986	5 726	6 579	6 471	6 488	7 515	8 165	8 206	7 501	8 203
Real effective exchange rate (index: 1990=100)"	59.4	61.5	61.6	61.5	61.7	62.3	62.6	61.9	60.6	60.8	59.8	60.1	58.9	59.3
Real interest rates (annualized, %)														
Deposit rate	11.4	15.0	7.4	8.7	10.1	7.4	5.3	7.5	5.8	7.5	4.5	8.7	3.0	11.0
Lending rate	22.0	31.3	26.3	14.5	30.9	18.2	14.0	14.9	12.2	14.9	12.2	14.9	10.2	17.9

Source: ECLAC, on the basis of official figures.
Preliminary figures. Refers to the exchange rate for imports.

time of persisting high unemployment. The national public-sector deficit narrowed in 1997, according to plan, while the funding requirements of the provincial administrations again decreased.

National government tax revenues increased more than GDP, which meant that in 1997, unlike the previous year, there was a primary surplus (0.5% of GDP) and the national public-sector deficit decreased. Large government bond issues covered the deficit for the period and served to refinance the large amount of maturing obligations.

Value added tax (VAT) revenue increased by 9%, the amount collected on imports rising particularly sharply. Revenue from domestic sales also increased, but was offset by an increase in the volume of rebates. Capital gains tax revenue continued to grow (2.5%), especially on company profits, because of an increase in the rate (to 33%) and in the tax base. Receipts from external trade tariffs expanded considerably (although their share in total tax revenue remained small), owing to the rise in imports and, to a lesser extent, the fact that the timetable for convergence of rates levied by Mercosur partners on imports of capital goods was brought forward. In addition, the effect of the increased fuel taxes agreed on the previous year began to be felt.

National government current expenditure increased by 11.5% to somewhat more than 17% of GDP. A large part of this increase was accounted for by expenditures of provincial pension funds absorbed into the national pension system and by family allowance payments. Larger transfers to the provinces as a result of a rise in receipts subject to revenue sharing also contributed to this increase, as did greater interest payments. On the other hand, personnel costs and payments by the national social security system (excluding the absorbed pension funds) remained practically unchanged. National public-sector capital expenditure increased in line with the increase in aggregate activity and stayed at 1.2% of GDP.

National government revenue from privatizations and other capital revenues amounted to a mere 0.2% of GDP. The most important operation was the sale of shares in Yacimientos Petrolíferos Fiscales (YPF).

Government financial management was facilitated by a steady decline in the risk premium implicit in the interest on Argentine debt paper. This trend was abruptly reversed at the end of October. Spreads reached their maximum in November, at levels similar to those seen in mid-1996, although much lower than those recorded in the 1995 episode. The tightening of financial conditions was also reflected in interest rates on National Treasury bills.

In these circumstances, the Government suspended placements on the international market for a time. However, conditions for obtaining credit improved and in December issues were resumed, although for relatively short maturities. In the first few months of 1998, the volume of bonds issued was again considerable; yields were equal to those of a year earlier, but still higher than before the Asian crisis.

In the first quarter of 1998, the national public-sector deficit amounted to some 1.2 billion pesos, lower than the figure provided for in the agreement with IMF. Despite the expenditure required to remedy the serious flood damage that occurred in various parts of Argentina in April, the authorities did not revise their objectives as to the size of the debt.

(b) Monetary policy and the financial markets

The rapid increase in the volumes of the monetary aggregates continued in 1997. M3, which includes money in circulation in the hands of the public and bank deposits in pesos and dollars, rose by 26% to a level more than 45% higher than three years earlier. Of special note was the increase in interest-bearing deposits in the local currency (36%). There was also a marked, though slower, increase in deposits in dollars. The rise in demand for money supply in 1997 was comparatively moderate (8.6%) and similar to growth in output.

The financial liabilities of the Central Bank expanded in the light of greater money demand and increased bank placements with that institution. Over the year as a whole, the external credit of the Central Bank covered those liabilities almost totally. The minimum liquidity requirements for banks were increased on two occasions in 1997, each time by one percentage point (the differentials in the ratios required by placements with varying maturity terms being maintained).

The volume of bank credit to the non-financial private sector increased by around 17%, the increases in peso and dollar financing being comparable. There was a proportionately large upturn in the total value of loans to individuals. Interest rates fell in the period before the Asian crisis. The differentials for the various types of operation remained very large, but the gap between yields in local currency and foreign currency narrowed. In September, the average interest rate charged by banks to first-class-risk corporate borrowers was less than 8%, much the same as that for dollar loans. The securities markets behaved in a similar way. In the first nine months of the year, public-sector securities, in both pesos and dollars, continued to rise in price. In the same period, between the end of December 1996 and September 1997, share prices went up by more than 30%.

Towards the end of October there was a turn-around in this situation, with declines in the prices of financial assets and rises in interest rates, especially on assets denominated in pesos. Nonetheless, the flow of funds into the banks continued uninterrupted. In any event, the financial repercussions of the Asian crisis did not worsen. In the last few weeks of 1997, interest rates began to go down, while bond prices recuperated, although with ups and downs, and share prices fluctuated erratically. During the early months of 1998, bond and share prices advanced, without, however, regaining their levels of prior to the upheaval, while interest rates fell and the volume of bank deposits continued to increase. But uncertainty as to financial market trends was not dispelled and at the end of May share prices again slipped.

(c) Structural reforms

In the area of privatization, the main events were the sale of shares in the YPF petroleum company, the granting of the postal service concession and the adoption of an act providing for the sale of the operating concession for the electricity-generating nuclear power plants. Parliamentary approval was also granted for the Banco Hipotecario Nacional to be privatized. At the beginning of 1998, the Government implemented a decree on the granting of an airports management concession. Reform of the labour market continued to be debated, in view of the divergent approaches of the Government, the trade unions and the employers' associations. In addition, as of mid-1998, the Congress was considering various tax reform bills.

3. The main variables

(a)Economic activity

The growth rate accelerated in 1997, with a rise in GDP of around 8.5%. The level of economic activity was thus greater than that achieved in 1994, the peak of the previous cycle. The major components of aggregate demand increased significantly, but the upturn in investment was especially marked (more than 27%). Contributing factors in this result were the fulfillment of expectations concerning economic performance and the favourable financial conditions that prevailed for much of the year, marked by readily available credit, which had a perceptible effect on construction and probably also on decisions to install equipment. Investment in construction increased by almost 24%, but spending on machinery and equipment was even higher: 30% more than in the previous year and 19% more than the 1994 maximum. Investment in equipment of domestic origin remained below previous levels, in spite of an increase of around 8% in 1997. In contrast, purchases of imported capital goods, which increased in volume by almost 40%, far exceeded those recorded three years previously.

Consumption went up sharply (more than 6%), although somewhat less than output. As a result, the national savings rate increased more than one point, to 22.8% of GDP, the highest rate for the decade. However, the increase in savings was considerably less than the increase in investment; the external savings ratio thus rose, to around 5% of GDP (in constant prices).

The volume of exports of goods and services increased considerably. Compared with the cyclical high in 1994, exports continued to be the item of aggregate demand with the greatest grov*h (more than 40%). The volume of imports, which In recent years has fluctuated considerably in response to variations in the level of domestic spending, surged (28%) in 1997.

The information available for the early months of 1998, mainly relating to manufacturing industry, indicates significant advances. In mid-May, particular attention was being paid to the issue of whether the level of activity and the volume of spending, especially on imported goods, were gradually decreasing in such a way as to narrow the trade gap without provoking abrupt changes in the rate of production.

The expansion observed in 1997 involved all the major sectors. In every case output exceeded the peak recorded three years previously. Aggregate activity in goods-producing industries increased proportionally more than overall GDP, with particularly strong growth in construction (24%). Manufacturing activity also accelerated, while mining maintained the momentum of recent years. The increase in agricultural output was more modest, despite a much larger grain harvest in 1996/1997. Infrastructure services as a whole, which throughout the decade have been undergoing drastic changes as to the form in which they are provided and have attracted very large investments, expanded 6.5%.

The 1996/1997 grain harvest was 26% larger than the previous season's. The much greater area sown after good agricultural prices were obtained in 1996 and changes in cultivation methods that gave improved yields per unit were factors contributing to this result. Cereal crops (up 50%) accounted for the bulk of this expanded production, with especially large increases in wheat and maize.

Grain production is expected to have expanded again significantly (17%) in the 1997/1998 season, to more than 62 million tons, although that estimate does not take into account the damage caused by the huge floods that occurred in April 1998. This time, the main increase has been in the oil seed harvest, which was almost one third larger. Apart from a few exceptions, such as sunflower seeds, there were significant improvements in yield per hectare, with an especially notable jump in soybean production (47%). Cereal production increased by almost 10%, with greater volumes of maize, sorghum and other grains. On the other hand, the wheat crop was down, although in absolute terms it was considerably larger than a few years earlier.

More intense competition with grain for land use had resulted in a decrease in the number of cattle reared in the previous few years. In the biennium 1995-1996, more animals were slaughtered than were bred. In the same period, the average weight of cattle slaughtered went down and the number of breeding heifers slaughtered increased. Herd reduction was carried over to the beginning of 1997, but the down-turn in supply affected prices and tended to restore incentives for activity in this sector.

Mining output continued to expand rapidly (8%), with petroleum and, especially, natural gas extraction on a satisfactory course. Intense activity continued in metal mining, a sector that is starting to be developed in Argentina.

Industrial production indicators showed growth of about 9%, some 7% more than the maximum of three years previously. The rise in manufacturing output continued throughout the first 10 months of 1997 when firms in the sector, on aggregate, interpreted the demand for their goods positively. In the latter part of the year this perception slipped, as did production, but at the beginning of 1998 there were renewed signs of expansion. In mid-year, however, it was unclear which way the trends were leading.

Output performance by the different manufacturing industries throughout 1997 as a whole was extremely varied. Among the expanding sectors, the automobile industry, construction-related activities and the manufacture of agrochemicals stood out. Production of such goods as food and beverages, household articles, cellulose and paper, iron and steel and petroleum products expanded at a slower rate. In contrast, there was a decline in production of various goods in the chemicals and machinery categories.

There was generalized expanded provision of basic services, with especially spectacular growth (more than 150%) in the number of cellular telephones. Electricity generation increased by around 8%. Water supply and gas production also went up (3.6% and 7% respectively).

(b)Prices, wages and employment

In a context of stability, the increase in the consumer price index (0.3%) was a little higher than in the previous year (0.1%) mainly because of adjustments in tariffs for public services, especially the urban telephone system. During the first few months of 1998, consumer prices posted somewhat larger increases than in previous periods. The cumulative increase for January and February was 0.9%; this reflected changes in transport tariffs and increases, in part seasonal, under other headings. Although the rise in the consumer price index halted in March and April, the cumulative increase over 12 months was 1.2% in June. Wholesale prices went down 0.9% during 1997, both for domestic products -agricultural and non-agricultural alike- and for imported goods, and remained lower until well into 1998.

The recovery that followed the severe recession of 1995 did not initially provide increased employment. The figures for May 1996 showed the employment rate in the main urban areas to be at a minimum level (34% of the population), although unemployment, at around 17%, had declined somewhat from its peak level because of a drop in the number of people declaring themselves members of the workforce. From this point on, there was a marked turn-around in the volume of employment. In the latter part of 1996 and in 1997, the employment rate went up and the October 1997 figure (36.5%), exceeded pre-recession levels. Net job generation was greater than the increase in the labour supply (the participation rate also increased), with the result that unemployment fell noticeably, although it remained high (13.7%) and there was much underemployment. The fall in unemployment was evenly spread geographically and was observed in about three quarters of urban population centres surveyed.

Between October 1996 and October 1997, a large amount of net employment was generated (around 800,000 jobs), as estimated by extrapolations from the results of household surveys. In part, this increase reflected the larger numbers included in official programmes offering temporary employment. But, the private sector accounted for the bulk of labour absorption, largely through fixed-term contracts.

Unit wage indices for industrial workers declined slightly during 1997. However, average remuneration in the private sector, calculated on the basis of declarations to the social security system, went up 1.2% between the first quarter of 1996 and the same period in 1997. Wages increased (by up to 7%) in such sectors as banking, mining, trade and health services, and decreased in transport and communications, construction and several branches of industry.

(c)The external sector

The deficit in the balance-of-payments current account widened to some US$ 10 billion in 1997, a similar amount to three years previously. Its size relative to merchandise exports, although considerable (40%), was less than in the three-year period 1992-1994. The large increase in the deficit (more than US$ 6 billion) between 1996 and 1997 was mainly due to a significant rise in imports. To a lesser degree, the expansion of imports of real services and the widening deficit in investment income also contributed to widening the deficit.

Interest paid out increased considerably, in particular as a result of higher yields on public debt. This was partly compensated for by the rise in income on assets of the Central Bank, the banks and, according to estimates, the non-financial private sector. The deficit on profits and dividends, which had been reduced in 1996 in spite of increasing inflows of foreign investment, rose to more than US$ 2.2 billion in 1997.

Capital inflows enabled the current account deficit to be financed and appreciable reserves (almost US$ 3.2 billion) to accumulate in the Central Bank. The volume of reserves fluctuated during the year, rising significantly (by US$ 2.4 billion) in the fourth quarter.

Net capital inflows reached an unprecedented level, around US$ 13 billion. Flows were especially large in the fourth quarter (almost half the total for the year), after the crisis broke out in Asia. For the year as a whole the banking sector posted a net outflow of funds, while external financing of the non-financial public sector, although very substantial, was lower than in 1996. The increase in capitai inflows was accounted for by operations of the non-financial private sector. Bond issues by this sector generated net proceeds of US$ 4.1 billion. The deficit on other transactions, including errors and omissions, contracted to less than one third, from US$ 5.4 billion in 1996 to US$ 1.6 billion in 1997.

There was remarkable and sustained growth in direct investment not associated with privatizations. It exceeded US$ 5.5 billion and represented around 43% of the net inflow of funds, a lower share than in 1996, but more than double the figure for the three-year period 1992-1994. Privatizations (of electricity companies in the province of Buenos Aires) brought in some US$ 750 million of external resources (less than 6% of capital inflows, as against 20% in the period 1992-1994).

The national government issued bonds to the value of around US$ 11 billion to non-residents, a similar amount to the previous year. However, redemptions increased and the Government bought back paper worth a little over US$ 2.2 billion.

As a result of borrowing abroad, the estimated gross external debt, excluding direct trade and financial liabilities of the non-financial private sector, went up by some US$ 10 billion in 1997 and totaled nearly US$ 110 billion. Somewhat more than two thirds of this amount corresponded to the overall debt of the pubhc sector, including the Central Bank, whose share of the aggregate has been consistently decreasing. After going down for three consecutive years, the ratio of gross external debt to exports increased to around 4:3. The ratio of debt to GDP, at about 34%, was a little larger than in the previous year.

Unit prices declined for the first time since 1991, which slowed the rise in value of exports. Over the year as a whole, export volumes increased significantly (by more than 11%) and were up more than one third compared with four years previously.

The lower export prices chiefly affected fuels and commodities, and were most pronounced in the case of cereals, which had achieved satisfactory price levels in 1996. The deterioration in wheat and maize prices lasted into the early months of 1998. A similar pattern was observed for petroleum prices. On the other hand, the prices of some other export products, including oils, maintained their levels or improved.

Notwithstanding price behaviour, the value of cereal exports rose sharply in 1997 (more than 16%) thanks to considerably increased volumes of maize and rice shipments. After several years of sustained growth, oil-seed product exports as a whole contracted; this included a sharp reduction in the volume of soybean and sunflower seed exports, although sales of oil derived from them increased. The total value of sales of other agricultural products fell.

In spite of prospects of controlling foot-and-mouth disease, the value of meat shipments declined by around 4%. Wool exports were also down, but sales of leather and skins increased.

After a period in which they shot up, fuel sales declined. As a result, manufactures accounted for almost the entire increase in total exports in 1997. There was a remarkable increase (of 65%, to US$ 2.5 billion) in exports of vehicles, although the trade deficit of the automobile sector widened because of larger purchases of parts and finished goods. Other manufacturing exports grew by about 11%, with rises in exports of iron and steel, chemical products and machinery and apparatus industries.

Sales to Mercosur expanded (13.5%) more than the aggregate. As a result, the share of regional sales in total exports from Argentina was around 36%. In the case of industrial manufactures, more than 60% of the value shipped went to Mercosur destinations.

Merchandise imports expanded by 28%. Purchases of capital goods increased at a particularly fast rate (37%), as did imports of consumer durables (30%). Purchases of intermediate goods increased a little less sharply (25%), with large growth in imports of metal manufactures and metalworking inputs.

In the area of external trade policy, talks were held concerning the proposed creation of a hemispheric free trade area and the Mercosur countries decided to support the negotiations to that end as a bloc. Towards the end of 1997, Mercosur agreed on an increase in external tariffs; in the case of Argentina, this would compensate for the abolition of the statistical surcharge, the application of which had been objected to by the World Trade Organization. The regional partners held talks on, among other issues, non-tariff restrictions, particularly financial restrictions, applied by Brazil to intra-Mercosur imports; the rules for banks of one country operating in the market of another; and policies relating to specific sectors, such as the automobile and sugar industries.

BOLIVIA

1. General trends

With inflation at its lowest level since 1975 (6.7%), the growth rate of the Bolivian economy exceeded 4% in 1997, but the external and fiscal deficits, mostly financed with external resources, widened considerably. Monetary and fiscal policy remained subordinate to the priority objective of consolidating macroeconomic stability. Supported by the flow of foreign capital, investment was as high as 19% of GDP, an increase linked to the privatization (capitalization) of public enterprises, thereby giving effect to one of the main goals of the outgoing Government. In accordance with the agreement on heavily indebted poor countries concluded with multilateral financing organizations, Bolivia's external debt was reduced by more than US$ 500 million over a period of 10 years. This debt reduction entails a commitment by the State to expand considerably its investments in education and health.

The increase of the overall non-financial public sector deficit to the equivalent of 3.4% of GDP was basically due to the cost (2.6% of GDP in 1997) of the transition to the new pension system.

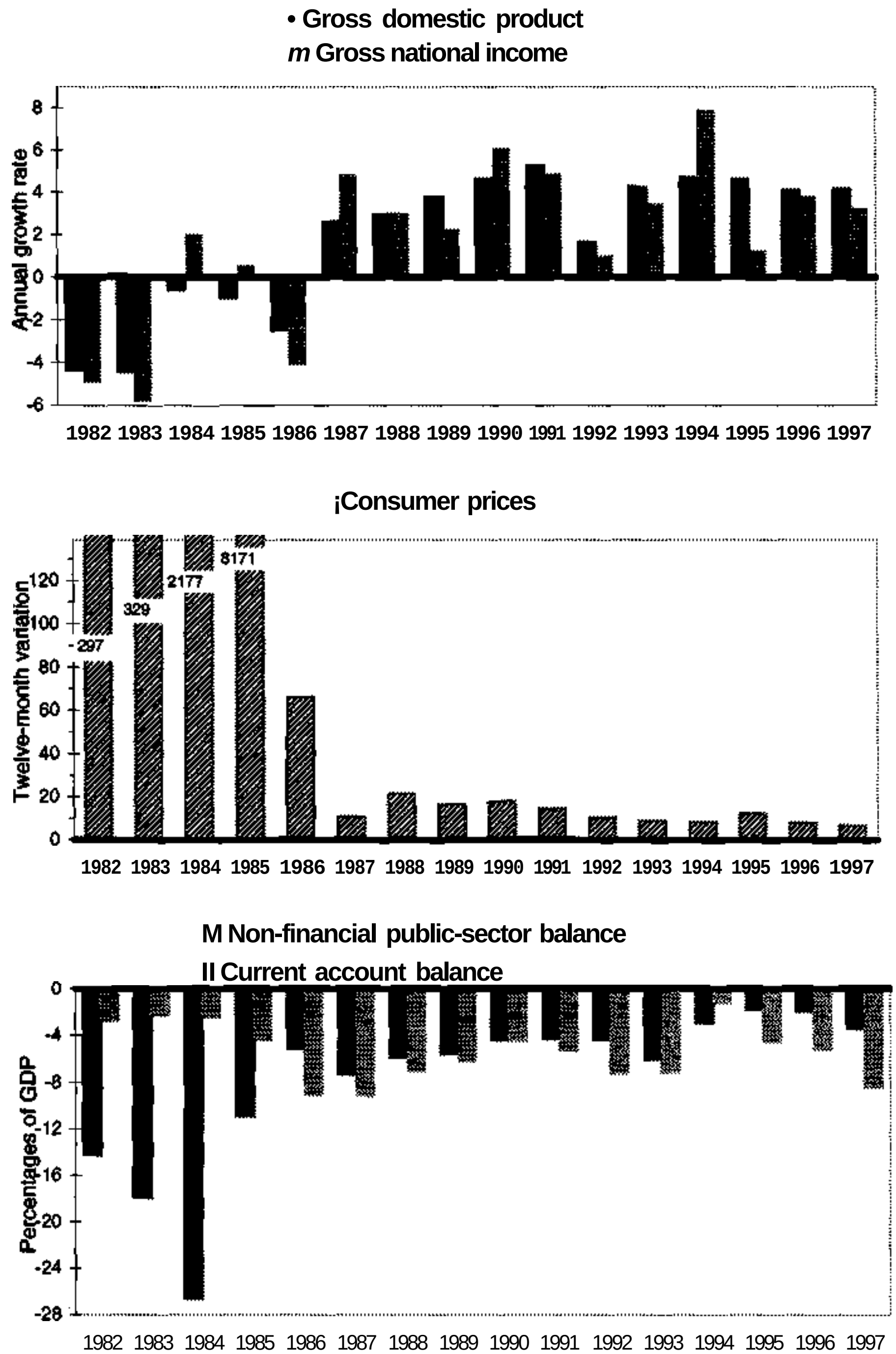
In the external sector, the current account deficit widened considerably, to 8% of GDP, owing to a surge in imports and stagnating exports.

In August, a Government was formed, incorporating all of the main political groupings except for the party of the outgoing administration. The new Government's programme contemplates no major changes in the economic sphere; its priority objective remains macroeconomic stability, which entails respecting the autonomy of the Central Bank. Using resources derived in part from the Heavily Indebted Poor Countries Debt Initiative, public-sector investment in both infrastructure and in the areas of health and education will be promoted. The Government will also endeavour to consolidate the recovery in domestic and foreign private investment in production, in order to promote growth and generate sources of employment to bring down the high level of unemployment.

The Government's political programme features a national drugs control plan; in the last few months of 1997, major progress was made in terms of the number of hectares of illicit crops which were eradicated.

At the end of the first half of the year, growth in GDP of the order of 4.5% was projected for 1998, although there was some uncertainty owing to the impact on production of the El Niño phenomenon and the earthquake which struck the central area of the country in May. Inflation had increased as a result of the decision in late 1997 to raise domestic hydrocarbon prices. The fiscal deficit was expected to decrease by the equivalent of 4% of GDP. It was hoped that private-sector investment would remain buoyant, particularly in the hydrocarbons sector, thanks to the construction of the gas pipeline to Brazil, the expansion of the domestic network and the fulfilment of investment commitments by the enterprises involved in the capitalization of Yacimientos Petrolíferos Fiscales Bolivianos (YPFB).

Figure 1
BOLIVIA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

2. Ecori ic policy

There were no major changes in economic policy in the early part of the year. The outgoing Government continued its endeavours to preserve macroeconomic equilibrium and to complete the ambitious structural reform programme that it had begun during its four years in office. Economic growth with price stability was maintained, but imbalances in the external and fiscal sectors worsened.

The incoming Government, which is based on a broad coalition of the former opposition parties, does not propose to make fundamental changes in macroeconomic policy. Its basic intention is to consolidate progress in structural reforms and in the stabilization policies which have been applied for more than a decade, and to give increased priority to the social sector.

(a)Fiscal policy

The implementation of the programme of structural reforms, especially in the areas of pensions and capitalization, halted the downward trend of the non-financial public sector deficit, which rose to the equivalent of 3.4% of GDP. In particular, measures in connection with the change in the pensions system represented additional outlays of about 2.5% of GDP.

The proportion of non-financial public-sector income in relation to GDP declined slightly from 31.3% the previous year to 30.6% in 1997. This was essentially due to the fall, equivalent to three percentage points of output, in income from sales of hydrocarbons on the domestic and external markets, which in turn was due to the transfer of the State hydrocarbons company, YPFB, to "capitalize" firms. For the same reason, there was also a fall in income from sales by other enterprises transferred to the private sector. On the other hand, tax revenue increased to 13.1% of GDP, compared to 11.9% the previous year.

The financing of the social security system and of the capitalization of public enterprises remained pending. Spending in 1998 to cover the deficit from pensions reform is estimated at about 4% of GDP. Since it is intended to restrict the overall imbalance in the non-financial public sector to 4.1%, the rest of the sector will have to achieve a balanced result.

(b)Monetary policy

Monetary policy remained focused on keeping money supply growth in line with product growth and domestic inflation goals. Relative to the previous year, analysis of some of the relevant variables suggests a more lenient approach, while others reflect a more restrictive policy stance. The monetary base expanded by 19%, owing to the net accumulation of international reserves, the fall in net domestic credit to the financial system, the expansionary effect of credit to the non-financial public sector and the increase in medium- and long-term liabilities.

The 16% growth, mostly fuelled by increased money creation, in means of payment in national currency caused some concern, especially since the Central Bank considers it to be one of the key inflationary factors in Bolivia. Quasi-money in national currency increased by as little as 10%, which accentuated its marginalized position as a reserve instrument in relation to foreign currency deposits. It should be noted that the differential in the real deposit rate between savings deposits in national currency and in dollars was barely three points, whereas for lending rates it was more than 15 points. Money supply in dollars expanded by 18%. Broad money (M3), including dollar deposits, grew by 17%.

Monetary policy also sought to temper interest-rate volatility and to ensure a stable yield from Government securities. In the medium term, domestic and international rates (including a country-risk premium) are expected to converge. Lending and deposit rates fell a little, but the spread did not change. The foreign-currency lending rate remained stable in 1997, fluctuating around 17%. The lending rate in national currency for short terms (up to 60 days) fell steeply from an annual average of 37% to 17%. However, the longer-term rate remained above 40%, showing that the country risk premium is still very high.

Table 1

BOLIVIA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997"
					Growth rates				
Growth and investment									
Gross domestic product	3.8	4.6	5.3	1.6	4.3	4.7	4.6	4.1	4.2
Per capita gross domestic product	1.5	2.3	2.8	-0.8	1.8	2.2	2.2	1.7	1.8
Gross national income	2.2	6.1	4.9	1.0	3.5	7.9	1.2	3.8	3.3
Gross domestic product, by sector									
Goods	4.6	6.3	6.0	-0.4	4.6	5.1	5.0	3.2	3.7
Basic services	7.5	5.4	6.6	4.6	6.0	6.8	6.4	8.8	6.9
Other services	2.8	2.5	3.8	4.1	4.2	4.0	3.0	3.9	4.6
					Percentages				
Contribution to growth of GDP									
Consumption	2.3	2.7	2.8	2.8	3.1	3.3	3.1	1.9	2.9
Government	0.1	0.0	0.4	0.4	0.3	0.4	0.8	0.1	0.4
Private	2.2	2.7	2.5	2.4	2.8	3.0	2.3	1.8	2.5
Gross domestic investment	-2.1	2.0	3.7	0.8	0.0	-1.6	1.6	2.9	3.9
Exports	3.6	2.0	1.4	0.2	1.0	2.8	1.9	1.5	-0.1
Imports	-0.1	-2.0	-2.6	-2.2	0.2	0.2	-1.9	-2.2	-2.5
					Percentages of GDP				
Gross domestic investment	11.1	12.5	15.4	15.9	15.3	13.1	14.0	16.3	19.3
National savings	6.0	8.7	10.2	8.2	8.1	11.9	9.6	11.0	10.8
External savings	5.2	3.8	5.2	7.7	7.1	1.2	4.4	5.3	8.6
					Percentages				
Employment and wages									
Labour force participation rate	51.9	51.3	51.7	50.7	52.5	53.7	55.1	56.7	
Open unemployment rate[e]	9.9	7.3	5.8	5.4	5.8	3.1	3.6	3.8	4.4
Real average wage (index: 1990=100)	97.6	100.0	93.4	97.1	103.6	111.8	112.6	113.8	123.1
					Growth rates				
Prices (December-December)									
Consumer prices	16.6	18.0	14.5	10.5	9.3	8.5	12.6	7.9	6.7
Wholesale prices	21.7	19.8	13.8	13.6	7.5				
Terms of trade (index: 1990=100)[b]	112.9	100.0	94.9	83.0	74.5	81.6	77.4	69.6	72.1
Nominal exchange rate (bolivianos per dollar)	2.69	3.17	3.58	3.90	4.27	4.62	4.80	5.08	5.25
Real effective exchange rate (index: 1990=100)	85.2	100.0	99.7	104.2	110.4	116.2	119.0	111.1	108.4
					Millions of dollars				
Balance of payments									
Current account	-292	-220	-284	-409	-413	-72	-306	•373	•664
Trade balance (goods and services)	-161	-110	-198	-458	-432	-165	-350	-402	-680
Exports	867	977	917	812	892	1 177	1 229	1276	1271
Imports	1028	1086	1 115	1270	1 324	1 342	1579	1 677	1952
Capital and financial account	-18	58	136	291	336	19	240	673	779
Overall balance	-304	-161	-147	-119	-77	-54	-66	300	115
Variation in reserve assets (- indicates an increase)	57	-5	-8	-47	-134	-121	-131	-308	-89
					Percentages				
External debt									
Public debt (as a percentage of GDP)	78.3	77.4	67.0	67.0	65.9	70.5	67.4	60.6	54.2
Net interest (as a percentage of exports)[g]	30.1	25.4	26.8	21.3	20.0	13.0	14.4	14.1	12.2

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
					Percentages of GDP				
Non-financial public sector									
Current revenue	26.4	27.2	28.8	28.8	29.6	31.0	31.5	28.8	29.3
Current expenditure	25.0	24.7	26.0	25.8	28.0	27.5	26.7	24.9	27.0
Saving	1.4	2.5	2.8	3.0	1.6	3.5	5.0	4.0	2.3
Capital expenditure (net)	7.0	**6.9**	7.1	7.3	7.7	6.5	6.8	5.9	5.7
Financial balance	-5.6	*AA*	-4.3	-4.4	-6.1	-3.0	-1.8	-2.0	-3.4
					Growth rates				
Money and credit									
Monetary balances of banking system									
Net international reserves	-51.0	197.9	48.1	6.9	8.8	24.4	50.0	94.9	10.9
Net domestic credit to public sector		54.5	6.5	184.2	29.9	6.0	-75.2	-53.8	115.5
Domestic credit to private sector	42.0	41.1	47.8	45.7	39.3	24.0	12.6	13.6	19.2
Money (Ml)	3.1	17.6	25.2	19.0	14.6	33.4	23.5	10.4	15.6
Local-currency savings and time deposits	54.2	-90.5	8.9	-19.5	7.8	74.6	-22.4	84.5	10.4
M2	33.4	-56.5	22.7	13.9	14.0	37.1	18.2	15.9	15.0
Dollar deposits	30.6	106.7	68.1	44.2	41.8	18.7	7.5	27.1	17.5
					Annual rates				
Real interest rates (annualized)									
Deposit rate	6.7	5.3	8.4	11.9	11.9	9.2	5.6	9.4	7.6
Lending rate	18.4	20.7	23.5	32.7	40.8	43.5	36.7	43.4	41.0
Equivalent interest rate in foreign currency	2.8	8.4	12.2	12.4	12.1	12.1	13.5	13.1	10.9

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregates as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). Includes Errors and omissions. [i] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
BOLIVIA: MAIN QUARTERLY INDICATORS

	1995				1996				1997 [a]				1998 [a]	
	I	II	III	IV	I	**n**	**III**	IV	I	**II**	**III**	IV	I	**II**
Consumer prices (12-month variation, %)	9.7	10.9	9.4	12.6	14.5	12.3	13.3	8.0	3.6	5.2	3.7	6.7	9.4	7.9
Real effective exchange rate (index: 1990=100)	119.2	122.0	120.0	114.8	111.2	111.9	110.6	110.9	109.6	109.1	107.7	107.0	103.2	103.7
Real interest rates (annualized, *to)*														
Deposit rate	7.0	6.2	12.8	-3.8	2.7	16.6	8.1	10.2	16.6	5.5	9.7	-1.5	3.6	
Lending rate	34.3	35.3	51.3	26.0	27.7	53.2	40.1	52.7	58.5	44.5	43.0	17.7	31.7	

Source: ECLAC, on the basis of official figures.

Preliminary figures. Refers to the exchange rate for imports.

The Central Bank established new regulations concerning the reserve requirement, with a view to lowering its cost for financial institutions and improving the Bank's control of the financial system through new liquidity mechanisms. The new regulations incorporate two different models: reserves in cash and reserves in securities, both compulsory. In the first, the average of about 9% required in the past is reduced to 2%, to maintain cash reserves enabling the bank to conduct everyday transactions without difficulty. The second model will enable the banks to maintain a liquid assets fund which, invested in profitable instruments, will generate a market yield for participants. The latter model will give financial entities access to an automatic line of credit should they need very-short-term funds. This fund is mainly financed from amounts freed by the reduced reserve ratio.

Stock market transactions increased, totalling almost 40% more in 1997 than in the previous year. Trading was concentrated on a fixed-interest market characterized by lack of variety among the instruments and a very small number of institutional issuers and investors (mutual funds, pension funds).

(c) Foreign exchange policy

The Central Bank persevered in its policy of fixing the exchange by means of mini-devaluations. In its market interventions it continued to use an auction mechanism known as the "mini-market" *(bolsín)*. This policy has enabled it to preserve price stability and maintain a stable but competitive real exchange rate, to avoid eroding the competitiveness of the Bolivian economy in relation to its main trading partners. At the end of the year, the Central Bank's selling rate was 5.37 bolivianos to the dollar.

Nonetheless, the magnitude of external flows, in connection with the capitalization of public-sector enterprises and other direct investments, led to an appreciation of the real exchange rate which, while it relieved inflationary pressure, encouraged imports and weakened export performance. Bolivia experienced an appreciation of the exchange rate with practically all its main trading partners. As of December, the cumulative rate of devaluation of the nominal exchange rate was -3% and real appreciation against the dollar was about 3%.

(d)Structural reforms

The outgoing Government implemented a set of structural transformations: administrative decentralization, educational reform, popular participation, privatization or capitalization of public-sector enterprises, and changes in the pension system. The last two were closely linked, since the private pension funds, which manage the Individual Capitalization Fund made up of the contributions of all the participants, are also in charge of the Collective Capitalization Fund. The latter Fund operates using the resources set aside by the capitalized enterprises for payment of the solidarity bond (Bonosol).

In 1997, more than 350,000 persons received this benefit, equivalent to US$ 248 per capita. The amounts disbursed, including US$ 7 million paid by the private pension funds for administration, totalled US$ 96 million, exceeding the initial forecasts of US$ 75 million and 300,000 recipients. The payment of the solidarity bond is financed by means of shares owned by Bolivian citizens and the dividends paid to the private pension funds by the capitalized enterprises, which totalled about US$ 46 million in 1997. The remaining US$ 50 million was covered by means of a bank loan, at an interest rate of 11.25%, secured by the equity of the capitalized enterprises.

As part of its structural reform commitments, the new Government has undertaken to improve the regulatory framework, privatize the refinery and service areas of Yacimientos Petrolíferos Fiscales Bolivianos (YPFB), submit a new Code of Penal Procedure to Congress, draft amendments to the Labour Code and design a broad programme of customs reforms. The latter will include control and supervision systems and will be supported technically and financially by the International Monetary Fund, the Inter-American Development Bank and the World Bank.

One of the new Government's structural reform proposals is the Bolivian strategy for controlling drug trafficking, which aims to take the country out of the illegal drugs trade within five years. The goal is the eradication of all illicit and excess coca crops by the year 2002. The cost of this five-year strategy will amount to about US$ 950 million, 85% of which will require external financing.

3. The main variables

In 1997 the Bolivian economy grew by 4.2%, with particularly strong performances in basic services, construction and public works. Inflation continued to fall, reaching its lowest level since 1975 (6.7%); however, employment trends were not encouraging. In the external sector, the current account deficit widened considerably, financed by exceptional growth in foreign direct investment.

(a)Economic activity

Overall supply and demand grew by over 5% in 1997. Increased demand was mostly based on increased investment, particularly from the private sector, concentrated in the hydrocarbons sectors (petroleum and gas). Exports contracted slightly. Within the overall aggregate supply, there was significant increase in imports; this reflected growth in investments, an area incorporating a large imported component.

The almost 12% increase in gross fixed capital formation brought this item up to 17% of GDP in national currency. Higher investment was reflected in a US$ 75 million increase in capital goods imports and in the boom in public and private construction; construction was stimulated by the fact that the capitalized enterprises had begun to give effect to the investment commitments which they had undertaken. There was also a significant increase in inventory changes, owing to the construction of the gas pipeline to Brazil. Although total gross investment in national currency amounted to 19% of output, national savings remained stagnant at around 11% of GDP. Most of the increase in investment was financed from external savings, through the expansion of the current account deficit to more than 8% of GDP.

The electric power, gas and water industries registered the lowest growth rate in the past five years (7.6%), but were still among the most buoyant areas. The most important event of the year in this sector was the beginning of construction of the gas pipeline to link the department of Santa Cruz to the major Brazilian city of São Paulo; this accounts for more than one percentage point of the growth of output in 1997. Gas exports are expected to begin in 1999, with a commitment to supply eight million cubic metres per day for the first year. The Brazilian side has expressed interest in receiving up to 30 million cubic metres per day in the seventh year (2006).

In the area of goods production, the agriculture, forestry, hunting and fishing sector performed well, with a growth rate of 5%, significantly higher than the previous year, fuelled by good wheat, cotton and sunflower harvests, and good fruit crops. The livestock industry also performed well. The construction and public works sector grew by more than 7%, but growth in transport, storage and communications slumped to 6.8% owing to a slowdown in telecommunications.

The performance of manufacturing industry as a whole was similar to that of GDP. The most buoyant branches were clothing, leather footwear, chemicals, non-ferrous metal basic industries and printing.

(b)Prices, wages and employment

In November 1997 the cumulative inflation rate was under 4%, but there was a 2.9% surge in December owing to a 28% rise in fuel prices and an increase in transport charges. The increase in the level of consumer prices was 6.7% as of the end of the year, but this was still the lowest increase in 23 years. The area that showed the biggest increase at the national level (averaging 18%) was transport and communications, because the readjustment of fuel prices had a direct impact on transport charges. Food and beverages rose by only 0.6%.

The index of average private-sector wages, calculated by the National Institute of Statistics, showed an increase of 8%. The biggest real wage increases were in mining, manufacturing and financial services. No significant progress was observed in respect of job creation or the unemployment rate.

(c)The externa] sector

The current account deficit widened considerably, by US$ 300 million, resulting in an overall trade gap of US$ 660 million, equivalent to 8% of output. The worsening of the external deficit was to a great extent due to the increased trade imbalance, caused by considerable growth in the volume of imports and the stagnation of exports, although the terms of trade improved slightly.

The value of exports weakened slightly, mainly owing to the considerable fall (-25%) in natural gas exports following the break in the gas pipeline to Argentina early in the year. There was also a slight fall in the price of gas exports.

Bolivia's export base consists of a small number of commodities. Soya, zinc, gold, timber, tin and natural gas account for almost two thirds of total exports. Analysis of the composition of shipments in recent decades shows a stagnation of the share of minerals, a significant fall in that of hydrocarbons and a large increase of non-traditional agro-industrial products. When the gas pipeline to Brazil becomes operational, this export structure will change in favour of natural gas, exports of which will exceed US$ 500 million per year from 1999 onwards.

The value of imports grew by 12% as a result of an overall trend; imports of consumer durables rose by more than 10%, those of raw materials by 14% and those of capital goods by 11%. The latter increase was affected by rising domestic and foreign investment, with the implementation of investments agreed to as part of the capitalization of public-sector enterprises, the increase in foreign direct investment and the start of construction of the gas pipeline to Brazil. Thus, the volume of capital goods imports increased by 13%, although there was a slight fall in the unit values of those goods.

Foreign direct investment continued to rise in 1997. The new institutional framework, macroeconomic stability and the capitalization process encouraged capital inflows, and overall foreign investment increased by 16%. Hydrocarbons were the most attractive sector, accounting for 54% of the total. The start of construction of the pipeline to Brazil for natural gas exports contributed significantly to the increase of foreign investment in the sector.

The balance of the medium- and long-term external public debt at 31 December 1997 was US$ 4,233 million, US$ 133 million down on the previous year's figure. The country received US$ 383 million in external disbursements in 1997, mostly for the consolidation of structural reforms and for infrastructure projects, especially in the areas of transport and energy.

The net international reserves of the Central Bank of Bolivia increased by US$ 115 million, ending the year at US$ 1,066 million, an amount sufficient to cover almost six months' worth of imports.

In September 1997, Bolivia acceded to the Heavily Indebted Poor Countries Debt Initiative. This agreement represents valuable support for the sustainability of the balance of payments, since it is equivalent to a reduction from 270% to 225% in the present value of the debt-export ratio. This means a reduction of some US$ 450 million in the present value of the external multilateral debt.

BRAZIL

1. 1 trends

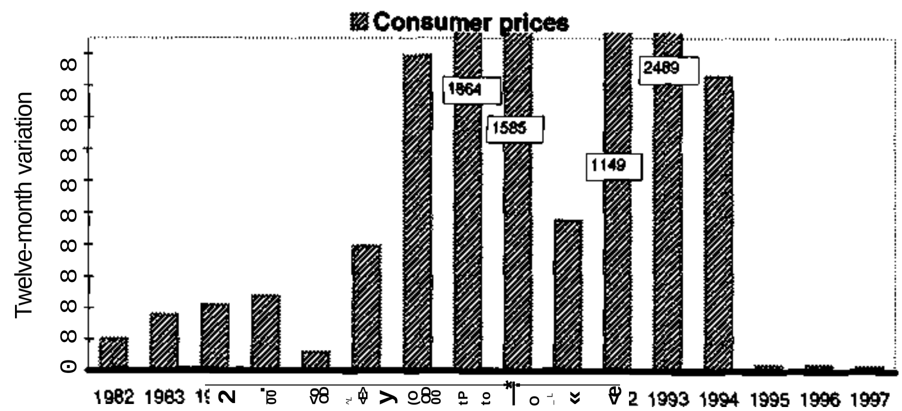
In 1997 the Brazilian economy grew at the same rather sedate pace (3%) as the year before, while the continued progress of the stabilization process was reflected in the lowest rate of inflation (4.3%) to be recorded in the last 50 years. The deficit on the country's external accounts deepened further, but the copious inflow of external resources provided enough financing to cover the shortfall. Nevertheless, the size of this deficit (the equivalent of over 4% of GDP) and the failure to move more quickly in carrying out a thoroughgoing adjustment in public-sector accounts have placed the country in a highly vulnerable position, as became evident in late October when the Asian crisis began to have a stronger impact on Brazil's economy (primarily in the form of voluminous capital outflows). The adoption of corrective measures and the severe deterioration in the external situation triggered an economic slowdown and pushed the unemployment rate up slightly. The Government did succeed, however, in checking the rapid descent of international reserves, and in the first half of 1998 it actually managed to reverse this trend altogether. The prospect of general elections in October complicated the situation further, since, depending on the outcome, they could spell changes in the course of economic policy.

The process of restructuring Brazil's production activities on the basis of reforms implemented in previous years moved forward in 1997. The high level of incoming foreign direct investment was associated with the Government's rapid progress in implementing its privatization programme, and the total investment rate reached its highest level of the decade (around 23%). Exports of goods and services expanded by over 10%, thereby regaining their former momentum, although imports rose even faster (15%). The real exchange rate climbed slightly but the local currency continued to appreciate at a considerable rate in real terms.

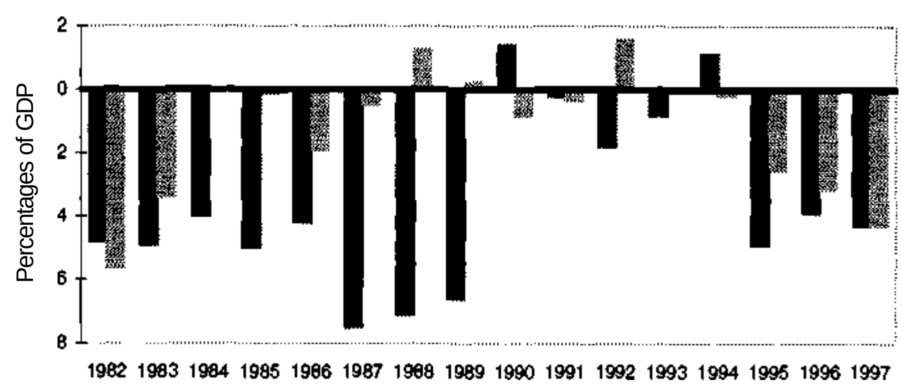
Exports to the Southern Common Market (Mercosur) were up by 24% and thus outpaced Mercosur imports (21%) by a small margin; Brazil nonetheless posted a deficit on its trade within this customs union, in contrast to the situation some years ago, when it had been running a large surplus. The operation of this agreement was upset to some degree when Brazil and other member countries introduced import barriers, and an arduous round of negotiations had to be undertaken in order to mitigate the impact of these measures.

Until October 1997, economic policy had been based on the assumption that the inflows of external savings used to cover the current account deficit would continue at their present level or even increase further. Economic policy-makers were also working on the assumption that nominal interest rates, which had been very high

Gross domestic product
Gross national income
Annual growth rate
1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997



Consumer prices
Twelve-month variation
1864
1585
1149
2489
1982 1983 1993 1994 1995 1996 1997



Percentages of GDP
1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997

ever since the introduction of the Real Plan in 1994, would begin to moved downward. These expectations were not borne out, however, and the decline in inflation led to further increases in real interest rates. This, in conjunction with the stagnation of total wages, precluded a more rapid expansion of the economy, and the high level of imports fueled expectations of an unstable growth pattern. Nevertheless, the headway made by the privatization programme, together with the merger and restructurings of numerous business firms and banks, drew investors into the stock market, and during the first half of the year the stock index soared by over 70%. The fiscal deficit for January-October 1997 was somewhat lower than it had been, but was still very high. Up to September, Brazil's bond prices were rising sharply, implying a favourable assessment by international economic agents of its country-risk. Delays in the passage of constitutional amendments needed to undertake civil-service and social-security reforms are hindering the Government's efforts to bring public-sector accounts under control, however.

Late in October, the intensification of the Asian crisis and a lack of confidence in the future course of the economy set off a flurry of sell orders on the São Paulo and Rio de Janeiro stock exchanges, and this was mirrored by a massive sell-off of Brazilian Brady bonds on international markets by national investors trying to cover their losses on the local and other emerging markets. The collapse of bond prices from November on provided a profit-making opportunity for arbitrageurs, since the domestic interest rate was lower than the implicit rate on these securities. When speculative movements in currency futures were detected, the Central Bank had to sell off a huge amount of its international reserves (over US$ 10 billion) in order to shore up its foreign exchange policy.

Policy-makers then changed course, and in response, in particular, to the prospect of a flow of resources into emerging markets, the Government adopted a package of measures aimed at reducing the economy's external vulnerability. Tighter monetary and fiscal policies were implemented in an effort to preserve the existing exchange-rate regime, maintain price stability and curb the increase in external borrowing requirements. Real annual interest rates doubled, jumping to over 35%, and the Government announced a series of measures designed to boost the public sector's primary balance by approximately 20 billion *reais* (2.5% of GDP) in 1998.

The uncertainty prevailing in the market paralyzed the domestic financial system, as the tightening of the money supply caused by the outflow of dollars prevented the system from achieving the necessary liquidity to set interest rates. At the same time, the heavy losses registered on the stock exchange and on other types of operations cast doubt upon the solvency of some financial institutions, especially in the case of a number of brokerage houses and investment banks. The Central Bank had to buy up large amounts of federal bonds from the financial system and announced that it was doubling its benchmark interest rates. In the final week of October, the Central Bank's net bond acquisitions amounted to 3.8 billion *reais* and the liquidity assistance provided to the system totalled 6.5 billion.

These adjustment measures, in combination with adverse expectations, pushed the economy into a severe slump in October 1997. During the first quarter of 1998, year-on-year GDP growth amounted to only 1.1%. This sluggish performance served to consolidate the progress made in terms of price stabilization and to curb the expansion of the current account deficit, but it did so at the cost of a deteriorating fiscal situation and retreating investment. This cooling down of the economy was seen mainly in the manufacturing and services sectors, where it had a direct impact on unemployment. In fact, unemployment. topped 8% in March as the level of manufacturing activity and the tertiary sector's job creation capacity both plummeted. The steepest downturn was in the production of consumer durables (-22%). In contrast, exports of manufactures soared by 17% in January-April, thanks to the momentum provided by automotive and aircraft sales.

Rising interest rates spurred capital inflows, and by the end of April 1998 the influx of funds

Table 1
BRAZIL: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
					Growth rates				
Growth and investment									
Gross domestic product	3.2	**-4.4**	1.0	-0.5	4.9	5.8	4.2	2.8	3.0
Per capita gross domestic product	1.4	**-6.0**	**-0.5**	-2.0	3.4	4.4	2.8	1.4	1.7
Gross national income	2.7	**-4.6**	2.1	0.1	4.6	7.4	4.4	2.2	2.7
Gross domestic product, by sector									
Goods	3.0	**-8.1**	0.1	-2.8	5.8	6.9	2.1	3.6	4.4
Basic services	6.3	2.2	**6.3**	2.2	5.8	6.1	10.6	6.0	4.0
Other services	2.0	**-2.0**	**-0.1**	-0.4	2.2	2.6	1.0	-0.2	0.8
					Percentages				
Contribution to erowth of GDP [c]									
Consumption	-0.3	**-0.5**	0.2	0.7	3.9	5.1	6.4	3.2	3.5
Gross domestic investment	3.7	**-2.4**	1.3	-2.6	2.2	2.6	1.9	0.4	1.4
Exports	0.4	**-0.4**	0.0	1.5	1.2	0.1	-0.2	0.5	0.9
Imports	-0.7	**-0.7**	**-0.5**	-0.2	-2.4	-1.9	-3.9	-t.3	-2.7
					Percentages of GDP [b]				
Gross domestic investment	22.2	20.2	21.3	18.8	20.0	21.4	22.3	22.1	22.8
National savings	22.4	19.3	20.9	20.4	20.0	21.1	18.4	15.3	14.3
External savings	-0.2	**0.9**	0.4	-1.6	0.0	0.3	4.0	6.8	8.5
					Percentages				
Employment and wages									
Labour force participation rate [e]		61.5	61.0	59.5	58.6	59.3	59.3	59.6	58.5
Open unemployment rate	*3A*	4.3	4.8	5.8	5.4	5.1	4.6	5.4	5.7
Real average wage (index: 1990=100)[8]		100.0	85.2	83.3	91.5	92.2	95.7	103.3	106.0
					Growth rates				
Prices (December-December)									
Consumer prices	1864	1585	476	1 149	2 489	929	22.0	9.1	4,3
Wholesale prices	1 749	1450	472	1 154	2 640	921	13.1	3.9	3.1
External sector									
Terms of trade (index: 1990=100)"	106.7	100.0	101.6	98.5	99.4	102.5	104.7	103.0	109.1
Nominal exchange rate (*reais* per dollar)	30001	0.000025	0.00015	0.0016	0.032	0.64	0.92	1.01	1.08
Real effective exchange rate (index: 1990=100)	106.8	100.0	131.7	141.2	136.7	137.9	121.4	114.3	113.1
					Millions of dollars				
Balance of payments									
Current account	1002	-3 823	-1450	6 089	20	-1 153	-17 972	-24 347	-33 484
Trade balance (goods and services)	13 327	6986	6 687	11 897	8 739	5515	-10 814	-14 586	-19 569
Exports	37 507	35 170	34 938	39 881	43 595	49 010	51 819	54 524	60 252
Imports	24 180	28 184	28 251	27 984	34 856	43 495	62 633	69 110	79 821
Capital and financial account '	-12 245	-5 737	-4016	4 496	6 789	7 578	31 905	33 122	25 647
Overall balance	-11220	-9 525	-5 424	10 639	6 890	6 598	13 933	8 775	-7 837
Variation in reserve assets (- indicates an increase)	-893	-474	369	-14 670	-8 709	-7 215	-12 919	-8 664	7 871
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	26.2	26.5	30.4	34.8	33.1	27.1	22.6	23.0	24.7
Net interest (as a percentage of exports)[J]	25.7	27.7	24.7	18.2	15.6	13.1	15.7	18.0	17.2

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
				Percentages of GDP					
Public sector									
Total income		28.9	24.6	24.2	26.3	28.5	27.2	28.1	28.9
Total expenditure		33.2	30.6	30.7	33.3	29.3	32.8	32.9	34.1
Operating balance		**1.4**	**-0.2**	**-1.8**	-0.8	1.1	-4.9	-3.9	-4.3
				Growth rates					
Money and credit									
Net international reserves	1.5	3.0	-5.7	152.5	35.6	20.5	33.6	16.0	-13.2
Money (Ml)	1 372.9	2 334.7	330.7	867.3	2 129.4	-99.0	23.4	4.6	60.1
				Annual rates					
Real interest rates (annualized)									
Deposit rate	57.1	3.3	34.7	31.9	23.0	26.0	24.8	16.5	19.6
Lending rate		405.8	89.6	196.8	229.1	301.0	81.8	41.0	44.1
Equivalent interest rate in foreign currency	108.1	6.4	30.2	40.8	27.0	54.6	33.9	18.3	16.5

Source: ECLAC, on the basis of official figures.

*** Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. For 1989 and 1990, includes changes in stocks. [e] Percentages of the working-age population; six metropolitan areas. Percentages of the economically active population (EAP); six metropolitan areas. [8] Workers covered by existing social and labour laws. This rate is expressed in *reais* per US$ 1 million for the years up to 1989 and in *reais* per dollar from 1990 onward. One *reais* -Brazil's new currency- is equivalent to 2,750 cruzeiros *reais.* ' Includes Errors and omissions. [J] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. Includes operating adjustments. Interest rate on deposits, deflated by the variation in the exchange rate.**

Table 2
BRAZIL: MAIN QUARTERLY INDICATORS

	1995				1996				1997"				1998[a]	
	I	**II**	**III**	IV	I	H	**III**	IV	I	**II**	**III**	IV	I	**II**
Gross domestic product (change from same quarter of preceding year)"	10.4	6.4	1.0	-0.3	-1.4	2.2	5.4	4.8	3.8	3.9	2.9	2.2	1.1	1.7
Consumer prices (12-month variation, %)	277.1	33.4	25.5	22.0	20.1	16.3	13.0	9.1	8.6	5.9	4.4	4.3	4.3	4.6
Real effective exchange rate[c] (index: 1990=100)	120.9	125.0	121.3	118.4	115.6	113.5	113.5	114.7	112.4	112.2	112.9	115.0	114.3	115.4
Exports (millions of dollars)	9731	11 719	12729	12 328	10 302	12619	12955	11 882	10 656	14 130	14899	13301	11 902	14 103
Imports (millions of dollars)	12 085	13 631	11918	12 030	10 734	12 474	14 235	15 835	13 233	15 409	17 248	16 103	13 415	14 560
Real interest rates (annualized, %)														
Deposit rate	33.0	24.7	25.8	15.7	19.9	9.9	17.2	19.0	13.0	16.1	19.5	29.9	21.7	18.0
Lending rate	114.5	89.9	59.9	63.1	44.0	28.1	46.0	48.5	41.7	32.8	37.8	63.8	63.2	92.2
Money (Ml) (change from same quarter of preceding year)	202.0	145.0	22.3	26.0	34.6	33.4	31.9	4.6	62.2	58.7	56.1	60.1	11.0	17.4

Source: ECLAC, on the basis of official figures.

Preliminary figures. Based on figures expressed in the local currency at constant prices. Refers to the exchange rale for imports.

had driven up international reserves to approximately US$ 72 billion, or US$ 12 billion more than before the outbreak of the crisis in October 1997. The country has been receiving substantial inflows since February 1998 in the form of medium-term financing (bonds and notes), equity investment and short-term capital. In addition, thanks to the narrowing of the trade gap brought about by slower import growth and an increase in exports, the current account deficit has leveled off at slightly over 4% of GDP.

In response to the improved foreign trade situation, more optimistic expectations concerning the international financial scenario, the abundant foreign exchange inflows of the preceding months and the slippage in the level of economic activity, the Central Bank lowered its benchmark interest rate on a number of occasions, and by May 1998 it had dropped to 21.75%, which was almost as low as its pre-crisis level. It was hoped that this lower rate would spur a reactivation of production while still attracting external financial resources.

The reduction in interest rates will also have a positive effect on public-sector accounts, whose balances have taken a turn for the worse since the final quarter of 1997. The total operating deficit for the 12-month period ending in September 1997 had decreased to 2.6% of GDP, but it then surged upward, thus closing out the year at 4.3%, which was higher than the 1996 figure. The gap continued to widen during the early months of 1998, carrying the cumulative 12-month figure to 5%, as a result of the combined effect of higher debt service payments and a steep drop in the primary balances of all levels of government and of State enterprises. If privatization revenues are factored in, then the figures are less worrisome, but the use of those earnings has sparked a heated controversy. The dispute centres around the fact that some units of government, particularly the states, have used them to pay back wages, to cover debts owed to suppliers, to make pension fund contributions and to undertake social investments and expenditures, whereas the federal government had intended for the bulk of these funds to be used to reduce the public debt.

The fiscal measures adopted in November 1997 did not have the expected results. Federal government revenues for the first four months of 1998 were up 26%, but this was partly due to factors that had nothing to do with the new policy package. What is more, the deficit was no smaller than before, since the upturn in receipts was offset by higher debt service and other spending pressures. In addition, the central government's primary surplus virtually disappeared and the positive primary balance registered by State enterprises shrank. One of the main causes of this poor outcome was the social security system's mounting deficit.

2. Economic policy

The country's heightened external vulnerability and, later on, the impact of the Asian crisis obliged the Government to adopt a series of measures to cut its fiscal deficit. Furthermore, the policy aimed at lowering the domestic economy's high interest rates, which had been implemented in conjunction with the introduction of the Real Plan in 1994, had to be suspended and, ultimately, reversed so completely that rates actually doubled. Foreign exchange policy was not altered, however, and the exchange-rate band therefore remained in place, although it's slope was somewhat steeper than the increase in the consumer price index. Structural reforms continued to move forward, and the Government's ambitious privatization programme was once again a central feature of this effort.

(a)Fiscal policy

Up to September 1997, the Government's operating deficit was shrinking, thanks to improvements in the primary balance and lower interest payments in real terms. The public sector posted a primary surplus equivalent to 0.7% of GDP (in contrast to a 0.1% deficit in December 1996). The slight decline in interest payments (from 3.8% of GDP in December 1996 to 3.4%) lowered the operating deficit to 2.7% of GDP (versus 3.9% the year before).

The results turned in by State enterprises and by the state and municipal governments were responsible for this improvement, as the federal government had made the refinancing of the latter's debts conditional upon the implementation of fiscal austerity policies. The elimination of the primary deficit, however, was mainly attributable to the use of privatization revenues and to the reduction in the debt burden achieved through its renegotiation with the federal government. For their part, State enterprises were able to improve their primary balance through rate adjustments and stricter controls on current expenditure.

In contrast, the federal government ran into difficulties when it tried to improve its finances. Apart from the additional receipts obtained from the provisional financial transactions tax (CPMF), real revenues were flat, and the Treasury had to increase its transfers in order to cover the social security system's growing deficit. Disbursements for unemployment insurance and other current expenditures also rose.

During the last quarter of 1997 the fiscal situation took a turn for the worse. In December, state and municipal governments ran up the lion's share of their primary deficit for the entire year (5.1 billion *reais* out of a total of 6.6 billion). After having eliminated virtually the whole of their nominal deficit in the 12 months to September, State enterprises' outlays rebounded sharply in the final quarter. As was also true of Brazil's state governments, some public enterprises used their privatization revenues for investments, but others had to make very costly adjustments or modifications before they could divest themselves of all or part of their assets.

The deteriorating fiscal situation and the renegotiation of payment obligations between the executive branch of the federal government and state governments both influenced the level of domestic public debt, particularly with regard to federal government securities. In December 1996, the balance of those securities was equivalent to 21.4% of GDP, but by December 1997 the figure had risen to 29.9% and by the following February to 35.8%. Then, with the outbreak of the Asian crisis, debt maturities began to grow shorter, and the Government reached the point where it was issuing indexed 35-day bonds, something which had not been seen since the first few months of the Real Plan. This combination of mounting debt levels, sharply rising interest rates and shorter maturities coalesced into a vicious circle in terms of the Treasury's cash flow.

Despite the new conditions prevailing in the international market, the Government wanted to prevent the rate of depreciation from accelerating, since this would negate the beneficial effects of the stabilization process. Accordingly, it took steps to bring about a drastic reduction in the supply of external financing. In addition to restrictive monetary measures, it announced a tough fiscal package and a series of export-promotion measures. All this was intended to reduce the public sector's deficit for 1998 by 20 billion *reais*.

To this end, cuts were made in both current and capital expenditure (the budget allocations for health, education, social welfare and agrarian reform were not touched, however); tax rates and other charges were increased (personal income taxes; excise taxes on motor vehicles, beverages and fuel; the airport tax; and the rates and prices charged by federal government enterprises); and regional and sectoral tax incentives were cut back. In addition, the transfer of available assets and profits of government-owned banks was made mandatory, new borrowing limits were set for state and municipal governments and for State-owned firms, and all applications for external loans from multilateral and government agencies were suspended. The Brazilian Reinsurance Institute was added to the list of firms slated for privatization, and the authorities began to consider the possibility of auctioning off additional highway operating concessions. A credit guarantee fund was set up for loans to small and medium-sized exporters, and provisions were introduced to provide their raw material suppliers with access to external financing. The necessary regulations were established for the re-introduction of export-credit insurance coverage, and funds were transferred to the Banco Nacional do Desenvolvimento Económico Social (National Bank for Economic and Social Development, or BNDES) as backing for export credits. The common external tariff was raised by three percentage points under an agreement with the other members of Mercosur, and a number of measures relating to the financial system were adopted in an effort to reduce expenditures and exercise greater control over commercial banks' foreign-exchange positions.

The implementation of these measures encountered a great deal of resistance and ran into operational difficulties. The increase made in income taxes and the cutback of tax incentives were, as expected, the measures that roused the greatest opposition. As part of the Government's response to this reaction, lay-offs of civil servants were scaled back and greater selectivity was employed in determining which staff members should be let go. In addition, the level of severance pay was increased.

Eight months after this policy package was announced, the fiscal situation had still not been cleared up. The federal government's increased revenues were the result of one-off measures, such as cellular telephone operating concessions, the temporary tax on financial transactions (CPMF) and advance payments on corporate income taxes. Meanwhile, spending pressures in the areas of health and education continued to be felt. The best-case scenario for state governments and State-owned enterprises was that they would manage to balance their primary accounts. At the same time, the state governments' privatization drive was slowing down, although the State of São Paulo did carry off the auction of one of its electric power distributing companies (ELEKTRO) successfully, selling it for nearly US$ 1.3 billion. The picture is even bleaker than it would otherwise seem because some of the most important fiscal instruments used to boost revenues -including the CPMF tax, the fiscal stabilization fund and the increase in the ceiling rate for personal income taxes-have only been authorized for a fixed time period.

(b)Monetary policy

The influence of the Brazilian economy's increased external vulnerability on monetary policy had already made itself felt in 1997. In May, the Central Bank suspended the gradual reductions it had been making in its benchmark interest rates since the year before and stabilized its basic rate -the TBC- at a monthly level of 1.58%. Factors underlying this decision included the prevailing uncertainty as to the future course of domestic economic activity and the trade balance, the need to hold the rate of devaluation to around 0.6% per month without eroding the rate of return in dollar terms of local-currency operations, and the need to take precautions given the possibility of impending changes in international interest rates. In November, the Central Bank doubled its benchmark rates as a way of firming up the stabilization process, which was being undermined by the sharp downturn in capital inflows prompted by the Asian crisis.

At the same time, steps were taken to consolidate the restructuring of the country's financial system. A number of major Brazilian banks were sold to foreign firms (Hong Kong & Shanghai Banking Corporation and Banco Santander), the privatization of a number of State-owned banks was begun (including those of the states of Rio de Janeiro and Minas Gerais) and two privately-owned local banks merged (Banco Brasileiro de Desconto, or Banco Bradesco, and Banco de Credito Nacional, S.A., or BCN).

Because of the high cost of inter-fund transfers -owing, *inter alia*, to the establishment of a temporary 0.2% tax on financial transactions (the CPMF)-economic agents stopped using other monetary instruments, such as time and savings deposits, that are usually very common during periods of high inflation. Consequently, both the monetary base and Ml expanded substantially (by around 60%). The October crisis obliged the monetary authorities to adopt an expansionary stance in order to counteract the effects on domestic liquidity of the country's losses of international reserves, and in the final quarter, the

Central Bank had to buy up 20.5 billion *reais* worth of Treasury securities.

The stock market index skyrocketed 70% in the first half of the year, thanks to the progress made in implementing the Government's privatization programme and to the merger and restructuring of a number of firms and banks. During the first nine months of the year, net portfolio investment inflows totalled US$ 8.4 billion. In late October, however, the deepening crisis in Asia and doubts concerning the economy's future sparked heavy selling on Brazilian exchanges, which recorded a cumulative drop of over 30%; nevertheless, the stock index was still 20% above its end-1996 mark.

(c) Foreign exchange policy

No major changes have been made in the Government's foreign exchange policy. Price stability continued to be its prime objective, although policy-makers also took care to keep the country's external accounts in balance by promoting exports, curbing the rapid growth rate of imports and paving the way for capital inflows so that the country would be able to cover its current account deficit. These efforts have played a decisive role in maintaining price stability, but they have not stopped the current account deficit from increasing sharply, even though in 1997 export growth rebounded from the sluggish rates of the two preceding years.

In order to safeguard the progress made by the stabilization process, the Government decided to hold the currency's rate of depreciation steady despite the adverse implications of the October crisis, and it therefore had to adopt certain monetary and fiscal measures to ensure the viability of that policy stance. The requirement that import sales be made on a sight-payment basis was maintained, except in the case of operations having a term of over one year, and the common external tariff was raised three percentage points by agreement with the other member of Mercosur.

In 1997 the depreciation of the currency bordered on 7.4%, with a monthly average of 0.6%. This rate was maintained well into 1998, apart from small discretionary deviations, as the currency band was adjusted to permit some slippage in the exchange rate. In practice, the system has worked much like a preset crawling peg, since the Central Bank is constantly intervening in the market, setting up a succession of large increases and decreases in reserves.

Thanks to the greater convergence of domestic prices (for tradables and non-tradables), the real exchange rate declined in the first half of 1997, but it rose in the second, and this trend carried over into the early months of 1998. The exchange rate rose against the United States dollar but fell against the other currencies in the basket, since the dollar appreciated against the yen and the deutsche mark.

(d) Structural reforms

In the area of State reforms, US$ 17.4 billion worth of federal and state assets were privatized in 1997. The federal government sold off its Companhia Vale do Rio Doce (CVRD) and the first power generating units to be privatized, as well as cellular telephone concessions. Meanwhile, a number of state governments transferred electricity distribution companies and shares in telephone companies to the private sector. Procedures were also established for the sale of State telephony firms and of the major power generating companies that are scheduled for privatization in 1998. On 29 July 1998, the Government auctioned off 12 firms that had made up Telebras, the State telecommunications holding company, for US$ 19 billion. Regulatory agencies were created to watch over the telecommunications, electricity and petroleum industries and the State petroleum monopoly was disbanded.

The federal government's hopes for quick passage of the constitutional reform bills concerning the civil service and social security system that it needs in order to balance its fiscal accounts were dashed, however, when Congress voted in June 1998 to eliminate a number of important provisions proposed by the Executive.

3. The main variables

(a)Economic activity

GDP growth remained in the 3% range in 1997, but showed a tendency to weaken in the second half of the year after ending the first half with a growth rate verging on 5%. Thanks to a strong increase in the volume of imports of goods and services, total supply expanded by 5% (two percentage points more than GDP). The external component of total demand grew considerably more rapidly than its domestic component (9.2% versus 4.6%); within the latter, however, fixed investment was quite robust (up by nearly 8%) after its sluggish performance of the year before. As a result, gross capital formation rose to 22.9% of GDP, thus reaching its highest level so far this decade. At 4.3% of GDP, the increase in investment in imported machinery and equipment was particularly notable. This coefficient had been a meagre 0.8% in 1990, but has been climbing steeply ever since in response to the country's structural reform process.

As was also true during the three preceding years, consumption outpaced GDP, thus causing national saving to slip to 15.8% in 1997 (versus 20% in 1993), and external saving consequently had to be used to finance nearly a third of gross capital formation.

The manufacturing sector's performance was very uneven. Until the third quarter, the sector's GDP was growing at a year-on-year rate of 5.3%, but this trend came to an end in November, and was reversed altogether in the first quarter of 1998. Consumer durables surged upward at an annualized rate of 16% up to June 1997, but by September this category ' s growth rate had cooled to 10%. This loss of momentum was attributable to flagging domestic demand for electronics and motor vehicles; nevertheless, the output of these products reached record levels, thanks to higher exports. In the course of 1997 the production of capital and intermediate goods rallied, however, as stronger investment, especially in infrastructure and industry, generated additional purchase orders for Brazilian producers. Meanwhile, suppliers of inputs and other raw materials have been carrying out a comprehensive restructuring process in order to heighten their ability to compete against imports; their efforts in this regard have been bolstered by a narrower spread between the cost of domestic and external financing and by the opportunity to lengthen their maturity profiles.

The measures adopted in response to the Asian crisis changed the situation, however. By December, the seasonally-adjusted monthly index for the manufacturing sector had fallen 8.2% below its October level. The adjustment was particularly dramatic in the case of consumer durables, where the drop for the two-month period amounted to 28%, and in capital goods, where it totalled 18%. The branches of industry that rely the most heavily on financing were hurt the most. For example, in that same two-month period, the production of motor vehicles plunged 11.6% year on year. In contrast, manufacturing production closed out the year with an increase of 4.1%.

In the first quarter of 1998, industrial output showed a 1.2% year-on-year decrease, but this adjustment was, as before, concentrated in consumer durables (-22%). The production of capital goods climbed by 5.6%, while intermediate goods and non-durables showed virtually no change.

Given the lack of growth in livestock production, the performance of the agricultural sector was somewhat lackluster (1.9%), but thanks to the persistent upswing in farm prices, which jumped by 18%, its earnings were more than double (5%) what they had been the year before. The soybean and maize harvests were up sharply (by 13% and7.5%, respectively), but the coffee harvest shrank by 13%. Coffee production is expected to rebound sharply (27%) in 1998 and soybean output is likely to maintain its forward momentum (19%), but a 12% contraction in the maize harvest is projected. As a consequence of the drought in the north-eastern part of the country, the first bean harvest was down by 20%, and the shrinkage in the rice harvest is estimated at nearly 5%. Unless the Government steps in and sells part of its stocks, the reduction in the supply of these staple foods, which are included in the consumer shopping basket, will be reflected in price levels.

Construction continued to display the buoyancy seen the year before (8.5% growth in 1997), thanks to the stimulus of investment in infrastructure (especially in privatized enterprises or areas of activity transferred to private operators, as in the case of highway concessions) and the reactivation of lending for housing and urban development projects. Although it was hurt by the steep rise in domestic interest rates and the crisis in the international marketplace, construction was helped by the passage of a law creating a new mortgage finance system which provides for more flexible regulations in terms of lending ceilings, repayment terms and collateral requirements.

(b)Inflation, wages and employment

Consumer prices rose by only 4.3% in 1997 (the lowest rate registered since the Second World War), thereby consolidating the downward trend observed since the stabilization plan was launched in 1994. Owing to the trend in food prices in general and in meat prices in particular, which registered a cumulative upswing of 22% in annualized terms, during the early months of the year the rate was somewhat higher than had been projected, but it then began to decline as agricultural markets returned to normal.

In early 1998, the 12-month inflation rate increased slightly, thus approaching 5%, as a result of the price pressures exerted by agricultural products, especially those destined for the domestic market. Until April, the wholesale index yielded a cumulative annualized rate of 7.3%, as compared to an increase of just 2.2% for industrial prices. In May and June, soaring rice and bean prices drove up the value of the staple food basket to levels not seen since the start of the Real Plan. The average price of this basket jumped by 7.7% between March and May. In response to the emergency situation created by the drought in the north-eastern region of the country, the Government was preparing to sell food from its stockpiles. Midway through the year, agricultural production was returning to normal, and the 12-month inflation rate consequently fell back to slightly over 4%.

The fact that prices have been absorbing part of the impacts generated by domestic and external shocks demonstrates that during the four years in which the Real Plan has been in effect it has succeeded in reducing the inflexibility of the price structure created by the country's now rapidly disappearing indexation mechanisms. Although increases have been seen in public-sector rates and service charges, they have primarily come in response to specific imbalances in supply and demand. Convergence towards low inflation rates has buttressed the use of nominal figures in loan contracts and wage negotiations.

The increase (to 5.7% in 1997 versus 5.4% the year before) in the average annual rate of unemployment in the country's major metropolitan areas was entirely due to the rise registered in the fourth quarter. In the first four months of 1998, unemployment was two percentage points higher than during the corresponding period of 1997. The bulk of this increase was attributable to the cooling of the economy brought about by the policy package implemented in early November 1997.

Nonetheless, the average income of workers employed in the formal sector of the economy in major urban areas was up by another 3%, after having risen 7.3% the year before. However, since this sector is shrinking as the informal sector expands, it is possible that the increase in average wages for all workers, taken as a group, was smaller.

(c)The external sector

The Brazilian economy's external vulnerability was heightened in 1997 as the deficit in its merchandise trade -and, consequently, on its current account as well-deepened. The shortfall on the country's merchandise trade account amounted to US$ 8.4 billion, which was 52% more than just a few years ago. The annualized deficit to September was US$ 9.7 billion, but thereafter it diminished as import growth slowed during the final two months of the year. These new trends firmed up in early 1998, cutting the deficit to nearly half its former level, but the current account deficit, which had totalled US$ 24.3 billion in 1996 (close to 3.1% of GDP), climbed to US$ 33.5 billion in 1997 (4.3% of GDP).

The rapid year-on-year growth of imports (19%) registered for the period January-October 1997 was associated with a rising level of economic activity and the consolidation of access to foreign products, especially raw materials and capital goods. Imports of consumer goods were also higher, with the increase being led by motor vehicles. The measures implemented in response to the Asian crisis had a severe impact on imports, however, and the level of external purchases recorded for the last two months of the year was quite similar to what it had been in the corresponding period of 1996. As was also true of domestic production, the most seriously affected sectors were consumer durables (except motor vehicles), raw materials and fuels, while imports of capital goods remained buoyant (31%).

During the first four months of 1998, the slowdown in imports continued; as a result, the level of imports for this period was 2% below what it had been in the first four months of 1997. The downturn was concentrated in fuels and lubricants (-20%) and consumer goods (-5%), while small advances were posted for intermediate and capital goods (2% and 0.8%, respectively). The decrease would have been even sharper had it not been for the 23% surge in motor vehicle imports that came in response to a reduction in the applicable tariffs; these lower customs duties are part of a scheduled rollback in the tariff regime for Brazil ' s automotive industry, under which assembly plants located in the country are authorized to act as direct importers.

Export growth accelerated to 11% in 1997, but even so did not manage to keep pace with imports. After registering a very small increase (2.5%) in 1996, the growth rate for exports began to steepen midway through the following year, with particularly strong increases being seen in such commodities as coffee beans and soybeans; the upward trend in exports of manufactures also finned up, especially in the case of aircraft and automotive products (motor vehicles, parts and accessories). Most of the demand for these products came from the Mercosur countries, Chile and the United States.

The upswing in commodity exports in 1997 was largely attributable to the decision to extend the authorized exemption from the value added tax, a more abundant supply of competitively-priced financing for export firms, and a number of other measures, particularly the establishment of an export credit insurance system.

In the first four months of 1998 exports rose by 7.7%, which was quite similar to the preceding year's growth rate; this was a quite creditable figure in view of the poor performance of commodity exports, which were down by nearly 8% as a consequence of a decrease in shipments of coffee and soybean meal and lower soybean prices.

The trend of commodity exports in 1998 was influenced by the crisis in the Asian countries, which are major buyers of those products. As of April, total sales of Brazilian products to the Republic of Korea, Malaysia, the Philippines, Thailand and Indonesia had plummeted by 43%.

The upswing in exports of manufactures (17%), on the other hand, was driven by high-value-added industrial products: transport equipment, communications equipment, electrical and electronic appliances, and other types of machinery. This appears to be associated to some degree with increased sales to members of the Latin American Integration Association (LAIA) and, to a lesser extent, to a number of European countries, including Italy and Germany.

The deficit on trade in services deepened in 1997 owing primarily to the results for international transport and travel, which generated a deficit of US$ 8.9 billion (26% more than the year before). In addition, the deficit on the income account jumped from US$ 12.7 billion to US$ 16.1 billion, chiefly as a result of increased outlays in the form of profit remittances, which amounted to US$ 6.5 billion (169% more than the year before). Net interest payments rose by just 5.5%, however, for a total ofUS$ 10.3 billion.

Three different phases can be identified with regard to trends in the capital account: (i) the situation that prevailed before the October 1997 crisis; (ii) the uncertainty or "closure" of international markets that occurred during the period from November 1997 to February 1998; and (iii) the resurgence of robust capital flows observed between then and the end of April. As of mid-1998, capital inflows were tapering off as fears regarding the Brazilian economy's future and the effects of the Asian crisis mounted.

Inflows to Brazil were abundant in 1997, and the country was therefore able to build up its international reserves to over US$ 62 billion by September. The level of direct investment received as of October was twice as high as it had been for the same period of 1996 and, at US$ 14.1 billion, provided more than half of what the country needed to cover its current account deficit. Privatizations and the increase seen in external capital in the manufacturing, commercial and financial sectors accounted for the higher level of inflows.

In addition, funds continued to pour into the country's stock exchanges, and stock indexes rose sharply. In the first nine months of 1997, net inflows of portfolio investment totalled US$ 8.4 billion. In addition, particularly strong increases were seen in bond issues (US$ 17.1 billion up to October, which was 46% higher than for the same period of 1996) and credit operations (a gross sumofUS$ 19.9 billion), which were boosted by the system of mandatory import coverage. The public sector was much more active in the bond market than before, taking in US$ 6.9 million, and its interest rate spread on such instruments narrowed to less than 250 points over United States Treasury notes.

Inflows contracted drastically in the final quarter of 1997, and reserves were drawn down by US$ 10.3 billion as the net result of current account outflows of US$ 11.1 billion and total capital inflows of just US$ 1.4 billion (whereas the quarterly average for the year was US$ 8.5 billion). Incoming resources during this period were extremely limited, and it became difficult to roll over existing credits. Amortization payments for the final quarter amounted to US$ 13 billion, which was half as much as the sum of such payments for the entire year. A total of US$ 5.9 billion was paid out on bonds, but bond placements brought in only US$ 154 million.

Nevertheless, the private external debt continued to climb in 1997, and it did so at a faster rate than the public-sector debt. In 1995, the medium- and long-term private external debt amounted to US$ 37.3 billion, but by 1996 it had risen to US$ 53.7 billion and by December 1997 to US$ 77.5 billion. In contrast, short-term debt -mostly commercial bank loans and lines of credit for foreign trade operations- was down to US$ 35.2 billion from the previous year's level of US$ 37.8 billion. The figures for the first quarter of 1998 confirmed this trend, with medium- and long-term external debt totals of US$ 92 billion for the private sector and of US$ 82.2 billion for the public sector.

CHILE

1. General trends

In 1997 the Chilean economy completed 14 years of uninterrupted growth. Inflation again declined, slightly, ending at around 6%. Gross domestic product expanded by 6.9%, domestic demand by 8.5%. The national savings rate increased from 26.3% to 27.8%, but the amount saved was insufficient to finance the vigorous effort in gross capital formation (35.6% of output), which again required a significant amount of foreign capital. The current account therefore yielded a deficit of 5.3% of GDP, similar to the figure for 1996 but significantly higher than those for previous years; however, the deficit was more than covered by medium and long-term foreign investment. The public sector helped sustain investment with a savings rate of 5.5% of GDP and an overall surplus of 1.9%. Unemployment affected 6.1% of the labour force, while employment increased by 2.1%, real wages by 2.4% and average labour productivity by 5%.

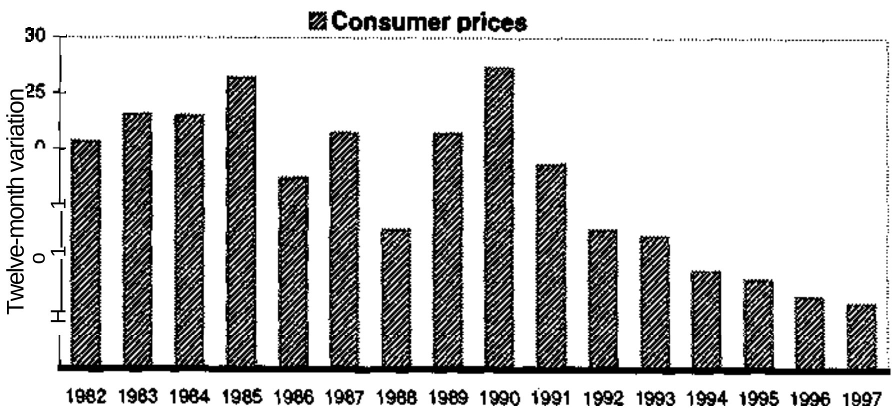
Until October, the economy was flourishing, thanks to a vigorous expansion in private spending, although the drop in the real rate of exchange was eroding the competitiveness of exports. The scenario altered as the Asian crisis took a turn for the worse, and the effect was compounded by the steep downturn in the international price of copper that had begun in July.

Confronted with a widening current account deficit and increasing pressure on the foreign exchange market, the authorities took major corrective steps in the first half of 1998, the last of them in June. As the real interbank exchange rate shot up for a few days to an annualized level of 100%, the authorities cut back on fiscal expenditure, substantially reduced the width of the currency band and reduced the reserve requirement on external credits. With these measures they also succeeded in maintaining the policy of gradually bringing down inflation.

For 1998 a current account deficit equal to 6.5% of GDP is projected. Economic activity should show a decline, both because of the Asian crisis and because of a deliberate policy of narrowing the gap between expenditure and output. This will mean living with higher interest rates and little margin to increase public spending. The decline in the terms of trade (between 6% and 10%) should allow for only a modest increase in national income.

2. Economic policy

The Asian crisis surprised the Chilean economy in the midst of an expansive phase characterized by the progressive easing of monetary policy, a marked decline in the real exchange rate, a sharp drop in the price of the country's main export commodity and a widening current account



Percentages of GDP

deficit. Roughly 30% of Chile's exports go to Asian markets, and the country has felt the ill effects of the crisis primarily in the trade sphere, in the form of lower export prices and volumes, to the detriment of the terms of trade and national income.

The price of copper began to slide in July 1997, and the average price of the metal is projected to be 30% lower for 1998 than for the previous year. The lost earnings, estimated at US$ 1.6 billion, or the equivalent of 2% of GDP, will heavily skew the balance of trade, since copper still accounts for a little over 40% of the country's exports. Moreover, the lower real exchange rate and the depreciation of Asian currencies have boosted imports. In terms of financing, external credit has become scarcer and more costly, an effect all the emerging economies are experiencing.

The expansive phase of the first three quarters coincided with a debate about the sharp decline of the real exchange rate and its possible impact on exports and growth. Debate focused on the sustainable level of the current account deficit and its counterpart, the economy's capacity to absorb new capital flows without risking macroeconomic stability or the dynamism of exports. Towards the end of the year, concern sharpened about the size of the external imbalance, since the large current account deficit of 1997 accumulated during a period when annual average international prices were still favourable.

Although ultimately it was a year of adjustment, 1997 saw GDP grow by 6.9% and domestic spending by 8.5%. Moreover, from the second quarter onward, growth in spending outstripped growth in output, and the gap increasingly widened, averaging four percentage points during the second half of the year. In the last quarter, GDP grew by 9.6%, spending by 13.7%.

The basic cause of the external deficit was excess spending over the course of the 1997, stimulated by successive cuts in interest rates, in combination with the sharp drop in copper prices. When the Asian crisis heated up in November, the Chilean economy was running a considerable external deficit and was faced with projections that copper prices would remain low, carrying the threat that the current account deficit would reach 6.5% of GDP in 1998. Since, moreover, the real exchange rate had accumulated a decline of 10% by the end of October, the reading of the markets was that an adjustment of the parity was imminent.

In January 1998, confused signals given out by the authorities concerning the appropriate level of the exchange rate caused turbulence in the market, which pushed the rate as high as 475 pesos to the dollar (414 pesos in October). Disorder in the financial and foreign exchange markets spread until the Central Bank raised the real cost of money to 8.5%, thereby restoring credibility, but at the cost of interest rates higher than those prevailing when monetary easing began. As the gravity of the Asian crisis was borne home, the public sector reduced its budgeted expenditure; it did so again in April. However, there was a fresh bout of turbulence in June as the Japanese situation worsened, bringing renewed pressure to bear on the exchange rate. The authorities reacted promptly to restore confidence. They made additional budget cuts, modified the currency band system and reduced the reserve requirement on foreign credits, as the interbank interest rate skyrocketed for a few days.

In the event that these measures should prove to be insufficient to narrow the spending gap, the authorities have expressed their willingness to increase the public sector's contribution in order to bring the external imbalance back to a level sustainable over the long term. The size of international reserves, the low level of external debt and the small proportion of short-term external commitments, in conjunction with the quality of domestic bank regulation and the continuing fiscal surplus, are important assets in the effort to put through the adjustment.

(a) **Fiscal policy**

Central government accounts again showed a surplus in 1997, this time equivalent to 1.9% of GDP, four tenths of a point lower than in 1996. This result was achieved despite the fact that current revenues expanded only 4.4% in real

Table 1
CHILE: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
				Growth rates					
Growth and investment									
Gross domestic product	9.8	**3.4**	8.0	11.4	6.6	5.6	10.1	7.3	6.9
Per capita gross domestic product	8.0	**1.7**	6.2	9.6	4.8	3.9	8.4	5.8	5.4
Gross national income	10.7	**3.3**	8.2	12.6	4.6	6.9	15.9	3.1	8.2
Gross domestic product, by sector									
Goods	9.2	**3.4**	6.0	7.9	6.4	5.2	8.2	6.9	5.0
Basic services	6.3	**2.7**	13.5	20.5	5.5	5.7	12.4	7.6	11.9
Other services	9.3	2.9	8.4	11.0	5.7	5.0	9.0	6.8	6.5
				Percentages					
Contribution to growth of GDP [c]									
Consumption	6.2	1.0	**6.3**	9.6	3.7	3.7	5.0	5.5	4.5
Government	0.4	0.1	0.3	0.5	0.4	0.2	0.3	0.2	0.3
Private	5.8	0.9	6.0	9.1	3.3	3.5	4.6	5.3	4.2
Gross domestic investment	5.7	**1.3**	0.2	5.1	5.4	0.2	9.5	2.5	4.3
Exports	4.6	2.4	**3.8**	4.2	1.3	3.9	3.4	3.5	3.8
Imports	-6.7	**-1.4**	**-2.3**	-7.4	-3.7	-2.2	-7.8	-4.3	-5.7
				Percentages of GDP [b]					
Gross domestic investment	24.6	25.0	23.3	25.5	29.0	27.7	33.7	33.8	35.6
National savings	22.1	23.4	23.0	22.8	22.1	23.6	30.7	26.3	27.8
External savings	2.4	1.6	**0.3**	2.7	6.9	4.0	3.0	7.5	7.9
				Percentages					
Employment and wages									
Labour force participation rate	52.6	52.6	52.7	53.2	55.2	55.4	54.8	54.2	54.2
Open unemployment rate[e]	7.9	7.8	8.2	6.7	6.5	7.8	7.4	6.4	6.1
Real average wage (index: 1990=100)	98.2	100.0	104.9	109.6	113.5	118.8	123.6	128.7	131.8
				Growth rates					
Prices (December-December)									
Consumer prices	21.4	27.3	18.7	12.7	12.2	8.9	8.2	6.6	6.0
Wholesale prices	22.8	25.7	16.5	8.9	6.7	7.8	8.2	3.1	1.9
External sector									
Terms of trade (index: 1990=100)[b]	106.0	100.0	102.3	101.3	94.3	102.7	116.3	94.1	98.0
Nominal exchange rate (pesos per dollar)	267	305	349	363	404	420	397	412	419
Real effective exchange rate (index: 1990=100)	94.8	100.0	99.7	96.2	98.2	94.8	89.2	86.0	80.2
				Millions of dollars					
Balance of payments									
Current account	-689	-485	-99	-958	-2 554	-1 585	-1 398	-3 744	-4 057
Trade balance (goods and services)	1 024	1055	1 518	545	-1217	583	1020	-1448	-1610
Exports	9 613	10 221	11069	12 365	11709	14 444	19 234	18 771	20 608
Imports	8 589	9 166	9 551	11 820	12 926	13 861	18 214	20 219	22 219
Capital and financial account	1 208	2 808	1355	3 505	2 984	4 736	2 456	6 249	7 242
Overall balance	519	2 323	1 257	2 546	430	3151	1 058	2 505	3 185
Variation in reserve assets (- indicates an increase)	-548	-2 121	-1049	-2 344	-173	-2 919	-741	-1 107	-3 185
				Percentages					
External debt									
Gross debt (as a percentage of GDP)	62.1	61.1	50.3	44.4	43.1	42.1	32.3	32.0	34.7
Net interest (as a percentage of exports) [g]	16.0	13.2	9.5	7.1	6.1	4.3	3.1	3.4	2.6

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
					Porcentages of GDP				
General government									
Current revenue	21.7	20.6	22.1	22.9	23.2	22.5	22.2	23.2	22.7
Current expenditure	18.6	18.1	18.5	17.9	18.2	17.6	16.7	17.4	17.3
Saving	3.1	**2.5**	3.6	5.0	4.9	4.9	5.4	5.8	5.5
Capital expenditure (net)	1.6	1.7	2.1	2.7	2.9	3.2	2.9	3.5	3.5
Financial balance	1.5	**0.8**	1.5	2.3	2.0	1.7	2.6	2.3	1.9
					Growth rates				
Money and credit									
Monetary balances of banking system									
Net international reserves	25.2	124.6	34.8	62.8	17.8	22.5	13.3	8.3	14.5
Net domestic credit	27.2	-10.8	36.2	-19.4	39.7	-4.0	59.9	32.3	31.3
To public sector	-8.3	18.6	14.3	-2.9	11.8	-17.4	1.6	-13.7	-9.4
To private sector	37.3	16.1	22.4	37.0	30.2	12.8	28.8	18.0	13.6
Money (Ml)	5.5	27.0	39.7	21.2	29.2	-2.9	14.8	-7.8	97.9
Local-currency savings and time deposits	30.8	32.0	36.9	32.4	22.5	22.6	32.9	24.0	10.7
M2	23.7	30.8	37.6	29.7	24.0	16.8	29.4	18.6	22.1
Dollar deposits	46.8	28.7	23.2	-17.2	31.3	-20.7	-7.3	-9.9	6.2
					Annual rates				
Real interest rates (annualized)									
Deposit rate	7.6	10.4	3.1	5.0	5.3	5.7	5.1	6.4	5.8
Lending rate	11.9	17.1	8.4	10.0	10.8	10.4	9.2	10.1	9.2
Equivalent interest rate in foreign currency	16.9	24.0	10.2	16.5	5.9	22.2	14.9	10.0	8.6

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Percentages of the working-age population. [e] Percentages of the economically active population (EAP). Includes Errors and omissions. [8] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
CHILE: MAIN QUARTERLY INDICATORS

	1995				1996				1997[a]				1998[a]	
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)	7.3	8.4	8.9	9.6	9.0	6.4	5.7	7.7	4.0	5.8	9.0	9.6	7.2	5.4
Consumer prices (12-month variation, %)	8.2	7.6	8.6	8.2	7.9	8.3	6.3	6.6	6.8	5.3	6.0	6.0	5.3	5.4
Real effective exchange rate (index: 1990=100)	93.1	88.5	86.0	89.1	87.6	85.5	85.3	85.4	82.2	81.0	79.0	78.8	81.5	81.8
Exports (millions of dollars)	4 112	3 977	3 935	4015	4 062	4 273	3516	3 502	4 643	4 364	3 999	3918	4 040	3 990
Imports (millions of dollars)	3 183	3 445	4 022	4 005	3 799	3 925	4 212	4 564	4000	4 213	4 741	5 264	4 628	4 500
Real interest rates (annualized, *%)*														
Deposit rate	4.3	4.6	4.5	7.0	5.0	7.3	6.5	6.9	6.3	6.1	3.1	7.6	7.7	8.9
Lending rate	8.6	8.4	8.2	11.6	8.5	10.9	10.4	10.5	9.7	9.9	6.3	11.0	12.3	12.4
Money (MI)[c] (change from same quarter of preceding year)	22.5	27.3	24.5	19.4	16.6	15.0	16.9	13.0	14.4	17.3	20.6	19.3	10.8	8.0

Source: ECLAC, on the basis of official figures.
Preliminary figures. Refers to the exchange rale for imports. " Private sector.

terms, considerably less than output, and is explainable by the relatively moderate increase in spending (6.1%). Current outlays expanded by 5.7%, investment spending by 7.8%. Prepayments of external debt in previous years allowed for a major reduction in interest payments (-20%) and thus helped substantially in generating the surplus. Other items of expenditure increased at a rate in line with output growth. That revenues grew only modestly was owing to two factors: the performance of foreign trade taxes, reflecting tariff reductions under economic integration agreements, and reduced collections of value added tax (VAT).

The fiscal surplus was not large enough to slow the rate of expansion of domestic demand, given the vigour of private demand. Moreover, projections for 1998 foresee slower growth in public revenues due to a decline in copper export earnings and in taxes on domestic activity. In view of these projections, the Government on three occasions (January, April and June) revised its budget downward. The spending cuts should amount to some 0.9% of GDP.

(b) Monetary policy

Pursuing a policy of gradually easing monetary controls, the Central Bank reduced the interbank interest rate by one quarter of a point on four occasions in 1997, lowering it from 7.5% in February to 6.5% in September. The long-term rate did not follow suit; in fact, it was expected to rise, given the rapid expansion of spending and the extent to which the external accounts were deteriorating. In the third quarter, the tendency towards a moderate rise in long-term rates was accentuated once the high levels of economic activity for the period became known. In addition to these signs that the economy was overheating, interest rates also became more sensitive to the impact of the Asian crisis on the external accounts.

The exchange rate reacted by rising beginning in November, reversing nearly ten months of nominal stability and hence of steady real appreciation of the peso. Since by October the real rate of exchange had declined by 10%, the adjustment was sharp, resulting in unaccustomed nominal depreciations of 2.5% in November and 3.1% in December. At first the Central Bank allowed the exchange rate to slide, in view of the accumulated cushion. However, given the aggravation of the Asian crisis and data projecting a further deterioration in the external accounts in 1998, on 8 January 1998 the Central Bank raised the interbank rate from 6.5% to 7.5%. The market viewed the measure as insufficient and unleashed a heavy speculative attack against the peso that carried the exchange rate to a high of 475 pesos to the dollar. In this situation, banks directed their resources towards realizing foreign exchange profits, even to the point of neglecting their provisions to meet monthly reserve requirements. In response, the Central Bank decontrolled the interbank rate, which on one day rose to 100% in real terms and hovered for a couple of weeks at a real rate of 15%.

On 3 February, the Central Bank set the interbank rate at 8.5% in real terms, an increase of 1.5 percentage points, in effect abandoning the policy of mini-adjustments it had been following and raising the rate by twice the amount it had been lowered in 1997. This increase underlined the Central Bank's commitment to moderating the rise of the exchange rate, reining in spending and meeting its inflation target.

During the first five months of 1998, interest rates on short-term instruments again lagged behind long-term rates. A fresh outbreak of turbulence in June obliged the Central Bank once again to float the interbank interest rate, while the Government implemented a package of measures that cut budgeted expenditures and altered foreign exchange policy.

(c) Foreign exchange policy

In January 1997 the Central Bank widened the currency band from 10% to 12.5% to either side of the reference parity and changed the composition of the basket of currencies that defined the exchange rate, increasing the relative weight of the dollar. In March, noting what it deemed excessive levels of arbitrage, it re-imposed reserve requirements on external credits on transactions from US$ 10,000 to US$200,000, reversing the measure of the previous December eliminating them; however, the exemption was maintained for transactions of under US$ 10,000. In October, in an attempt to limit both the capital account surplus and arbitrage options, the Foreign Investment Committee lowered from 70% to 50% the maximum amount of financing with external credits allowed for projects registered under Decree-Law 600, at the same time raising the minimum for such operations from US$ 25,000 to US$ 1 million.

During the first three quarters there was a noticeable decline (8%) in the real exchange rate. But during the last two months of the year, the nominal exchange rate began to rise, obliging the Central Bank to intervene a number of occasions between November 1997 and mid-May 1998, at the cost of US$ 2 billion in international reserves.

There followed two months of exchange rate stability, which ended in June 1998 with a fresh attack on the peso, triggered by the fall of the yen against the dollar and the effects of this latest episode in the Asian crisis on the price of copper and external financing. A resurgence of demand pressures in the foreign exchange market obliged the Central Bank to sell approximately US$ 1.3 billion in June.

The intensification of pressure on the exchange rate led to the adoption of a set of measures, one of which was to narrow the band to a minimum of 3.5% below and a maximum of 2% above the reference value. The bandwidth of 12.5% to either side of the peg had not, in fact, been functioning, owing to the continual interventions of the Central Bank, which had made large inroads into international reserves. The idea behind narrowing the band was to limit Central Bank interventions to occasions when the price moved all the way to one edge of the band or the other.

3. The mam variables

(a)Economic activity

The fastest-growing category of expenditure was gross fixed capital formation, which increased by 13.2% over the previous year, bringing the ratio of fixed capital investment to GDP to a record 32%. Private consumption increased by 6.8%, that is, at a pace similar to the growth of output. Aggregate supply increased by 9%, outstripping output by more than two percentage points, owing to a surge in imports.

A favourable trend in the terms of trade formed the basis for an increase of 8.2% in real disposable gross national income. Lower prices for imported goods and the drop in the real exchange rate combined with the gradual easing of interest rates to direct this enhanced purchasing power towards consumer goods, especially imports.

Among non-tradable sectors, growth was particularly strong in transport and communications (12.9%) and electricity, gas and water (9.5%); among tradable sectors, mining (8.1%) and fisheries (7.9%) were the leaders. Manufacturing achieved growth of 4.4%, while agriculture and forestry suffered a 2.1% setback because of adverse climatic conditions, in the form of drought in the first half year and excess rainfall in the second, affecting truck-farming in particular.

In the first quarter of 1997 output increased by 4% and spending by only 1.6%, thanks to the reinforcement of monetary restrictions applied at the end of 1996, when it became evident that output and spending were both growing at an unsustainable pace. The slowdown was also facilitated by the increase in interest rates in December 1996 and the impact of the drought. But a significant upturn in levels of activity and spending was already visible in the second quarter and was consolidated in the third, owing to an improvement in the terms of trade and successive reductions in interest rates. By the third quarter GDP growth reached 9%, spending 12.9%. These high growth rates were surpassed in the fourth quarter, when output grew by 9.6% and spending by 13.7%.

In the first quarter of 1998, GDP increased by 7.2% and domestic demand by 14.6%, still excessive in view of the desire to slow spending and reduce the current account deficit to manageable proportions. Beginning in May the economy began to show signs of the cooling the adjustment was intended to accomplish.

(b)Prices, wages and employment

Inflation in 1997 was 6%, six tenths of a point lower than the rate for the previous year. The tight money policy that prevailed during the early part of the year facilitated a rapid drop in wage inflation and in utility rates in the first half year. The twelve-month variation in prices of non-tradables gradually slowed from 8.2% in the first quarter to 6.3% in the fourth. The rise in prices of tradables also tended to slow, but that trend was interrupted in third quarter despite a drop in the real exchange rate, suggesting rigidity in the mark-up on tradables.

Between July and October inflation accelerated temporarily, owing to increases in the prices of perishable goods, meats at first and later fruits and vegetables, because of the effects of rainstorms associated with the El Niño phenomenon. Basically, however, excluding seasonal variations in a few products, the underlying trend of inflation was downward.

The labour force increased by 1.7%, following an increase of barely 0.4% the year before. The rise in employment (2.1 %) occurred mostly in the second half and was stronger in non-tradable sectors (construction, commerce, transportation and communications), although there was also an upturn in industrial employment.

The average unemployment rate was 6.1% of the labour force; the rate hovered around 6.7% throughout the third quarter and fell sharply in the last. Stronger job creation and a mild tendency to higher unemployment in the third quarter coincided with a strong expansion of the secondary labour force. The annual unemployment rate marked its third straight year of decline from a high of 7.8% in 1994.

The increase in nominal wages slowed; whereas the annualized rate was around 10% in the first quarter, by the end of the year the cumulative annual variation was 7.8%. The slowdown was reflected in real wages, which rose only 2.4%, at half the rate of increase in average labour productivity (5%). Moreover, the increased participation of the secondary labour force, coupled with the location of most new jobs in sectors of lower-than-average productivity, tended to keep average real wage increases low.

(c)The external sector

The overall balance-of-payments surplus equalled US$3.2 billion, combining a current account deficit of US$ 4 billion and a capital account surplus of US$ 7.2 billion, or 9.5% of GDP. International reserves increased by US$ 3.2 million to total US$ 17.84 billion by year-end, equivalent to a year's worth of imports. The steady accumulation of international reserves was interrupted between November 1997 and January 1998, when around US$ 2 billion were lost. Further declines in 1998 amounted to some US$ 1.3 billion by June.

The widening of the current account deficit compared with 1996 was due primarily to a US$ 200 million increase in the trade deficit, which developed chiefly in the last quarter. The terms of trade improved, and merchandise export volumes grew by 10.7%. The deterioration in the merchandise trade balance, then, was a result of the pick-up in aggregate demand, which fuelled a surge in imports, causing them to expand by 20% in volume in the second half. The value of merchandise exports increased by 9.9%, despite a drop of 0.8% in unit prices. Imports for the year increased by 10.4% in value and 16% in volume, while import prices dropped by 4.7%. In value terms, copper exports expanded by 18.7%, other exports by 4.2%, including a 6.9% increase in non-traditional exports.

Medium and long-term flows maintained their preponderance in the capital account. Net foreign investment flows, including both direct and portfolio investment, were 20% greater than in 1996. Net foreign direct investment amounted to US$ 3,467 million, while portfolio investment totalled US$ 2,370 million, double the previous year's figure, including strong sales of American Depositary Receipts (ADR), both primary and secondary. Proceeds of bond issues increased by 57%, roughly half of that issues by the banking sector.

COLOMBIA

1. General trends

In 1997 the Colombian economy stepped up the pace of growth to 3.2% and inflation slowed, but other macro-economic indicators were less favourable; the domestic scene was marred by a serious deterioration in public order.

The rate of inflation declined by four percentage points to 17.7%, but the cumulative variation in the first half of 1998 reached 14.1%, which may make it difficult to achieve the target for the year.

The unemployment rate continued to rise. The rate for urban areas rose from 11.2% in 1996 to 12.4% in 1997 (on average) and further increased to 15.8% in June 1998.

The fiscal gap continued to widen, although less rapidly than in previous years. The consolidated non-financial public sector deficit equaled 3.1% of gross domestic product (GDP), the central government deficit 4.2%.

The deficit on the current account increased from5.8%in 1996 to 6.0% in 1997 and was offset by a surplus, estimated at some 6.7% of output, on the capital account. Net foreign direct investment mounted to an unprecedented level of US$ 5,170 million, owing in large part to privatization proceeds: in the course of the year the sale of State assets brought in US$ 3,180 million (3.4% of GDP).

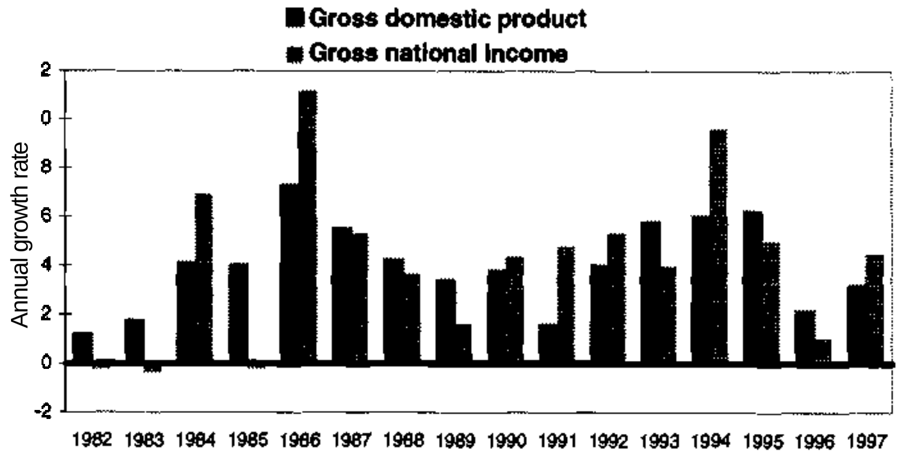
On the external front, in March 1997 the Government of the United States, Colombia's main trading partner, decided that it could not certify Colombia's efforts against drug trafficking, a position it changed a year later. The effects of the El Niño climatic phenomenon and the Asian crisis up to the end of 1997 appeared to be moderate.

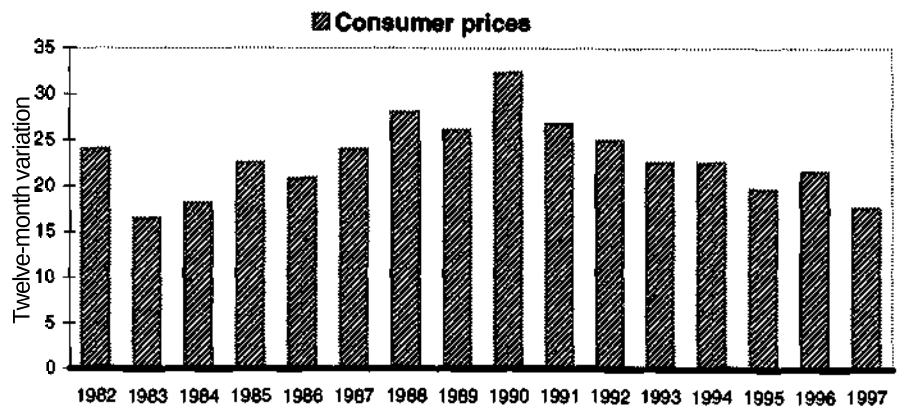
In the first half of 1998, however, the trend towards depreciation on foreign exchange markets intensified and, in conjunction with the uncertainty surrounding elections, brought on speculative attacks against the currency. A drop in world prices for the country's three main exports (oil, coffee and coal) further complicated the picture.

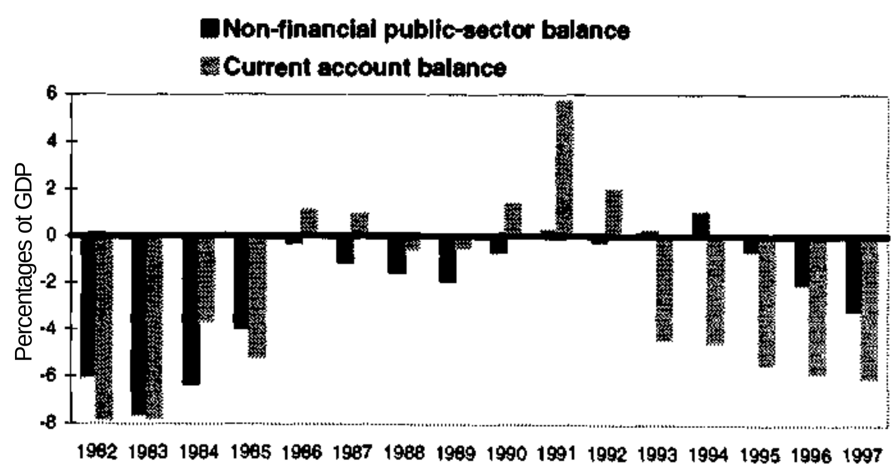
The central bank (Banco de la República) made its main goal the defence of the currency band, a goal it pursued by selling over a billion dollars, raising interest rates and relaxing the conditions on external borrowing. Pressure on the exchange rate eased after the presidential elections this June.

2. Economic policy

The start of 1997 saw an end to efforts to cool down the economy to correct for the imbalances created during the expansionary phase from 1992 to 1995. The authorities began to work towards reviving output, without abandoning the goals of fighting inflation and correcting external and fiscal imbalances. Recovery was visible by the second quarter of 1997 and was accompanied by a slowing of inflation. The best that could be achieved in regard to the fiscal and current account deficits, however, was to slow their rate of expansion. In January 1998, attention turned







Source: ECLAC, on the basis of official figures.

to defending the currency band against speculative attacks.

(a)Fiscal policy

In January 1997 the Government declared a state of economic emergency and, exercising its emergency powers, adopted a number of measures to combat the appreciation of the peso, tax evasion and smuggling, measures it hoped would raise revenues equivalent to 0.8% of GDP. In March, however, the Constitutional Court held the decree declaring the emergency to be unenforceable. To make up for part of the revenue thus lost, the Government opted for a temporary (three month) increase in tariffs starting in April, which raised the average tariff rate from 11% to 14%. Moreover, in mid-year Congress approved a new tax reform package that included most of the measures implemented during the economic emergency. In May, the Banco de la República adopted a more restrictive policy for managing short-term external debt.

For the second year running, the central government deficit was above 4% of GDP. In addition, the erosion of the social security surplus and the deficits posted by the electricity and petroleum sectors and by regional and local governments widened the consolidated deficit for the non-financial public sector (NFPS) widened from 1.9% to 3.1% of output. However, if the plentiful proceeds from privatization are included, consolidated NFPS accounts show a small surplus.

The central government deficit was financed primarily (80%) with domestic credit, in response to a major shift in debt management policy. The authorities are trying to phase out the practice of requiring certain investors to buy government paper at interest rates below market. As a result of the new policy, the stock of non-mandatory treasury bills (TESs) in circulation increased by 63% in 1997. However, the sharp rise in interest rates in the first half of 1998, associated with defence of the currency, led the Government to change its financing plan, dropping the target for net TES placements for the year from 6 billion to 2.8 billion pesos.

(b) Monetary policy

In 1997, the Banco de la República tried to reconcile the goals of bringing down inflation and reviving the economy. To that end, it planned for annual increases of 16% in the monetary base and 22.3% in broad money (M3 plus bonds). In May, owing to the unexpected increase in currency in circulation, it raised the first of these targets to 20%, but adhered to its original target for the broad money supply. By year's end, the monetary base had expanded by 25% (compared with 10.6% the year before), the money supply (Ml) by 21.7% and broad money (M3 plus bonds) by 25%. These results were influenced by the spectacular drop, from 2,337 billion pesos in May to only 54 billion pesos by the close of the year, in the outstanding stock of central bank open market securities (títulos de participación). The combined effect of a number of seasonal and domestic demand factors kept the increased liquidity from accelerating the rise in consumer prices.

Thanks to acceptable trends in inflation, the Banco de la República was able on three occasions to reduce the interest rates associated with its interventions in the money market. The minimum rate of 23% and maximum rate of 33% were reduced to 21.25% and 28.5%, respectively, in March; to 20.5% and 27.5% in May; and to 20% and 27% in August. Since credit demand was low to begin with, these actions resulted in an appreciable decline in the cost of money. Lending and deposit rates in August 1997 were some eleven percentage points lower than they had been 12 months earlier. In the third quarter, however, they began to go up again, a trend that was accentuated in the first quarter of 1998. A wave of speculative attacks on the currency obliged the central bank to sell foreign exchange, a move that contracted the monetary base, and to raise the minimum and maximum rates for its money market interventions from 20% and 27% to 23% and 30%, respectively. The interbank rate became erratic and tended to rise. In May the monetary authorities took steps to control that volatility and to absorb liquidity. As a result of these measures by the central

Table 1
COLOMBIA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
					Growth rates				
Growth and investment									
Gross domestic product	3.4	3.8	1.6	4.0	5.8	6.0	6.2	2.2	3.2
Per capita gross domestic product	1.3	1.8	-0.4	2.0	3.8	4.1	4.3	0.4	1.4
Gross national income	1.6	4.3	4.8	5.3	4.0	9.6	5.0	1.0	4.5
Gross domestic product, by sector									
Goods	4.4	3.0	1.6	1.2	3.3	3.5	5.9	0.4	1.6
Basic services	3.7	3.7	3.4	2.9	6.3	5.9	4.2	4.2	5.0
Other services	2.4	3.8	2.0	4.8	5.2	7.4	7.4	4.4	3.6
					Percentages				
Contribution to growth of GDP [c]									
Consumption	3.1	2.5	1.3	1.9	3.9	3.9	4.8	2.9	5.1
Government	0.6	0.3	0.3	1.1	0.4	1.7	0.9	1.2	0.6
Private	2.6	2.2	0.9	0.8	3.5	2.3	3.9	1.7	4.5
Gross domestic investment	-1.6	-0.2	-1.6	7.2	8.8	8.0	2.9	-0.5	1.2
Exports	1.4	3.6	2.1	1.5	2.3	0.0	2.0	1.4	1.9
Imports	0.4	-2.0	-0.2	-6.5	-9.1	-5.9	-3.4	-1.6	-5.0
					Percentages of GDP [b]				
Gross domestic investment	19.5	18.5	16.7	22.9	29.9	35.8	36.4	35.1	35.2
National savings	18.9	19.9	22.9	25.4	24.1	28.1	26.8	24.4	23.1
External savings	0.5	-1.3	-6.2	-2.5	5.8	7.7	9.6	10.7	12.1
					Percentages				
Employment and wages									
Labour force participation rate [d]	57.6	58.4	59.5	60.8	60.1	60.0	59.9	59.7	59.9
Open unemployment rate [e]	10.0	10.5	10.2	10.2	8.6	8.9	8.8	11.2	12.4
Real average wage (index: 1990=100) [f]	101.3	100.0	97.4	98.6	103.2	104.1	105.4	107.0	109.4
					Growth rates				
Prices (December-December)									
Consumer prices	26.1	32.4	26.8	25.1	22.6	22.6	19.7	21.6	17.7
Wholesale prices	25.6	29.9	23.1	17.9	13.2	20.7	15.4	14.5	17.5
External sector									
Terms of trade (index: 1990=100) [b]	105.1	100.0	96.9	90.8	87.7	100.4	104.5	107.1	113.2
Nominal exchange rate (pesos per dollar)	383	502	633	679	787	827	913	1037	1 141
Real effective exchange rate for imports (index: 1990=100)	90.5	100.0	101.0	89.4	85.7	74.7	74.8	69.4	65.0
					Millions of dollars				
Balance of payments									
Current account	-201	544	2 347	876	-2 219	-3 113	-4 366	-4 946	-5 683
Trade balance (goods and services)	1 200	1 633	2 572	1063	-1 591	-1759	-2 290	-2 156	-2 869
Exports	7 322	8 679	9 100	9 246	9 948	12 090	13 815	14 590	15 888
Imports	6 122	7 046	6 529	8 183	11 540	13 849	16 106	16 746	18 756
Capital and financial account [g]	635	83	-471	292	2 426	3 280	4 714	6 428	5 653
Overall balance	434	626	1 876	1 167	206	167	348	1482	-30
Variation in reserve assets (- indicates an increase)	-434	-626	-1 876	-1 167	-206	-167	-348	-1482	30
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	44.5	44.7	42.0	39.1	37.2	32.0	31.2	34.1	33.3
Net interest (as a percentage of exports)	18.1	15.3	12.4	9.9	7.4	8.1	7.9	9.3	8.8

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
				Percentages of GDP					
Non-financial public sector									
Current revenue	22.4	23.6	25.1	25.4	27.1	27.0	30.8	32.3	31.6
Current expenditure	16.7	16.7	18.2	18.5	19.0	19.3	23.6	24.1	24.4
Saving	5.7	6.9	6.9	6.9	8.1	7.7	7.2	8.2	7.2
Capital expenditure (net)	7.6	**7.6**	6.7	7.1	8.0	6.7	7.8	10.3	10.3
Financial balance	-1.9	**-0.7**	0.2	-0.2	0.1	1.0	-0.6	-2.0	-3.1
				Growth rates					
Money and credit									
Monetary balances of banking system									
Net international reserves			94.1	29.9	-2.1	-7.2	17.8	20.2	19.7
Net domestic credit			-0.4	39.1	84.2	25.8	29.8	32.3	25.3
To public sector			40.9	-12.9	27.2	-15.0	-19.7	-10.9	162.8
To private sector			17.1	37.6	57.8	36.0	35.7	25.3	25.0
Money (Ml)[1]			28.1	39.1	32.8	22.3	19.6	16.4	22.2
Local-currency savings and time deposits			30.7	27.4	45.8	50.0	29.9	21.8	25.9
M2			29.9	30.9	41.7	41.8	27.3	20.5	25.0
				Annual rates					
Real interest rates (annualized)									
Deposit rate	6.3	3.2	8.2	1.4	2.7	6.6	10.4	7.7	5.2
Lending rate	13.7	9.9	16.6	9.0	11.2	15.1	19.2	17.2	14.2
Equivalent interest rate in foreign currency[J]	3.7	4.0	9.8	-1.4	14.8	26.0	11.8	5.8	-2.9

Source: ECLAC, on the basis of official figures.
* Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Percentages of the working-age population; seven metropolitan areas. [e] Percentages of the economically active population (EAP); seven metropolitan areas. [f] Manufacturing industry workers. [g] Includes Errors and omissions. Refers to net interest as shown on the balance of payments, divided by exports of goods and services. ' In the private sector. [J] Interest rates on deposits, deflated by the variation in the exchange rate.

Table 2

COLOMBIA: MAIN QUARTERLY INDICATORS

	1995				1996				1997[a]				1998[a]	
	I		111	IV	I	II	III	IV	I	II	III	IV		
Gross domestic product (change from same quarter of preceding year)"	6.4	5.9	4.3	5.2	4.4	2.3	2.0	-0.2	-0.3	2.9	4.2	5.4	5.7	
Consumer prices (nationwide) (12-month variation, %)	21.3	21.2	20.8	19.5	20.2	19.7	21.6	21.6	19.0	18.8	18.2	17.8	19.3	20.7
Real effective exchange rate (index: 1990=100)	72.7	73.0	75.4	78.2	73.7	71.0	68.7	64.2	63.5	62.0	64.4	70.2	69.3	67.2
Exports (millions of dollars)	2 341	2 547	2 441	2 514	2 387	2 754	2 525	2 907	2 429	2 109	2 961	3 025	2 589	
Imports (millions of dollars)	3 145	3 545	3 553	3 611	3 245	3 411	3 478	3 539	3 143	3 901	4 062	4 271		
MI (change from same quarter of preceding year)	19.4	17.9	13.1	20.2	19.3	15.6	15.3	16.5	14.9	22.7	19.6	21.5	12.2	
Real interest rates (annualized, %)														
Deposit rate	-2.6	9.0	18.1	17.2	-5.8	10.0	11.7	14.8	-2.4	3.5	7.6	12.2	-7.4	
Lending rate	4.9	17.2	28.1	26.6	2.4	19.9	21.9	24.9	6.5	12.8	16.8	20.9	0.4	

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Refers to exchange rate for imports.

bank, from October 1997 to June 1998 the reference rate (the average interest rate on fixed-term deposits) rose by more than ten percentage points.

Despite the lower cost of financing in 1997, only in the final quarter did credit demand revive. The total loan portfolio of the financial system grew by 27%, more than the previous year (24%), but still well below the 37% recorded in 1995. The financial sector was still in the throes of the restructuring process initiated in mid-1996. Between June 1996 and April 1998, 8 banks, 3 savings and loan associations, 10 finance corporations, 11 conventional commercial finance companies and 16 commercial finance companies specializing in leasing were created, privatized, acquired, merged or liquidated. As a result, the financial system moved into a stage characterized by greater competition, larger institutions, narrower intermediation margins and accelerated technological change.

In order to strengthen the capacity and transparency of the financial system, the Banking Superintendency in mid-1998 will assume the oversight of cooperative financial institutions, and the introduction of a mandatory risk rating system in 1999 has been announced.

(c) Foreign exchange policy

The movement of the exchange rate went through two completely different phases in 1997. In the first half of the year the rate stayed close to the floor of the band, despite measures taken to make foreign borrowing more expensive.

In August, the value of the peso began to depreciate and in barely two months hit the ceiling of the band, fora variety of reasons. Given a large current account deficit and the poor outlook for the Colombian oil industry (see box 1), external capital inflows played an active role on the foreign exchange market. The steady decline in domestic interest rates shifted the relative yields of investments in pesos and foreign currencies in favour of the latter, while the measures taken by the Banco de la República made foreign borrowing more expensive. For the same motives, the authorities and the Empresa de Energía Eléctrica de Bogotá agreed that the company would not bring into the country the full amount of the foreign exchange proceeds from its capitalization. Lastly, the private sector decided to prepay foreign loans by taking advantage of low domestic interest rates and a US$ 150 million line of credit set up by the Government at the Banco de Comercio Exterior (Bancoldex).

Instability on international stock exchanges in the last quarter of 1997 did not help to soften the tendency towards depreciation. The nominal depreciation of the exchange rate for the year was 29%, equivalent to 8% depreciation in real terms.

The Bank of the Republic decided to change the gradient of the currency band from 15% to 13% in 1998. Nevertheless, during the first half of the year, the exchange rate remained close to the ceiling of the band. The currency even suffered some speculative attacks, especially intense during February, May and June. In defence of the peso, the central bank sold over US$ 1 billion dollars of its international reserves, and towards the end of January reduced the reserve requirement on external loans from 30% to 25% and shortened the time the deposit would be frozen from 18 to 12 months, thereby easing private sector access to international financing. Subsequently, it raised the interest rate on its open-market securities, in order to increase the cost of sources of liquidity and discourage speculation. The attacks on the currency in May and June, however, obliged the authorities to rein in liquidity and loosen the interest rates on its interventions in the money market, which then climbed to levels of around 80%. The Government succeeded in placing US$ 160 million in the British Eurobond market and US$ 225 million in the Italian market. It also announced that it would repatriate US$ 420 million that it was holding in accounts abroad.

(d) Structural reforms

In terms of structural reform, 1997 was an important year for privatization. The sale of State assets brought in proceeds of US$ 3,180 million.

Boxl

OIL PROSPECTS

If no new reserves are discovered, Colombian crude oil exports could decline over the medium term. Since exploratory drilling has been lagging, proved reserves have remained at 2.6 billion barrels. In 1997 only 18 test wells were drilled (76 in 1988), a decline attributable to the high costs of exploration and development (sabotage by guerrillas), unfavourable contracts and the offer of better terms by other countries (such as Venezuela).

In order to reverse this tendency, the Government made and the State-owned enterprise Ecopetrol made changes in petroleum contracts to render them more attractive, announced a strategic plan for discovering new reserves and launched an aggressive campaign to attract investors to the industry.

The capitalization of the Empresa de Energía Eléctrica de Bogotá (US$ 2,177 million) netted the largest amount in the history of Colombian privatization. In addition, the long-distance telecommunications sector was opened to competition.

3. The main variables

(a) Level of economic activity

While 1997 did not get off to a promising start, as the pace of activity continued to slow in the first quarter, later in the year the economy showed a significant recovery, closing the year with growth of 3.2% and continuing the upward trend into the first quarter of 1998 (5.7%).

The growth in domestic demand was steeper, at 5.6% (2.1% in 1996). Of particular note was the recovery in investment (3.4%), after a decline of 1.4% the year before. There was also vigorous growth (6.7%) in final consumption (3.9% in 1996), spurred by the private sector, while the growth rate of public-sector consumption was cut by more than half (4.6% in 1997, as compared with 10.4% in 1996).

The activities that posted the strongest growth were transport, storage and communications (5.5%); mining and quarrying (4.4%); community, social and personal services (4.2%); financial services (3.5%); and electricity, gas and water supply (3.4%). Manufacturing overcame the 2.7% setback it suffered the year before, and wholesale and retail trade, restaurants and hotels (3.1%) more than made up for their slight decline in 1996.

Agriculture turned in the poorest performance in 1997, with output down by 0.7%. Despite good international prices, green coffee production dropped by 4.4%. Production of annual crops again declined, this time by 1.8%, while the value of perennial crop production held steady. Livestock raising increased by 2%, reflecting a surge in pig-farming (6.4%).

The rebound in manufacturing in 1997 was in response to stronger domestic demand. Excluding coffee threshing (processed coffee), manufacturing production dropped 6.7% in the first quarter and rose 11.7% in the last. Coffee threshing showed no growth in 1997, following the previous year's 10% increase.

Under the heading of manufacturing, the following categories turned in the best performance: electrical machinery and apparatus (15.6%), iron and steel basic industries (14.9%) and pottery, china and earthenware (14.6%). Altogether, 20 manufacturing industries showed growth, while 11 experienced declines. The worst results were recorded in wood (-29%), footwear (-19%) and rubber products (-14%).

The construction industry remained depressed, although the sluggish results hid two opposing tendencies. The decline in the construction of housing and other buildings (-22.1% in 1996) braked in 1997 (-3%), while infrastructure construction expanded by a further 1.2%, following the 15.6% expansion of the previous year.

Mining and quarrying production increased by 4.4%, lead by natural gas production (27%) and iron ore mining (25%). Coal mining continued to expand at a good pace (10%), while gold and silver mining continued a precipitous decline (-66%). Growth in crude petroleum production slowed to 3.9% (7.2% in 1996).

(b) Prices, wages and employment

Inflation as measured by the consumer price index (CPI) slowed to 17.7% in 1997 (from 21.6% the previous year) and thus fell within the target (18%) set by the Bank of the Republic.

Prices of tradables rose by 12.7%, much less than those of non-tradables (20.5%), which were pushed up by large increases in the costs of education (22.8%), health care (21.5%) and transportation.

In the first half of 1998, prices rose by 14.1%, compared with a figure of 11.2% for the same period in the previous year, an increase that undermined chances of achieving the official target of 16% for the year as a whole. El Niño weather conditions reduced food production, and the resulting scarcity pushed up prices. Another factor was probably the delayed effect of the devaluation of the peso, which put pressure on production costs and made tradables more expensive. Nevertheless, setting aside food prices, the rate of inflation has been on the decline.

As a result of the sharp nominal depreciation of the currency and fluctuations in international prices of relevance for Colombia, the producer price index (PPi) accelerated its rise, reaching 17.5% (14.5% in 1996) and thereby reversing the trend of previous years.

The employment situation continued to worsen. The unemployment rate in seven metropolitan areas rose from 10.2% in March 1996 to 12.3% in March 1997 and 14.5% in March 1998. The economic recovery created 340,000 new jobs between March 1997 and March 1998, a substantial figure for the Colombian economy. But since the total labour force participation rate rose from 58.3% in the first quarter 1997 to 62.3% in the first quarter 1998, the new jobs generated did not match the increase in the number of persons seeking employment. The trend worsened in July 1998, when the unemployment rate reached 15.8%.

Real industrial wages improved by 4.2% in 1997 (2.3% in 1996), but the gap widened between the pay of manual and non-manual workers: wage of manual workers increased by 2.8%, those of non-manual employees by 5.7%.

(c)The external sector

The current account deficit (US$ 4,950 million in 1996) widened further to US$ 5,680 million in 1997 and as a percentage of GDP increased from 5.8% to 6.0%.

Both exports and imports showed great dynamism in 1997. Exports grew by 9.7% (at twice the previous year's rate) to a level of US$ 11,680 million. Imports, which in 1996 recorded a slight decline of 1.1%, increased by 12.6%, to a total of US$ 14,410 million. As a result, the merchandise trade balance rose from US$ 2,140 million to US$ 2,730 million.

Among traditional exports, the value of coffee sales soared (43%), an improvement entirely due to better international prices; the opposite occurred with prices of oil and petroleum products, so that Colombian oil exports declined by 7% in value. Non-traditional exports did well, growing by 12%.

The increase in imports was a consequence of the economic recovery. Imports of consumer goods expanded by 16% in 1997, after declining by 4% the year before, imports of capital goods followed a similar path (increasing by 28% in 1997 after declining by 9% in 1996), reflecting a surge in private investment. Imports of intermediate goods stagnated.

The surplus on the financial account shrank to US$ 6,320 million, equivalent to 6.7% of GDP (US$ 7,100 million the year before), but was large enough to cover the current account deficit. Net reserves of the Bank of the

Republic declined slightly, ending the year at around US$ 9.9 billion. The structure of the capital account continued to improve, thanks to a copious influx of long-term funds. Net foreign direct investment reached an unprecedented level (US$ 5,170 million), owing in large part to privatization proceeds. The influx of capital from foreign borrowing dropped appreciably because of changes in the management of the publicdebt.

Total external indebtedness increased by 8% in 1997 to US$ 31.4 billion; 52% of that amount was owed by the public sector. The country's total external debt was equivalent to one third of GDP.

COSTA RICA

1. Outline of recent developments

With a 3.1% increase in gross domestic product (GDP), Costa Rica resumed the growth which had been interrupted in 1996, when there had been a decline of 0.5%. Macroeconomic variables generally showed improvement, particularly the inflation rate, which fell from 13.9% to 11.2%, and the fiscal deficit, which fell from 3.3% to 1.6%. The latter reflected a special effort to break the political pattern of an expansionist phase during the pre-election period.

The recovery in GDP resulted from a 14% increase in gross fixed investment, mostly due to easier access to credit -thanks to greater liquidity in the banking system and lower real interest rates- and to considerable flows of foreign direct investment into free trade zones. Of lesser importance for the economic recovery was growth in consumption (1.7%), which was encouraged by rising employment, a slight increase in real wages, improved access to credit and lower inflation. At the same time, helped by a notable improvement in the terms of trade, national income rose by 4.1%.

The behaviour of external indicators was less encouraging; there was a marked worsening of the current account deficit (by about US$ 300 million). However, thanks to the abundance of foreign capital, mostly in the form of foreign direct investment, the previous deficit was covered comfortably and foreign exchange reserves grew by about US$ 130 million.

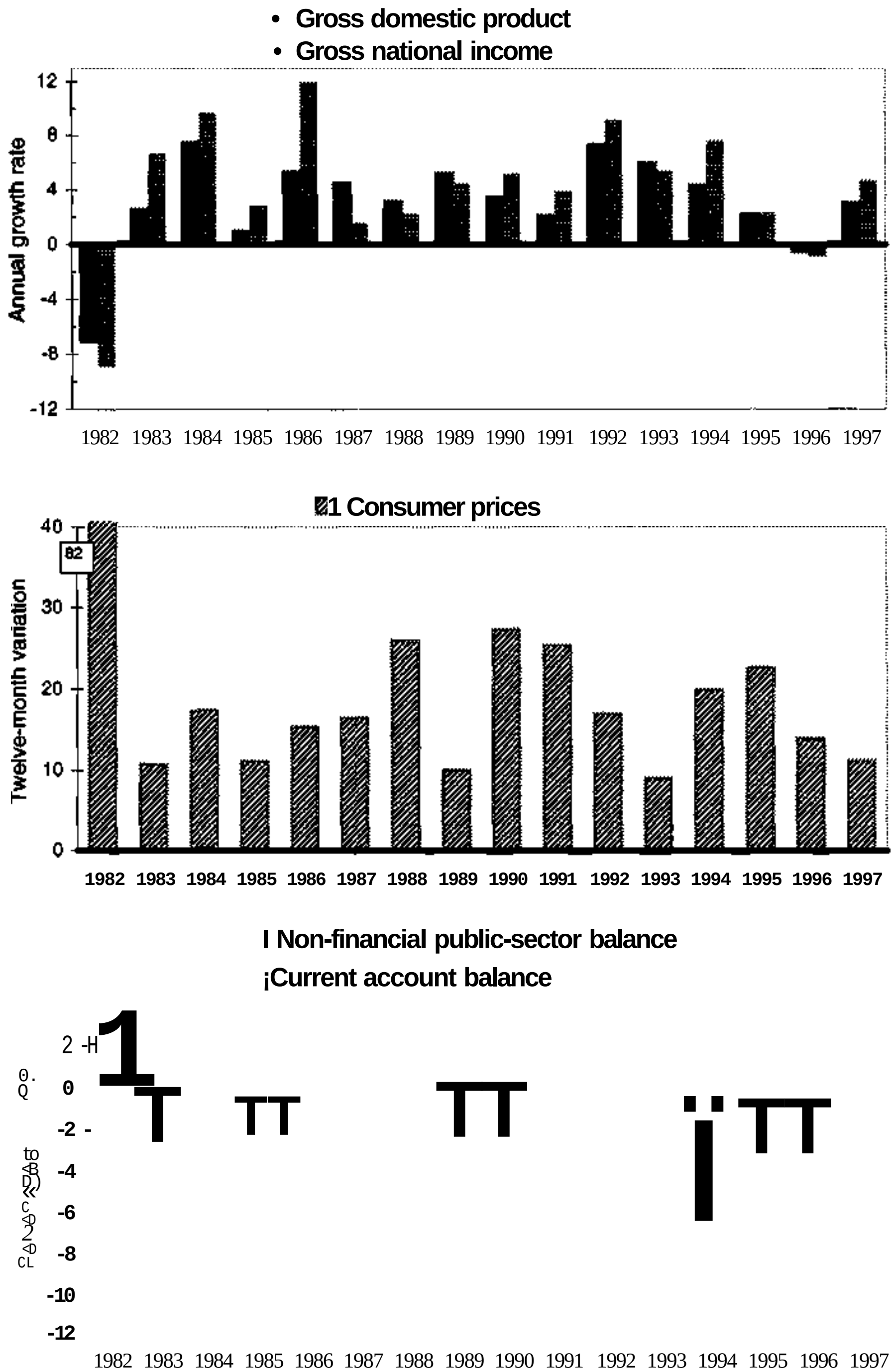
The country's new specialization in the manufacture of electronic and telecommunications products in *maquila* plants deepened; this activity was also a major focus for foreign direct investment (FDI) and foreshadowed the possible creation of a technological cluster. The quality of the labour force continued to be a comparative advantage for attracting this type of investment. The new law on free trade zones and increased competition in industrial inputs also helped to make the country more attractive as a location for such ventures. On the other hand, Costa Rica continued to lag behind in terms of other competitiveness indicators, such as infrastructure.

The outlook for 1998 includes an improved rate of GDP growth (about 4.7%), inflation close to 1997 levels, a marginal increase in the current account deficit and a fiscal deficit of the same order as that recorded in 1997. The financial crisis in Asia is expected to have some repercussions for the Costa Rican economy because of falling demand for the country's exports, but this should be of limited scope, since only 3% of its exports in 1997 went to Asia.

2. Economic policy

Generally speaking, economic policies combined to create favourable conditions for economic recovery or at least not to impede it. Monetary and wage policies less restrictive than the year before and an expanded government construction programme stimulated economic

Figure 1
COSTA RICA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

activity. The containment of government spending with the aim of reducing the public-sector deficit was not strong enough to correct the financial imbalance, which remained fairly large, although smaller than in the previous year. Lastly, foreign exchange policy was consistent with the goal of maintaining export competitiveness and avoiding inflationary pressures.

(a)Fiscal policy

As in previous years, fiscal policy was designed to reduce the central government deficit, and that indicator was in fact brought down from 5.2% to 4% of GDP between 1996 and 1997. This was achieved thanks to an increase in revenue of about 7% in real terms resulting from economic growth and a marginal fall in real central government spending.

Wages and pensions continued to be a large proportion of overall spending, totalling about 42%.

The reduction in the fiscal deficit is a notable achievement in view of the fact that it took place during an election year. However, the deficit is still one of the weaknesses of the country's economy, especially because of the size of the debt in the form of bonds, equivalent to 34.5% of GDP in 1996 and 36.6% in 1997. Bond interest paid was 5.4% of GDP in 1996 and 4.7% in 1997. This slight decrease was mostly due to lower interest rates. The operational deficit, which reflects interest paid in real terms, was 2.3% of GDP in 1996 and 1.4% in 1997.

Generally speaking, progress in reducing the fiscal deficit in 1997 was due not so much to legislative changes and the restructuring of domestic debt over the previous two years, but rather to growth in economic activity and lower real interest rates. The economic upturn led to increased imports, which contributed substantially to tariff revenue (30.8%) and, under the heading of indirect tax revenue, amply made up for the reduction in sales tax from 15% to 13%. In addition, lower real interest rates helped to reduce current expenditure by cutting the real cost of servicing the domestic debt. In 1997 that cost increased only marginally in nominal terms (2.3%).

The 1995 tax reforms intended to increase tax revenue (the Tax Equity Act and the Tax Adjustment Act) and the package of measures introduced in 1996 for the specific purpose of reducing the domestic public-sector debt were still showing limited results. Increased numbers of people filing tax declarations and more efficient tax administration, including simplified procedures for taxpayers, together with economic growth, contributed to an increase in direct tax revenue (about 10% in real terms).

Of the bills proposed in 1996 to reduce domestic debt, only a few had been adopted by 1997, some of them late in the year, so their results were not yet visible; others were still before the Legislative Assembly. Measures which had come into effect included the replacement of government bonds in the hands of public bodies with so-called "real-yield securities"; taxation of the income of certain public bodies; an increase from 280 to 535 in the number of enterprises included in the list of "major taxpayers"; the imposition of an excise tax on gasoline; and the abolition of the tax ceiling on luxury cars.

Having achieved more room for manoeuvre in its budget, the Government was able to increase its real investment expenditure by more than 40%. Much of this was spent on repairing the damage caused by hurricane Juana and on providing the education sector with equipment and new premises, which were necessary for the implementation of the education reform.

The privatization of public enterprises and the concession of maritime and coastal areas, also part of the public debt reduction package, remained stalled.

1 This measure is not without consequences, since it leads to a reduction in revenue for certain public bodies.

2 This measure will take effect in 1998.

3 The education reform provides for 6% of GDP to be spent on education. In addition, the teaching of computing and English became compulsory at all levels of schooling.

Table 1
COSTA RICA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
	Growth rates								
Growth and investment									
Gross domestic product	5.2	**3.5**	**2.1**	7.3	6.0	4.3	2.2	-0.5	3.1
Per capita gross domestic product	2.4	**0.8**	**-0.4**	4.7	3.5	1.9	-0.1	-2.7	0.9
Gross national income	4.5	5.2	**3.9**	9.1	5.4	7.7	2.3	-0.9	4.7
Gross domestic product, by sector									
Goods	5.8	**2.1**	**3.0**	7.1	5.5	3.5	2.8	-3.0	3.1
Basic services	7.7	**6.6**	**3.5**	11.0	8.8	7.6	4.9	2.5	3.8
Other services	4.5	**4.0**	**1.3**	7.0	6.0	4.4	1.3	0.8	2.9
	Percentages								
Contribution to growth of GDP[c]									
Consumption	4.9	3.9	**0.6**	4.9	5.2	3.9	2.9	3.2	1.3
Government	0.7	**0.4**	**-0.2**	0.5	1.0	0.2	0.3	0.2	0.1
Private	4.3	**3.6**	**0.7**	4.4	4.2	3.7	2.6	3.0	1.2
Gross domestic investment	2.6	**1.1**	**-3.7**	9.0	3.9	-1.8	-2.0	-4.4	7.3
Exports	3.6	2.5	**3.6**	4.5	4.2	2.8	2.5	3.6	2.5
Imports	-5.9	**-4.0**	**1.6**	-11.1	-7.3	-0.6	-1.2	-2.9	-8.1
	Percentages of GDP[b]								
Gross domestic investment	27.2	27.3	23.2	30.0	32.0	28.9	26.4	22.1	28.5
National savings	18.2	**18.7**	**21.5**	23.9	22.9	25.5	24.5	20.5	23.3
External savings	8.9	**8.7**	**1.7**	6.0	9.1	3.4	1.8	1.6	5.1
	Percentages								
Employment and wages									
Labour force participation rate	53.0	53.5	52.2	51.5	52.6	53.1	53.9	52.2	53.8
Open unemployment rate[e]	3.8	4.6	5.5	4.1	4.1	4.2	5.2	6.2	5.7
Real average wage (floor rate) (index: 1990=100)	98.4	100.0	95.4	99.3	109.5	113.6	111.4	109.1	110.0
	Growth rates								
Prices (December-December)									
Consumer prices (nationwide)	10.0	27.3	25.3	17.0	9.0	19.9	22.6	13.9	11.2
Wholesale prices	10.7	27.9	22.3	12.7	6.6				
Industrial producer prices				10.4	6.2	19.9	21.9	13.3	10.1
External sector									
Terms of trade (index: 1990=100)[b]	104.6	100.0	104.0	105.9	104.7	109.1	112.1	113.4	120.4
Nominal exchange rate (colones per dollar)	81.50	91.60	122.40	135.00	142.00	157.00	179.83	207.75	232.60
Real effective exchange rate for imports (index: 1990=100)	102.0	100.0	109.8	104.6	104.5	105.0	101.4	100.4	102.6
	Millions of dollars								
Jalance of payments									
Current account	-480	-494	-99	-380	-620	-244	-143	-126	-422
Trade balance (goods and services)	-237	-383	-43	-341	-538	-271	-111	-97	-356
Exports	1 831	1963	2 190	2 580	2 906	3317	3 790	4 124	4 478
Imports	2 068	2 346	2 232	2 922	3 444	3 588	3 901	4 221	4 834
Capital and financial account[8]	22	-47	262	395	362	141	374	49	550
Overall balance	-458	-541	163	14	-258	-103	231	-77	128
Variation in reserve assets (- indicates an increase)	-112	197	-416	-177	60	66	-154		
	Percentages								
External debt									
Total external debt (as a percentage of GDP	85.9	68.7	70.8	59.2	50.9	45.9	43.1	37.4	34.7
Net interest (as a percentage of exports)[h]	17.9	9.6	5.7	5.0	5.0	2.4	2.7	2.5	2.4

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
				Percentages of GDP					
Consolidated non-financial public sector									
Current revenue	26.7	26.1	27.6	28.2	28.2	26.1	28.1	28.9	30.4
Current expenditure	23.6	23.9	23.7	22.3	22.2	26.6	25.5	27.1	26.2
Saving	3.2	**2.2**	**3.8**	5.9	6.0	-0.6	2.6	1.8	4.1
Capital expenditure (net)	5.6	**4.8**	3.9	5.3	5.4	6.1	4.6	5.1	5.7
Financial balance	-2.5	**-2.5**	**-0.1**	0.7	0.6	-6.6	-2.0	-3.3	-1.6
Domestic financing	2.1	**2.2**	**-1.6**	-1.3	0.2	5.7	3.0	4.5	2.8
External financing	0.4	**0.3**	1.7	0.6	-0.9	0.9	-1.0	-1.2	-1.2
				Growth rates					
Money and credit									
Monetary balances of banking system									
Net international reserves	29.2	-19.8	156.5	23.0	4.9	4.6	41.6	8.9	21.1
Net domestic credit	4.0	30.4	4.7	24.3	31.5	27.6	3.9	42.7	16.4
To public sector	-2.4	30.7	4.9	-4.3	2.7	28.6	30.8	127.1	37.5
To private sector	10.1	30.2	8.9	48.0	36.1	15.7	30.9	18.7	26.5
Money (Ml)	18.2	7.5	29.0	36.0	7.8	31.1	-0.4	17.5	43.2
Local-currency savings and time deposits	21.6	44.4	22.2	40.9	40.1	10.6	18.2	35.1	-0.4
M2	19.8	24.9	25.3	38.6	25.2	18.7	10.1	28.1	15.4
Dollar deposits	30.9	39.5	67.1	0.2	10.3	20.9	29.6	33.1	22.9
				Annual rates					
Real interest rates (annualized)									
Deposit rate	5.2	-4.9	1.5	-1.0	7.3	-1.7	1.3	3.1	1.6
Lending rate	17.6	4.0	10.8	9.8	19.3	11.1	11.6	11.0	10.2
Equivalent interest rate in foreign currency '	9.2	- 0.4	- 2.8	15.1	6.4	7.9	5.0	3.7	1.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Percentages of the working-age population. [e] Percentages of the economically active population (EAP). In 1993 the wholesale price index was replaced by an industrial producer price index. [g] Includes Errors and omissions. Refers to net interest as shown on the balance of payments, divided by exports of goods and services. ' Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
COSTA RICA: MAIN QUARTERLY INDICATORS

	1995				1996				1997[a]				1998[a]	
	1	II	HI	IV	I	n	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)					-1.6	-2.0	-0.3	1.3	0.5	4.6	4.4	6.0		
Consumer prices (12-month variation, %)	23.6	22.3	22.0	22.6	18.3	19.3	17.4	13.9	14.9	13.6	11.9	11.2	11.2	10.8
Exports (millions of dollars)					772	726	734	782	770	903	771	837	973	968
Imports (millions of dollars)					835	835	884	926	949	1 047	1012	1080	1 109	1 129
Real effective exchange rate (index: 1990=100)	98.6	102.7	102.6	101.7	99.3	99.9	100.6	101.6	100.9	101.8	103.1	104.6	103.3	103.8
Real interest rates (annualized, %)														
Deposit rate[c]	-6.0	10.8	4.3	-3.8	8.7	0.5	2.4	0.7	-1.4	1.6	5.9	0.5	-2.9	
Lending rate	4.9	22.4	13.5	5.5	16.4	8.3	10.4	8.9	6.6	10.1	14.7	9.2	5.3	
Money (Ml) (change from same quarter of preceding year)	16.6	11.6	-0.1	1.9	15.0	11.4		1.6	9.8	28.4	35.6	43.2	44.8	26.1

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Refers to the exchange rate for imports. [c] 180-day deposits. Short term.

(b)Monetary policy

The overall objective of monetary policy remained the lowering of the inflation rate. Beginning in September 1996, however, policy was eased in order to permit some degree of recovery in economic activity.

Domestic credit certainly grew, particularly in the private sector, thanks to reductions in real lending rates of about one percentage point (except for the rates charged by financial enterprises) and in reserve requirement rates, which were intended to bring them to a uniform level of 15% in March 1998. The private sectors most favoured with credit were housing, which absorbed 6.8% in 1997, as compared to 2.4% in 1996; the agricultural sector, with an increase from 6.4% to 8.2%; and consumption, which expanded its share from 17.4% to 19.8%.

Trends in monetary policy during 1997 are difficult to discern through the corresponding statistics, because of two major problems which are reflected in the accounts and make analysis difficult: the change in the mechanism of bond issues by the Central Bank of Costa Rica between 1996 and 1997, and the change in the registration of current account deposits and time deposits owing to the shift from a system of differential reserve requirement to an uniform rate.

The first phenomenon can be seen in the 600% increase in the issuance of monetary stabilization bonds compared to the previous year. Although it was in fact necessary to issue these bonds in 1997 as a means of sterilizing part of the inflow of foreign exchange, it produced serious distortion in the figures.

The second problem is reflected in the figures for monetary liabilities. Although they grew by 17.9% overall in nominal terms, analysis of Ml and M2 shows highly abnormal trends: Ml rose by 43%, as a result of a 66.7% increase in current account deposits, and M2 rose by 15.4% because of a 7.9% decrease in time deposits. Although there were factors which favoured growth in M1, such as the reduction in interest rates, which lowered the opportunity cost of liquid assets, and the competition among banks to bring in clients through services attractive to current account holders, deposits in current accounts were artificially high owing to accounting transfers by banks from time deposits to current account deposits.

Foreign currency deposits expanded more slowly than in previous years (22.9%), probably owing to renewed confidence in the economy and greater investments in the productive sector.

An important aspect of longer-term financial policy was the adoption in January 1998 of a securities market regulation act which had been debated during 1997. The new legal framework provides for more adequate regulation of the market by taking into account the new instruments which have been developed internationally in recent years. The Office of the Superintendent of Securities, created under the new law, will have important functions, including the authorization, regulation and supervision of the public offering of securities and the entities that deal in them, such as stockbroking firms and investment fund managers.

In October 1997, in a further effort to improve security in non-banking financial markets, the Central Bank decided to broaden the base of instruments subject to minimum reserve requirements to include credit unions and housing cooperatives.

(c) Foreign exchange policy

The authorities continued the policy of daily mini-devaluations, leading to a nominal

4 It should be made clear that the excessive growth in monetary stabilization bonds in 1997 is solely an accounting problem. In 1996 joint auctions were held for Central Bank and Ministry of Finance bonds, and monetary stabilization bonds were therefore no longer issued. In April 1997, the Central Bank began issuing monetary stabilization bonds again, and the 1997 increase in the latter therefore appears disproportionate.

5 This also involves an accounting problem resulting from the reclassification by the banks of long-term deposits as current account deposits. Some current accounts had typically been classified as long-term accounts to avoid the high reserve requirement on the former, but this practice ceased to be necessary with the introduction of the 15% uniform rate.

cumulative devaluation of 12% over 1996. The result was a slight devaluation in real terms of the adjusted real exchange rate, suggesting a policy favourable to exports but fairly neutral in terms of inflation.

3. The main variables

(a) Economic activity

Economic activity took a positive turn, moving from a 0.6% contraction in 1996 to 3.2% growth in 1997. As for demand, the greatest improvement came from a major upturn in investment in machinery and equipment (14.5%) and construction (13.1%). Both of these areas had experienced a phase of contraction or low growth lasting several years. Although the private sector provided the greatest boost, public sector investment, which had been sluggish for a long period, also grew significantly.

Exports, on the other hand, grew only half as quickly as in the previous year, while consumption had only a marginal effect on aggregate demand.

On the supply side, imports of goods and services showed considerable dynamism, mostly in response to investment activity and the overall economic recovery.

With the exception of agriculture, down by 0.7%, the other productive sectors showed improved performance in 1997, particularly construction, which grew at the exceptionally high rate of 16.3%. There was a significant upturn in manufacturing (4.5%), and services in general averaged the same growth rate as GDP (3.2%).

There were various reasons for the exceptional growth in construction. In addition to the usual construction boom during periods of economic recovery, activity in this sector was boosted by the granting of low-income housing vouchers, which the Government financed by issuing bonds on the domestic market, and by the beginning of the construction of Intel plants. New public works were also undertaken, including school buildings.

In the manufacturing sector, increased investments and the growth in construction provided a particular stimulus to metal manufactures and machinery, which grew by 15.2%, and to non-metallic minerals (11.6%). This reduced to some extent the widening gap between the growth sectors producing primarily for international markets, and the more stagnant sectors supplying the domestic market. Increased private consumption also had some impact in certain sectors such as printing and publishing, which grew by 14.7%.

Agricultural activity, on the other hand, decreased by 0.7% owing to highly unfavourable climatic factors which affected both export crops (bananas, coffee and sugar) and certain basic grains, particularly beans. In the case of bananas, there was also a further deterioration in production conditions on the plantations; productivity, in cases, per hectare has fallen by about 30% since 1990.

Lastly, in the services sector, transport, storage and communications showed a 4% increase; this was influenced by the proliferation of telematic services and the upturn in seaport activity due to high imports. Commerce also grew by 4%, owing to the increases in both domestic economic activity and imports. Growth in electrical services reflected increased demand for energy (5.7%), which was met thanks to the substantial increase in electric power generation (13.2%). Two geothermal power plants, Boca de Pozo 2 and 3, came into operation in late 1996 and early 1997 respectively, and some new private hydroelectric plants began functioning in the past year; this explains the exceptional growth in electric power generation.

6 Between 1989 and 1997, enterprises producing mostly for export doubled their share of overall industrial production; by the end of the period, they accounted for three quarters of manufacturing production.

(b) Prices, wages and employment

The inflation rate was lower than in the previous year: 11.2% compared with 13.9%, December to December. Various factors were involved, including the lowering of sales tax from 15% to 13% and the fall in oil prices on the international market; these compensated to some extent for the new fuel consumption tax.

Wages, after falling steadily in real terms over the previous two years, recovered by about 1%, but this did not make up for the decrease of about 4% during the previous period. The lowest wages, especially the minimum wage, increased the most in real terms (3.7%). State pensions also increased significantly in real terms (about 12%).

The unemployment rate fell from 6.2% to 5.7%, with a larger proportional decrease in urban areas (from 6.6% to 5.9%) than in rural areas (from 5.9% to 5.6%). In urban areas, construction and services absorbed labour and helped to reduce unemployment. On the other hand, despite the expansion in manufacturing, the sector did not generate many jobs, a sign of improved productivity.

(c) The external sector

The current account deficit widened markedly (by US$ 297 million over the previous year) basically owing to the 16.2% increase in merchandise imports.

Expanded purchases of goods on the international market were mostly due to the boom in investment and construction. Although, imports of consumer goods rose by only 2.3%, imports of intermediate and capital goods increased by 24%. A major part of the growth in the former was due to construction, while in the case of capital goods, those intended for the transport and manufacturing sectors showed a considerable increase (27.6% and 20.3% respectively), as did those for the agricultural sector (62%), although these were only a small proportion of the total.

Imports, especially of capital goods, resulted in part from investments by foreign enterprises, of which Intel was the most important, and entailed inflows of foreign capital to finance them. Foreign direct investment (FDI) was very high during 1997 (US$ 446 million). Those investments were closely linked to export activities, so the spending on imports generated foreign currency inflows through foreign sales. The trade deficit was therefore of a different nature from those observed during periods of economic recovery, when imports for consumption, which are comparatively difficult to finance, were much more significant.

Exports rose by 8.8%, owing mainly to non-traditional exports (15.8%), since traditional exports fell for the second consecutive year (-3.6%). A considerable part of the increase in non-traditional exports, however, was due to favourable movements in international prices (12%), while volume grew by only 5%. Traditional exports were affected by floods and other climatic phenomena; in the category, only coffee showed an improvement in export value thanks to steep increases in international prices.

Non-traditional exports gained impetus owing to renewed access to the United States market following the World Trade Organization (WTO) ruling prohibiting the United States from continuing to impose quotas on clothing imports from Costa Rica.

Exports produced in the free trade zones were particularly dynamic and posted an increase of 23% over the previous year. Government policy was aimed at giving additional stimulus to investments in this sector, through the June 1997 reform of the law on free trade zones; among other things, the reform provided for substantial fiscal incentives for the reinvestment of profits in the sector and broadened the definition of what constituted a free trade zone.

The structure of exports by destination was much the same as in the previous year, although exports to North America (over 50% of the total) increased, as did those to South America and the

7 This rate of increase differs from that which can be deduced from the "merchandise" heading in the balance of payments, since the latter does not include goods for processing (value added of *maquila* plants and free trade zones), which come under the heading of "Other goods, services and income".

Caribbean; exports to the European Union decreased, owing to the fall in banana exports. The proportion of exports to Central America, other European countries and Asia remained constant. Within Central America, which absorbed 13.6% of the total, exports to Panama and Nicaragua showed particular improvement.

Tourism, which has become an important source of foreign exchange, grew more quickly than in the previous period; income from tourism showed a net growth of about 4%, and new projects continued to be undertaken in this area.

As mentioned above, FDI remained at very high levels, totalling US$ 446.2 million, more than double the amount recorded in the early 1990s; the electronics company Intel accounted for about a quarter of the overall amount.

External debt showed a marginal decrease over the previous year, owing to loan repayments by the public sector, while private-sector debt tended to increase because of the need to finance new investments during the economic upturn. The policy pursued in 1996 of replacing public external debt with domestic debt was partly reversed in 1997, when it was decided that bonds should be issued on the international market in 1998.

CUBA

1. General trends

The rate of recovery of the Cuban economy slowed to 2.5% in 1997 (7.8% in 1996) and the balance-of-payments current account deficit grew owing to a large increase (21%) in the volume of merchandise imports and mediocre export performance (3%). Growth in income from tourism services and current transfers helped to mitigate the foreign currency shortage. Despite persistently high liquidity ratios and a deterioration of 20% in the exchange rate, no major price adjustments were reported and the fiscal gap was reduced to 2% of output.

The smaller 1996/1997 sugar harvest (-4%) caused a decrease in the volume exported, and international prices also fell. The disappointing performance of the sugar industry and the escalation of the foreign embargo made it difficult for the Cuban economy, which is in the process of restructuring, to make progress. The country was faced with delays and higher costs for foreign borrowing, lower international prices for its main export commodities (sugar and nickel) and the effects of unfavourable weather phenomena and pests in the agricultural sector. Hurricane Lily, which struck the central area of the island in mid-October 1996, left damage estimated at US$ 800 million.

In the area of reform, the main positive developments were a major institutional reform of the banking sector and increased decentralization of operations in the external sector. However, the implementation of reforms in productive sectors lagged behind, resulting in inefficient use of inputs in the public sector, as was the case in the sugar industry, or handicapping the growth of new private-sector activities. The increasing dollarization of the economy and the adoption by more and more public-sector enterprises of management policies based on financial profitability are adding to the costs and tensions associated with the coexistence of the new economy with the old system of fixed prices and incomes.

In 1998, it is anticipated that progress with macroeconomic stabilization will be slow, owing to the difficulties confronting the external and fiscal sectors. Thus, it is expected that the non-financial public-sector deficit will rise to the equivalent of 3% of output and that cumulative monetary liquidity will contract to no more than 200 million pesos. Despite the reduced 1997/1998 sugar crop, there will probably be a slight improvement in external accounts, thanks to the fall in the oil bill and increased flows both of family remittances and foreign investment. However, the trade gap and the fact that the Cuban economy has scarcely any access to capital markets will limit output recovery to a maximum of between 2.5% and 3.5%.

2. Economic policy

The authorities persevered with the implementation of the macroeconomic and structural adjustment programme initiated in 1993, while seeking to improve depressed production levels without sacrificing basic social services.

Clearly, the increasingly swift transformation of the economy and the distortions in relative prices make analysis of the situation more difficult. The system of national accounts is being adapted to the new realities and may not fully take into account the activity of new actors. Wide price differentials (from 1 to 20) between regulated and free markets, and between the official and parallel exchange rates, make it difficult to compare the various monetary circuits and to establish a single price index.

(a) Public finances

The public-sector deficit fell to 2% of gross domestic product (GDP) in 1997, compared to 2.5% in 1996; in Cuba, this deficit has particular significance owing to the socialist nature of the economy, and is financed through money creation. The reduction in the deficit was due to the fact that revenue contracted less than expenditure (-0.8% and -1.6%). On the spending side, there was a slight increase in current expenditure (0.8%) and a contraction of capital expenditure (-14%). It should be borne in mind that the flows which were reported as expenditure correspond to amounts that the official entities concerned were unable to finance independently, from their own income or borrowing. This is particularly important in the case of investment, since the investment growth reflected in the national accounts is due to activities connected with the external sector and semipublic companies, which have their own foreign-exchange resources.

Tax revenue increased by 6.6%, while non-tax revenue fell by almost 15%. The reduction in circulation and sales taxes (-4.6%) can be explained by the decline in the supply of various goods at regulated prices, particularly tobacco, beer and alcoholic beverages. The profit margin, which forms the base for such taxes, also narrowed because of increased production costs.

A decline in taxes on utilities was associated with reduced revenue from the levy on electric power. As fuel prices increased, the wholesale price of electricity rose, but this was not passed on to consumers.

On the other hand, revenue derived from new activities increased. The higher amounts collected in personal income tax (22%) were due to increased payments by private farmers (40%) and self-employed workers (4.2%). There was also an increase in revenue from taxes on use of labour (132%) and on utilities (86%).

In accordance with social priorities in economic policy, social assistance expenditure increased (16%), as did spending on housing and community services (13%). The budgetary resources allocated to education and public health (6.2% and 5.4% of GDP respectively) made it possible to maintain positive achievements in those areas. Social security continued to absorb the lion's share of current expenditure (7.1% of output) because of the rising numbers of pensioners (1,323,000 persons); this is a burden to fiscal equilibrium and entails the adoption of innovative means of financing.

Transfers to public-sector enterprises fell by 10%, owing to decreases both in losses (-17%) and in price subsidies for various goods and services (-1.4%). The Ministries of the Sugar Industry and of Agriculture received the largest share of these funds because of profitability problems faced by entities under their jurisdiction. Government assistance to basic cooperative production units (UBPCs) also had to be increased by 4.5%.

The 1998 budget anticipates higher growth in expenditure (3.4%) than in revenue (1.5%), which will bring the unfinanced fiscal deficit up to 3% of output. With the extension of the new fiscal regime to all enterprises and entities in the country, the dual tax system will disappear.

(b) Monetary and financial policies

Excess liquidity in the hands of the population and the build-up of outstanding accounts among public-sector enterprises continued to be matters of primary concern in the monetary field. As a result, the monetary authorities continued to restrict the supply of credit in national currency. The rationing of foreign currency in the State circuit was accentuated because of the decline in sugar exports.

Poor yields from the circulation tax and from taxes on sales by the public sector of goods and services in national currency, made it difficult to make headway in absorbing excess liquidity. Net liquidity, in other words, currency outside banks plus regular savings accounts fell slightly to 40% of output (41% in 1996). Available information suggests that the problem of delinquent accounts in the public sector (3.58 billion pesos) remained serious, even in the thriving tourism sector, where the chain of unpaid accounts grew by US$ 16 million in six months.

At the beginning of the second half of 1998, interest rates on local currency deposits rose for the first time in many years. They were increased from 2% to 3.5% for savings accounts, and for time deposits the new rates ranged from 4.5% (30 days) to 5.5% (360 days).

The dollarization process intensified, with the expansion of markets in foreign currency and the increasingly significant role of income in convertible currencies in determining household purchasing power. Half the population is thought to have access to foreign currency, through purchases with Cuban pesos at exchange offices, family remittances from abroad, wage incentives in convertible currency and the growth of international tourism. The amount of merchandise sales in dollars to the population increased by 17.8% and is thought to represent more than US$ 750 million.

The official exchange rate remained at one Cuban peso to one United States dollar, while the average rate on the parallel foreign exchange market deteriorated from 19.2 to 22.8 pesos. The parallel exchange rate improved slightly in the first quarter of 1998 as tourism increased.

(c) Structural reforms

The most significant progress in restructuring the Cuban economy was made in the financial system and in the export sector.

The Central Bank of Cuba was established in 1997; its priority objectives are to implement policies for improved control of monetary and credit variables. In the course of the decade, 16 foreign financial institutions, including 13 banks, have been granted licences to establish agencies in Cuba. During the biennium 1996-1997, financial institutions (banking and non-banking) operating in Cuba extended credit totalling a billion dollars to Cuban entities, on strictly market conditions; this had a favourable effect on productive recovery.

Structural reforms have encouraged the decentralization of external trade; in 1997, some 300 enterprises had already been authorized to buy and sell abroad. Also, about 600 foreign firms had commercial agencies in Cuba, and 435 Cuban enterprises were entitled to carry out transactions in convertible currencies.

Eleven new bilateral investment treaties were signed in 1997, increasing to 30 the number of countries with which Cuba has agreements of this type, and the number of joint ventures with foreign entities increased to 317 (260 in 1996). Another 200 entities operate in three free trade zones, to respond to the growing demand generated by tourism and provide links between that sector and agriculture and related activities.

There are now semipublic enterprises in 34 different branches of industry. Telephony, oil prospecting and extraction, and metal ore mining are currently controlled 100% by such enterprises, as is the production of rum, lubricants, soaps, detergents and perfumes. Joint ventures involving foreign capital control 70% of citrus fruit production and 50% of nickel and cement production. Also, 10% of the country's hotel infrastructure for international tourism is owned by semipublic enterprises and a further 41% is operated by foreign hotel chains under management contracts.

With the creation in 1997 of five more joint ventures in the real estate sector, work began on projects totalling about US$ 300 million for the construction and refurbishment of property for rent or sale in foreign currency to foreigners or to Cubans resident abroad.

In the area of what might be referred to as the "second economy", consisting of the

Table 1

CUBA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
					Growth rates				
Growth [b]									
Gross domestic product	0.7	-2.9	-10.7	-11.6	-14.9	0.7	2.5	7.8	2.5
Per capita gross domestic product	-0.4	^.0	-11.5	-12.2	-15.4	0.5	2.1	7.5	1.9
Gross domestic product, by sector									
Goods		-3.5	-16.2	-19.2	-16.7	4.2	7.1	11.7	5.8
Basic services		-8.2	-10.4	-13.2	-17.2	-0.9	6.9	7.1	4.0
Other services		-1.5	-6.1	-5.5	-13.4	-1.2	-1.3	5.1	-0.2
					Millions of dollars				
Balance of payments									
Current account	-4 595	-2 **545**	-1454	-420	-388	-242	-518	-137	-428
Trade balance	-4 609	-2 076	-1 138	-215	-382	-211	-639	-390	-878
Exports of goods and services	5 562	5 940	3 563	2 522	1992	2 197	2 926	3 690	4 018
Imports of goods and services	10 171	8 017	4 702	2 737	2 373	2 408	3 565	4 080	4 896
Capital account	5 700	2 621	1 421	419	404	240	596	145	438
					Percentages of GDP				
External sector[c]									
Current account	-15.6	-13.0	-8.9	-2.8	-2.6	-1.3	-2.4	-0.6	-1.8
Trade balance	-13.6	-10.6	-7.0	-1.4	-2.5	-1.1	-2.9	-1.7	-3.7
Gross debt	31.7	34.6	40.0	42.9	58.2	47.3	48.3	45.0	44.7
Government income and expenditure									
Total income	65.0	62.4	67.4	62.1	63.0	66.4	60.0	52.6	51.7
Total expenditure	72.3	72.4	90.6	94.8	96.5	73.9	63.5	55.1	53.7
Financial balance	-7.3	-10.0	-23.2	-32.7	-33.5	-7.4	-3.5	-2.5	-2.0
Currency									
Liquidity	21.6	25.4	40.4	56.1	73.2	51.8	42.6	41.0	39.7
Currency outside banks	10.9	11.9	20.4	27.4	30.2	18.8	16.3	17.1	15.9
Regular savings deposits	10.7	13.5	20.0	28.7	43.0	33.0	26.2	23.9	23.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Calculated on the basis of series in constant 1981 pesos, and as the official exchange rate of 1 peso to the dollar. [c] Calculated at the official exchange rate of 1 peso to the dollar.

activitiesoftheemergingprivatesector.themost important event was the legalization of the renting of rooms. Since about 20% of tourists obtain accommodation in private homes, standards were established for this activity in May 1997 and a mechanism was created for the payment of the corresponding taxes. In late September 1997, some 3,000 landlords had registeredas taxpayers,mostly in thecapital city.

The fifth Congress of the Communist Party of Cuba recognized the legality of the work of self-employed persons and its contribution to employment and to supply, but reiterated that such activities would remain within the existing system. In 1996, self-employed workers made up 8% of the employed population, in addition to the 4.1% employed in the agricultural private sector.

3. Them variables

Economic performance continued to be determined by the severe restrictions facing the country, both externally and in the reorganization of its productive and commercial system. In this context, the reduced sugar crop had a significant impact, not only because of the close links between the sugar industry and the rest of the economy, but also owing to the fact that sugar production is used as collateral for foreign borrowing. However, increasing numbers of public-sector enterprises are showing signs of recovery following radical restructuring.

(a)Economic activity

The 5% growth in total supply originated in the significant increase in imports of goods and services (20%), while GDP grew by only 2.5%. The growth of the economy was driven by exports of goods and services, which increased by more than 9%, and investment, which rose by almost 8%. As for sectoral performance, there was an 18% surge in tourism, mining grew by 11.9% and manufacturing industry by 7.7%, whereas agriculture contracted (-1.6%).

Tourism from abroad grew to 1,180,000 visitors, providing gross income of US$ 1,546 million. With the expansion of hotel infrastructure, the number of rooms increased from 26,878 in 1996 to about 29,000 in 1997.

Mining and quarrying expanded on the basis of joint ventures involving foreign capital and Cuban entities, as well as the introduction of new models of self-financing in foreign currency and incentive schemes for workers. Once again, a new record was set for nickel production (62,600 tons).

Two opposing trends were observed in manufacturing industry. On the one hand, non-sugar industries made progress, with growth in light industry (4%), the food industry (6%), building materials (10%), and metal manufactures and machinery (17%). On the other hand, the sugar industry suffered because of a further decrease in the sugar crop, to 4.3 million tons. The situation was worsened by other factors, including interruption in financing in the amount of more than US$ 200 million which was needed for timely purchases of inputs before the sugar harvest, delays in the application of economic reforms, which had an unfavourable impact on production management, and adverse weather conditions. To remedy this situation, an incentive programme was launched in the UBPCs (cooperatives set up on former State lands), including a 52.8% increase in the price of sugar cane.

The disappointing performance of non-sugar activities in the State and cooperative sectors, and the stagnation of the livestock sector eroded the provision of supplies to the population at regulated prices and the availability of foreign currency. The small private subsector (17% of the land) appears to have performed somewhat better, as evidenced by the almost 40% increase in its contributions to the State budget and its improved participation in free agricultural markets, in a context of falling sale prices. The gross fish catch was up 14% as a result of new management systems and incentive schemes for workers.

Construction rose by 4.8% owing to work carried out on hotel, housing and airport projects, as well as water-related infrastructure. A total of 53,000 dwellings were completed in 1997. Two dams were built and work progressed on four others, for irrigation and for water supply to the population.

(b) Prices, wages and employment

The information available shows that consumer prices rose by only 2%. Prices fell in the free agricultural market (-2.2%) and the informal economy (-3.1%).

The value of sales on the free agricultural market fell by 5.3%, owing to reductions in both volume and prices. Private enterprise produced the lion's share of supplies (72.7%), while the participation of the State and cooperative sectors fell (by 23.7% and 3.6% respectively). The value of sales on the free markets for industrial and cottage industry products grew by almost 50%.

Although the appreciation of the dollar on the parallel markets did not affect regulated prices, it lowered households' purchasing power. The higher cost in pesos of buying consumer goods available only in foreign-currency shops increased the cost of living for that part of the population which does not have access to sufficient income in convertible currencies.

Average nominal wages improved by 3.3%, in the context of the policy of promoting priority activities. This system of incentives in kind and in foreign currency, linked to the employee's productivity and the fulfilment of production goals, was extended to more than 1.4 million workers. Despite this, average labour productivity rose by only 0.6%, owing to low efficiency levels in the agricultural and sugar industries and to insufficient progress in industrial downsizing. The number of workers available for relocation fell to 8,800, and the unemployment rate was down to 6.9% (19,000 and 7.6% respectively in 1996).

(c)The external sector

The balance-of-payments current account deficit widened owing to an increased merchandise trade deficit, despite increased current transfers and lower payments for factor services. The positive balance of the capital account was barely sufficient to finance the current account deficit, while international reserves remained very low. Capital inflows took the form of foreign direct investment, mainly in the communications and real-estate sectors, as well as bank loans and trade credits.

The deepening trade deficit is basically due to a steep rise in the value of goods imports and virtual stagnation of that of exports. The terms of trade declined by 1.5%. The mediocre performance of the value of external sales of goods (0.6%) was due, on the one hand, to the fact that the price of nickel fell, although the volumes exported were higher, and, on the other hand, to reduced shipments of sugar, the price of which also fell. Efforts to diversify exports were reflected in an increase of more than 15% in non-sugar exports. The increased value of imports (20%) was entirely due to the greater volumes involved (21%), since international prices fell slightly (-0.8%). Food and oil purchases increased in 1997. The services balance continued to show a surplus, attributable to increased tourism and international telecommunications.

Sales of domestic products in the market segment which operates in foreign currency accounted for 41 % of all purchases in 1997 (35% in 1996). These sales, either to meet demand from the tourism sector or in foreign-currency shops open to the population, enable import substitution and help to increase the foreign currency income of the State sector.

The external public debt increased slightly to about US$ 10.5 billion. One-fifth of that amount consisted of short-term borrowing. It should be noted that perception of the country risk on international financial markets has improved in recent years. Bid prices for Cuba's external debt on secondary markets was up from US$ 0.0825 in 1993 to US$ 0.25/0.27 in late 1997. In March 1998, a debt rescheduling agreement was signed with Japanese enterprises for an amount of 100 billion yen (approximately US$ 770 million). However, access to foreign bank loans and trade credits remains severely restricted and subject to very onerous terms, with high interest rates (14% to 16% on average) and very short repayment schedules.

ECUADOR

1. General trends

Despite political problems, Ecuador's economy grew by 3.7%, a better performance than in the preceding two years. Ecuador also managed to curb the upsurge in inflation that occurred in the early part of the year and to reduce the non-financial public-sector deficit. Even so, these were again modest achievements compared with the regional average.

The beginning of 1997 was marked by a profound political and social crisis that culminated in widespread social unrest; in February, the Government was forced to resign, and an interim Administration was appointed for a period of 18 months. The new authorities, endorsed by a general referendum in May, devised a programme to control a projected high fiscal deficit, reverse the rise in inflation and set the economy on a path of moderate economic growth.

The authorities were successful in their efforts to rein in the resurgence of inflation in early 1997, and at year's end inflation stood at 30.7%. The reduction in the non-financial public-sector deficit to 2.5% of GDP, prudent monetary policy and a 4% real appreciation of the sucre all contributed to this result. Thanks to the expansion of both exports and private investment, GDP grew by 3.7%. Owing to a strong increase in imports, however, the current account deficit widened to 4% of GDP, similar to the levels recorded prior to 1996. The problem of service arrears on public debt owed to Paris Club countries remained unresolved, a situation that explains in part the fact that international monetary reserves increased further, on this occasion by over US$ 200 million.

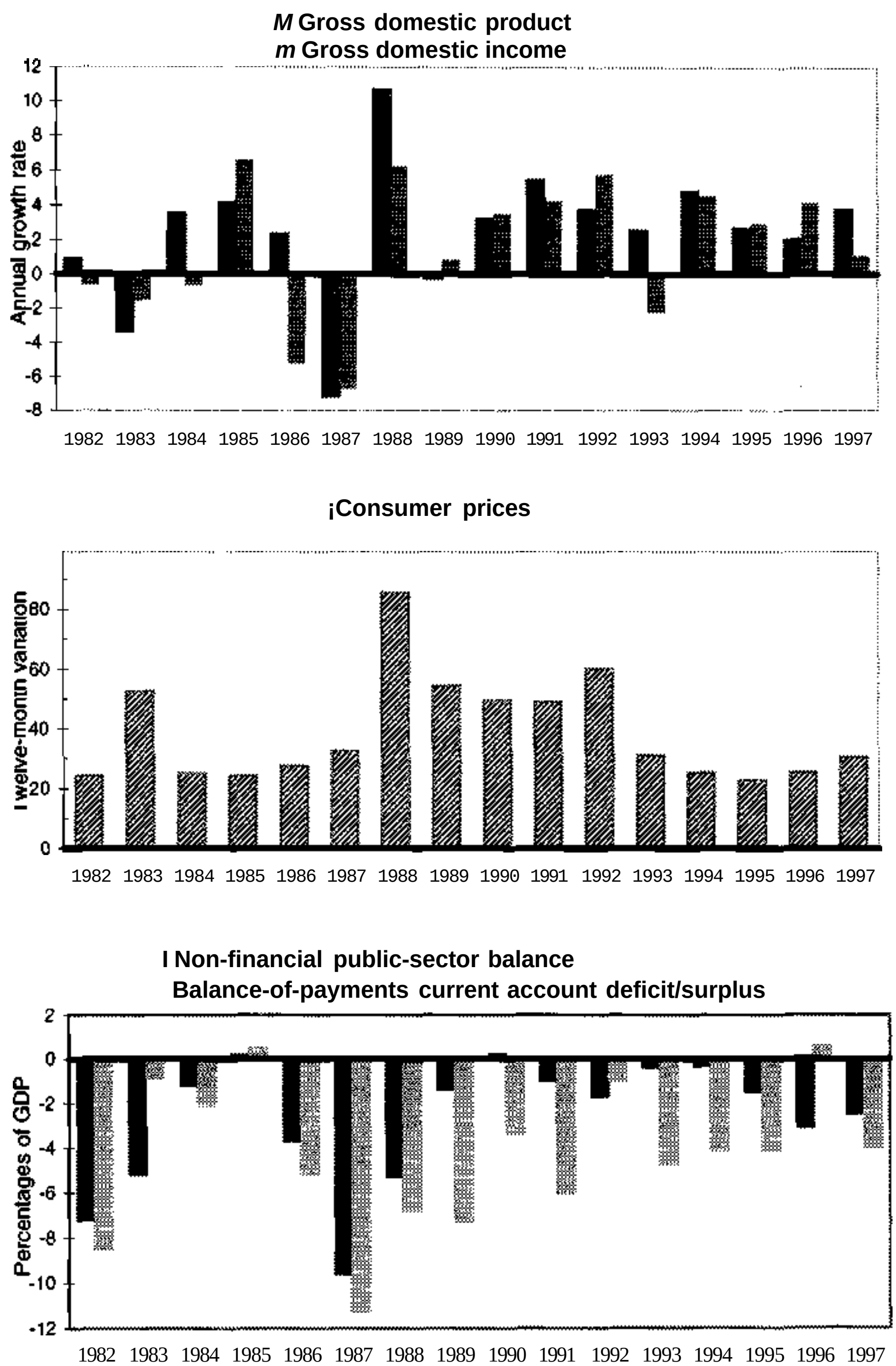
In contrast to the relative success of its macroeconomic policy, the Administration was unable to make progress on modernization of the State; for example, the auction of a 35% stake in the enterprises formed after Empresa Ecuatoriana de Telecomunicaciones (EMETEL) was split up had to be postponed twice.

Imbalances became more acute in early 1998, chiefly owing to a steep fall in oil prices and the effects of the El Niño weather pattern. Inflation again accelerated, while the fiscal situation and the trade balance both deteriorated. The period leading up to new elections was marked by labour disputes and conflict between the branches of Government, reflecting serious problems of governability. This complicated the search for solutions to these problems, especially the high fiscal deficit. As a consequence, projections for 1998 are for growth of only 1 %, inflation of close to 40% by year's end and an increase in the balance-of-payments current account deficit to 6% of GDP.

2. Economic policy

The Government that took office in August 1996 proposed major economic reforms, the key element of which was to be a foreign-exchange system based on a currency board, entailing a

Figure 1
ECUADOR: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

fixed exchange rate and local-currency liquidity management determined solely by the supply of international monetary reserves. The interim Administration appointed in February rejected this plan and -faced with major imbalances- made it clear that its principal objectives for 1997 would be to reduce the fiscal deficit, slow the inflation rate and boost economic growth; it also signalled its intention to move ahead in reforming the State.

To that end, the Administration took steps to rein in expenditure and boost government revenue and adopted a prudent monetary policy. The exchange-rate band was adjusted in order to control expectations of a devaluation stemming from the inflationary surge early in the year, and to head off a substantial hike in interest rates. A dollar auction system was introduced to dampen speculative fluctuations.

When new imbalances arose in early 1998, monetary control measures were adopted and the exchange-rate band was again adjusted. However, in the pre-electoral period, it proved impossible to reach a consensus on measures to deal with the critical fiscal situation. Under these conditions, the Administration was obliged to revise its growth and inflation targets.

(a) Fiscal policy

The difficult fiscal position influenced economic policy during the period. When the interim Administration took office in February 1997, the projected non-financial public-sector deficit was 6.6% of GDP, and the target set by the authorities was to reduce that to 2.5%. This goal was attained in late 1997, and the deficit came in slightly lower than in 1996, though it was still higher than in other years of the decade. The deficit was to a large extent -2.1% of GDP- financed with external funds.

This modest success in holding down the fiscal deficit was chiefly due to the reduction in expenditure from 27.6% to 25.9% of GDP; this reflected the fact that capital expenditure fell in real terms, while the rise in current expenditure lagged behind the rate of economic growth.

Government revenues began to feel the impact of markedly lower oil prices, as export earnings dipped by almost 2% of GDP and revenues from domestic sales of petroleum products showed a moderate drop in real terms. A further factor contributing to the downturn in fiscal revenue was the decline in the operating surplus of State-owned enterprises from 2.5% to 1.5% of GDP. This slump in income was partially offset by the growth in non-oil revenues; the most notable increases were in value added tax (VAT) and customs receipts, attributable in part to higher levels of economic activity.

The main steps taken to boost government revenues were a hike in customs tariffs by up to 4% for the remainder of the year by invoking the Andean Community safeguard clause, the reimposition of the 8% tax on financial income and a rise in some utility rates. In mid-1998, the corporate income tax rate was restored to 25% (it had been lowered in late 1996) and certain VAT exemptions were eliminated. Steps were also taken to improve tax collection efficiency, including the establishment of an autonomous internal revenue service.

In 1998, the Government again set itself the target of holding the non-financial public-sector deficit to 2.5% of GDP. However, projections of the deficit had to be revised upwards to nearly 7% of GDP, owing to a combination of wage hikes, higher outlays caused by El Niño and, especially, falling oil prices. To counteract this situation, a tariff of up to 5% was introduced on imports from countries not members of the Latin American Integration Association (LAIA), to remain in effect throughout 1998. Other measures proposed by the Executive early in the year, such as an increase in VAT, were rejected by Congress.

Thus, in the first half of 1998, Ecuador faced an extremely difficult fiscal situation, affected by strong pressures on both the expenditure and revenue fronts, as well as unfavourable political conditions that rendered a solution to fiscal problems difficult.

(b) Monetary policy

In response to the resurgence of inflation in early 1997, the authorities raised the reserve requirement from 10% to 12% in March. The additional 2% could be held in the form of monetary stabilization bonds (BEMs), as that they would earn interest, and not have an adverse

Table 1
ECUADOR: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
				Growth rules					
Growth and investment									
Gross domestic product	-0.1	**3.2**	5.4	3.7	2.5	4.8	2.7	2.0	3.7
Per capita gross domestic product	-2.4	**0.8**	**3.0**	1.4	0.3	2.5	0.5	0.0	1.7
Gross national income	0.8	3.5	**4.2**	5.8	-2.2	4.5	2.9	4.1	1.1
Gross domestic product, by sector									
Goods	-3.8	**-0.5**	**5.1**	3.7	3.5	6.3	3.0	1.7	3.8
Basic services	8.0	**4.7**	**6.1**	5.8	4.5	4.2	3.2	3.1	3.9
Other services	-1.6	3.0	**3.8**	2.6	2.4	3.1	2.2	3.6	2.7
				Percentages					
Contribution to growth of GDP '									
Consumption	0.4	**3.1**	1.2	1.0	2.4	1.9	0.8	2.1	1.4
Government	-0.2	0.2	**-0.2**	-0.3	-0.1	0.0	0.1	-0.1	0.0
Private	0.6	2.9	1.4	1.2	2.5	1.9	0.7	2.2	1.4
Gross domestic investment	0.6	**-3.2**	5.2	-0.3	-0.9	1.3	1.7	-2.4	3.1
Exports	-0.1	**2.6**	2.4	3.1	1.2	2.9	2.2	1.0	1.1
Imports	-1.0	**0.7**	**-3.4**	-0.1	-0.2	-1.2	-2.0	1.3	-1.8
				Percentages of GDP [b]					
Gross domestic investment	21.3	17.5	21.6	20.5	19.2	19.5	20.6	17.9	20.2
National savings	14.9	14.5	16.2	19.6	14.8	16.1	17.3	18.4	17.3
External savings	6.4	3.0	**5.3**	0.9	4.3	3.4	3.3	-0.5	2.9
				Percentages					
Employment and wages									
Labour force participation rate	56.3	48.8	56.8	58.9	58.0	55.6	55.8	55.8	57.3
Open unemployment rate[e]	7.9	6.1	8.5	8.9	8.9	7.8	7.7	10.4	9.3
Real average wage (index: 1990=100)	99.3	100.0	104.6	113.5	127.8	139.2	153.0	161.3	157.6
				Growth rates					
Prices (December-December)									
Consumer prices	54.3	49.5	49.0	60.2	31.0	25.4	22.8	25.6	30.6
Wholesale prices	80.1	45.5	48.0	54 7		18.2			
External sector									
Terms of trade (index: 1990=100)[b]	102.6	100.0	90.1	88.4	82.5	88.3	85.1	92.8	94.3
Nominal exchange rate (sucres per dollar)	526	768	1 046	1 534	1919	2197	2 565	3190	3 998
Real effective exchange rate for imports (index: 1990=100)	94.9	100.0	94.4	95.5	85.0	80.7	82.3	82.6	79.1
				Millions of **dollars**					
Balance of payments									
Current account	-715	-360	-708	-122	-678	-681	-735	I1l	-784
Trade balance (goods and services)	552	926	525	935	496	455	297	1 200	173
Exports	2 870	3 256	3 402	3 717	3 709	4 580	5 257	5 748	5 950
Imports	2 318	2 330	2 877	2 782	3 213	4 125	4 960	4 548	5 777
Capital and financial account[E]	-40!	-754	-453	-1038	2	107	167	-252	<V79
Overall balance	-1 116	-1 114	-1 161	-1 160	-676	-574	-568	-141	-105
Variation in reserve assets ,- indicates an increase)	-118	-194	-78		-494	-449	23?	-245	-23V
				Percentaçes					
External debt									
Gross debt (as a percentage of GDP)	117.4	114.4	108.9	101.1	y?.3	87.9	77.7	7Í.Í	7δ» 4
Net interest (as a percentage of exports)	37.3	34.5	30.3	23.1	22.3	19.4	15.5	16.3	14.9

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
				Percentages of GDP					
Non-financial public sector									
Current revenue	26.3	**27.1**	25.4	25.8	26.6	24.4	25.5	24.5	23.4
Current expenditure '	20.2	19.5	18.5	19.6	19.4	18.1	20.4	20.0	19.7
Saving	6.1	**7.6**	6.9	6.2	7.2	6.3	4.1	4.5	3.7
Capital expenditure	7.5	7.5	7.9	7.9	7.6	6.5	6.8	7.6	6.2
Financial balance	-1.4	**0.1**	-1.0	-1.7	-0.4	-0.2	-1.5	-3.1	-2.5
Domestic financing	-5.1	**-3.3**	-1.9	0.3	-2.3	-1.3	1.7	0.5	0.4
External financing	6.5	**3.2**	2.9	1.4	2.6	1.5	-0.3	2.7	2.1
				Growth rates					
Money and credit									
Monetary balances of banking system									
Net international reserves		279.9	80.0	65.4	50.7	46.6	4.4	68.1	11.5
Net domestic credit	9.3	21.6	44.9	50.4	54.6	74.7	59.6	32.9	48.4
To private sector	38.1	42.9	66.9	62.3	76.9	78.2	51.7	23.8	48.0
Money (Ml)	38.1	52.2	46.5	44.5	49.4	35.7	12.7	35.4	29.7
Local-currency savings and time deposits	52.1	80.8	68.6	60.8	52.1	64.6	41.1	39.7	20.0
M2	44.3	65.3	57.6	53.2	51.0	52.2	30.2	38.3	23.2
Dollar deposits	79.2	37.2	69.5	139.0	79.5	112.6	143.1	69.8	80.4
				Annual rates					
Real interest rates (annualized)									
Deposit rate	-13.7	-7.8	-4.7	-7.9	1.0	6.9	16.7	12.9	-2.0
Lending rate	-7.4	-3.7	-1.2	-1.7	13.2	15.1	26.8	22.3	10.0
Equivalent interest rate in foreign currency [J]	-11.6	0.2	-1.9	4.1	17.6	11.6	13.6	15.5	4.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Percentages of the working-age population; urban areas. [e] Percentages of the economically active population (EAP); urban areas. Up to 1992, refers to the exchange rate on the regulated market. From 1993 on, refers to the exchange rate on the open market. [8] Includes Errors and omissions. Refers to net interest as shown on the balance of payments, divided by exports of goods and services. ' In 1994 and 1995, includes expenditures related to staff reductions. [J] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

ECUADOR: MAIN QUARTERLY INDICATORS

	1995				1996				1997 [a]				1998"	
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)	3.2	5.5	0.7	0.1	2.4	-0.2	2.3	3.5	2.7	4.2	3.7	3.0	0.0	
Consumer price (12-month variation, %)	22.7	22.5	22.9	22.8	24.8	22.6	25.0	25.4	29.9	31.1	30.6	30.7	30.6	35.9
Real effective exchange rate (index: 1990=100)	80.9	82.6	82.3	83.3	82.4	82.0	82.6	83.5	80.2	79.8	78.9	77.6	75.9	79.3
Exports, f.o.b. (millions of dollars)	1057	1 137	1 084	1 133	1 127	1 172	1 264	1 326	1 273	1 322	1 369	1 308	1 128	1 311
Imports, c.i.f. (millions of dollars)	975	1 043	1 041	1 094	985	887	901	950	1 096	1 176	1280	I 393	1282	1 407
International reserves (millions of dollars)	1 608	1 770	1 661	1 557	1 559	1 571	1 690	1 831	1 920	2 226	2 231	2 093	1940	1 878
Real interest rates (annualized)														
Deposit rate	18.8	9.8	17.4	20.9	8.3	23.6	12.5	7.1	-16.2	4.7	0.4	3.0	-15.4	-4.0
Lending laic	24.4	22.9	28.5	34.2	16.6	33.2	24.1	19.2	-7.5	18.6	13.9	14.8	-9.1	1.7
Money (M11 (change from same quarter of preceding year)	23.0	[illegible]	14.9	12.7	22.2	19.5	22.9	35.4	38.8	40.3	40.6	29.7	25.0	20.2

Source: ECLAC, on the basis of official figures.
[ü] Preliminary figures. Refers to exchange rate for imports.

effect on the banks' operating results. The authorities also continued the policy of sterilizing the liquidity generated by international monetary reserves, which expanded during the first six months, owing in part to a high level of external financing (Eurobond issues). Growing non-financial public sector (INFPS) deposits, which over the period showed a cash surplus, were available for that purpose. In the second half of the year, international reserves dipped a fraction, thus facilitating the application of prudent monetary policy; by the end of the year, primary money had expanded by 25% compared to the end of 1996, below the inflation rate, in spite of a simultaneous drop in NFPS deposits with the Central Bank.

By December, growth in Ml had reached 30%, while M2 (excluding foreign-currency deposits) had increased by 23%. The slowdown in the growth of quasi-money in local currency (20%, versus 40% in 1996) was partly offset by increasing dollarization of financial savings. Foreign-currency deposits expanded by 47%, bringing their share of total quasi-money to 37% by the end of the year.

Interest rates had begun to decline in mid-1996, and continued on the same path until mid-1997; bank spreads followed suite. The greater credibility of foreign exchange policy, the overcoming of the severe liquidity problems that had beset banks during 1995 and part of 1996 and low demand for credit all contributed to this process. Midway through the year, interest rates on deposits became negative in real terms. In the second half, this tendency eased as interest rates recovered slightly, thanks to greater demand for credit. The volume of credit contracted in real terms up until the third quarter; however, by the end of the year, in a context of a mild economic recovery, credit had expanded by 39% in nominal terms. Increasingly, credit was extended in dollars, and by late 1997 loans made in foreign-currency accounted for 48% of the total.

In early 1998, in the face of a fresh outbreak of inflation and a difficult fiscal position characterized by a reduction in NFPS deposits with the Central Bank, the authorities extended the reserve requirement to deposits of 360 days and longer, while also relying increasingly on monetary stabilization bonds to control liquidity, and succeeded in cutting the annual rate of growth in primary money to 21% by the end of June. This caused interest rates to rise, which helped head off greater pressure on the exchange rate associated with the growing political and economic uncertainty.

The financial system continued to recover from the severe liquidity crisis in late 1995 and thereafter. By the end of 1997, the proportion of non-performing loans in private banks' portfolios dropped to 7%, while provisions for bad loans rose to 73% of the overdue portfolio. In order to improve banking supervision, the Superintendency of Banks established a risk assessment centre charged with monitoring trends in consolidated financial debt.

However, parts of the financial sector are still very vulnerable because of slowing of some economic activities and rising interest rates; by mid-1998, the proportion of non-performing loans had risen a gain to nearly 9% of the total portfolio.

(c) Foreign exchange policy

The interim Government reinstated the currency band to control expectations of devaluation in accordance with inflation. In response to the inflationary surge early in 1997, the authorities readjusted the band in March, raising the central parity by 3.8%, steepening the gradient from 18.5% to 21% and setting the bandwidth around the central parity at 10%. A dollar auction system was also introduced in an effort to curb speculative fluctuations in the exchange rate.

As the inflationary outbreak early in the year was brought under control and the auction system functioned successfully, the exchange rate, showing relatively little fluctuation, slipped slightly below the centre of the band. As a result, the sucre was devalued 25% with respect to the dollar. In real terms, the annual average reflected a 4% real appreciation of the sucre in relation to a basket of currencies of its main trading partners, largely as a result of the appreciation of the dollar with respect to other currencies, since the index of the real exchange rate of the sucre to the dollar rose by just 2%.

In response to a new wave of inflation early in 1998 and to counteract growing uncertainty, the authorities again raised the exchange-rate band, in March 1998, for the fifth time since the bank was introduced, on this occasion by 7.5%, though the gradient was reduced to 20%. Thus, although depreciation of the nominal exchange rate gathered momentum, in real terms, the sucre again appreciated 2.8% between December and June.

(d) Structural reforms

Late in 1997, a constitutional amendment authorized the State to delegate the delivery of public services to private firms and to privatize State-owned enterprises. That paved the way for privatization of a 35% stake in Andinatel and Pacifictel, the two companies to emerge from the split-up of EMETEL. However, the auctions scheduled for November 1997 and April 1998 both had to be postponed.

The National Finance Corporation continued to move forward with the disinvestment policy initiated in previous years, and in late 1997 sold its stock in two cement companies. In order to promote private investment, the Investment Guarantee Act was passed; this law guarantees income tax stability for a period of 10 to 20 years, depending on the type of investment.

In March 1997, a law was passed providing for the distribution of 15% of the central government budget (excluding income from loans) to municipalities and provincial councils by the year 2000. This percentage will be reached in steps, with 7% due to be transferred in 1998. Another law enacted in October set up the legal framework for the transfer of functions from the central government to sectional governments. However, many of the decentralized administrations have little experience in carrying out their new responsibilities, and this scheme for managing fiscal expenditure is proving very difficult to implement over the short term.

3. The main variables

The trends in the main variables were satisfactory, in light of previous years' results and the adverse circumstances encountered early in the year, but they are also an indication of the Ecuadorian economy's continuing structural weaknesses.

(a) Economic activity

In spite of the difficult political situation in early 1997, GDP grew by 3.7% and per capita GDP edged up; these results represented a slight improvement on the preceding two-year period. During the first six months, the main components of aggregate demand reflected the impact of the political crisis. Economic agents, however, viewed the prospects with a certain degree of optimism, and this translated into a strong build-up of inventories. In the second half of 1997, both merchandise exports and gross fixed capital formation by the private sector expanded relatively quickly, reaching annual growth rates of 5.4% and 4.0%, respectively. In contrast, household consumption increased by only 2.3%, roughly the same as the rate of population growth, while wages lost ground in real terms. Robust import growth caused aggregate supply to expand by 4.6%.

Almost all branches of activity grew faster than the previous year. The best performances were registered in agriculture (4.1%) and transport and communications (3.9%), while non-petroleum manufacturing grew by 3.5%. The most dynamic manufacturing sectors, thanks to increased exports, were the textile industry and the manufacture of machinery and equipment and transport equipment, with growth of over 5%. The good results of the agricultural sector were mainly due to a few export products such as bananas and coffee, though other products for domestic consumption such as rice, fish and livestock also played a role. With the exception of a few crops (sugar cane and soya), the El Niño phenomenon had little effect on the 1997 harvest, but it wreaked havoc on newly sown crops, plantations and road infrastructure, damage that -along with the decline in oil prices- will be reflected in the results for 1998. GDP for the first quarter of 1998 did, in fact, decrease by 3% from the previous quarter.

(b) Prices, wages and employment

Early 1997 saw a surge in inflation, owing to a combination of the earlier growth in the money supply, steep hikes in some utility rates and the uncertainty generated by the social and political unrest that culminated in a change of government; accordingly, the consumer price index (CPI) shot up 10% in the first two months of thé year. Subsequently, efforts to control inflationary expectations met with success, and, in general, monthly rates of price increases subsided to between 1.5% and 2%. The cautious fiscal policy applied in the first half of 1997, the sterilization measures undertaken by the monetary authorities and the real appreciation of the sucre all contributed to this stabilization. The year closed with an inflation rate of 30.7%, compared to a figure of 25.5% for the previous year, but the authorities proposed to achieve annualized rates of no more than 25% by the second quarter of 1998.

However, the weather-related damage sustained by the agricultural sector and the transport system, along with renewed uncertainty, led to a fresh outbreak of inflation at the start of 1998, so that by the end of the first half, the 12-month inflation rate was running at 35.9%.

During 1997, efforts to control inflation also had a bearing on policy with respect to the minimum wage. The real minimum wage (including supplementary allowances) had in recent years made up some of the ground lost prior to 1992, but in 1997 gains in the early and middle part of the year failed to match the rate of inflation, so that the minimum wage declined by 3.5% in real terms. Moreover, the real average wage declined by 2%. Given the inflationary spurt in the early part of 1998, by June the real minimum wage had fallen a further 8%.

The greater dynamism in economic activity seen in 1997 led to a slight improvement in the employment outlook. The unemployment rate dropped from 10.4% in November 1996 to 9.2% in November 1997, though it remained above pre-1996 levels. The informal sector's share in employment dipped from 44.3% to 41.6%. Social, community and personal services and manufacturing generated most of the new jobs created in urban areas.

(c)The external sector

Exports continued to expand, although at a slower pace. Among merchandise exports, bananas did particularly well and showed 36% growth that reflected increases in both prices and volumes; as a result, bananas replaced crude oil as the leading export product. In 1997, Ecuador managed to boost its sales in its traditional markets, while also expanding its presence in new ones, such as China. Shrimp exports also recorded vigorous growth (38%). In contrast, crude oil sales declined by 8%, since a slight increase i£ volume was not sufficient to offset lower prices. Sales of petroleum products went into an even greater slump, resulting in a 13% drop in petroleum exports as a whole. Other traditional export products, such as coffee and cocoa, also recorded flat sales.

In contrast to the strong growth of previous years, non-traditional exports expanded by a meager 1%, though products such as flowers, fruit juices and preserves, and motor vehicles remained robust. A drop in sales of non-factor services limited the increase in total exports of goods and services to just 3.5%.

Imports, which had declined the previous year, rose steeply in all categories. The merchandise trade surplus therefore shrank to less than half its level the year before. The deficit on the income account did not change significantly, but remained very high by regional standards. As a result, the current account swung from a surplus -a rare occurrence- in 1996 to a deficit equivalent to 4% of GDP, similar to the level of earlier years.

In April, the Government placed US$ 500 million in Eurobonds and used part of the proceeds to buy back Brady bonds with a face value of US$ 250 million. Public external debt decreased slightly, to 63% of GDP, but private external debt expanded by US$ 560 million. Notwithstanding the failed attempt to privatize portions of EMETEL, foreign direct investment reached a record US$ 580 million, reflecting growth in petroleum investments and cellular telephone concessions and helped to generate a substantial surplus on the financial account.

Even so, it proved impossible to offset the entire current account deficit, and the overall balance showed a small deficit of US$ 100 million. However, since payments to members of the Paris Club were delayed, reserve assets increased by more than US$ 200 million, causing international monetary reserves to swell to nearly US$ 2.1 billion, a new high.

During the first half of 1998, exports were seriously affected by poor weather conditions and low oil prices; that led, unusually, to the posting of a merchandise trade deficit on the order of US$ 350 million for the first six months of the year. During the same period, international monetary reserves also fell, by some US$ 215 million.

EL SALVADOR

1. General trends

In 1997, the economy of El Salvador performed better than in the previous year. Gross domestic product (GDP) rose by 4.1%, a change which was mostly due to a significant increase in exports. Although the trade deficit was still high, the current account balance moved into the black, leading to a considerable accumulation of international reserves. The overall economic picture was remarkably stable. December-to-December inflation fell to a record low of 1.9%, while the annual average was 4.5%; the nominal exchange rate remained unchanged and the fiscal deficit decreased. However, there was no improvement in the employment situation and real wages fell.

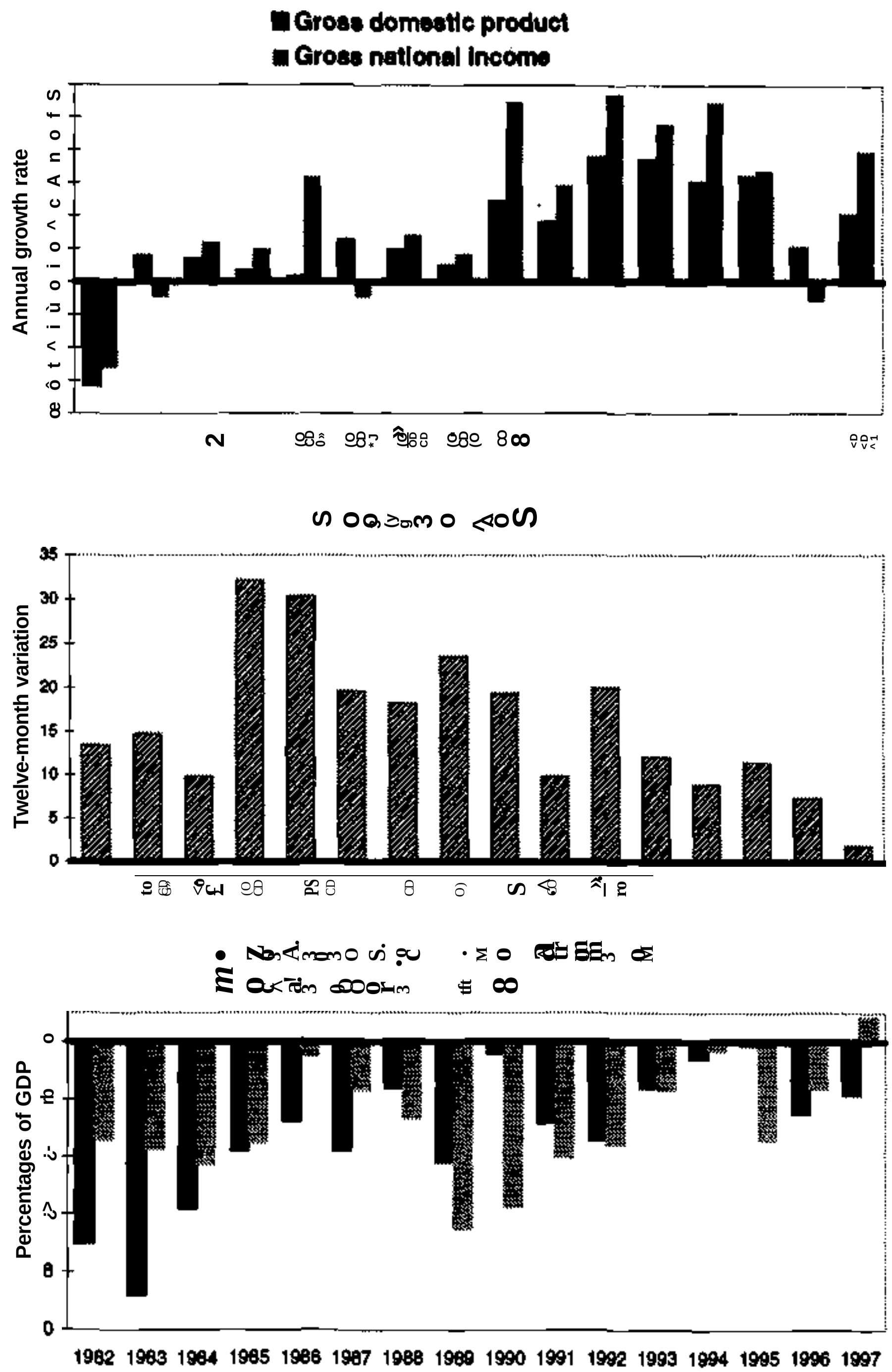
High international coffee prices brought about a considerable increase in export earnings and a notable improvement in the terms of trade in goods. The exports of the maquila industry grew and there was a significant increase in family remittances from abroad. Improved growth in production came from the manufacturing, financial, construction and commercial sectors. On the other hand, in the context of the debate on the forgiveness of agrarian debt, the performance of the agricultural sector deteriorated, partly owing to adverse weather conditions caused by the El Niño phenomenon, which also affected fisheries.

Stability in the financial and foreign exchange markets was a major objective for the monetary authorities; to that end, they developed an active policy of sterilization of external inflows. Furthermore, irregularities at the Financiera de Inversiones Seguras y Productivas (FINSEPRO) company and a number of related enterprises which were discovered in mid-year demonstrated the fragility of the system of financial controls.

In 1997, the non-financial public sector deficit was brought down to manageable levels, although the goal set in the Monetary and Financial Programme was not achieved. The overall outcome in terms of the non-financial public sector deficit was influenced by delay in the sale of State enterprises, which resulted in a lack of the capital revenue that had been anticipated, the fact that tax revenue was lower than expected and the payment of liabilities in the form of compensation to government employees.

In the area of structural reforms, reform of the pension system began and a legal and regulatory framework was set up for pension fund management firms. Progress was also made in drafting reforms of the regulatory and legal framework of the Central Reserve Bank (BCR) and of the bodies which monitor the financial system.

The outlook for 1998 points to increased growth in economic activity, inflation remaining at international levels and increases in the balance of net international reserves and in the rate of export growth. The favourable environment created by low interest rates and the privatization of State enterprises may lead to higher levels of public and private investment, based on privatization proceeds, increased foreign investment, lower tariffs and the success of the national competitiveness and State modernization programme.



Source: ECLAC, on the basis of official figures.

2. Economie policy and reform

Economic policy in 1997 continued to pursue the objectives of growth and macroeconomic stability adopted in 1996. Priority was given to the goals of reducing the inflation rate to international levels, maintaining exchange-rate stability in nominal terms, strengthening the stability of the financial system, adjusting credit to meet the targets for the growth of monetary aggregates and, lastly, increasing saving and investment.

The main achievement during the period was the reduction of the December-to-December inflation figure to international levels; for the first time in 25 years, it was as low as 1.9%. Success was also achieved in raising the growth rate to 4%, increasing exports of goods and services by 25% and lowering nominal and real lending rates relative to the 1996 average.

These results were achieved in the framework of a strategy of sustaining growth in foreign investment and improving linkages to international production chains. This strategy accentuated the importance of reducing the country cost and improving international competitiveness, through modernization of the physical and social infrastructure.

Progress also continued to be made in structural reforms. These included privatizations, particularly the sale of electric power distribution and telecommunications companies, and the establishment of a pension system fully funded on an individual basis and based on the profitability of investments made by the first pension fund management companies authorized to operate. New measures were taken to strengthen tax reform, particularly through the expansion of the tax base and the creation of a modern regulatory and legal framework, a key element of which will be the new tax code. In addition, the national authorities believe that further steps towards trade openness are needed and that the correct functioning of capital markets must be ensured, through a process of financial liberalization subject to supervision and control, to prevent the type of problems which arose in 1997 with FINSEPRO.

(a) Fiscal policy

In the context of falling current revenues, the goal of fiscal policy in 1997 was to balance public finances by containing current expenditure. The fiscal deficit of the non-financial public sector was equal to 1.8% of GDP, lower than the 1996 level of 2.5%, but not down to the target level of 1.1% proposed in the Monetary and Financial Programme. The deficit was mainly financed by expanding foreign borrowing through the issue on international markets of short-term treasury bills in dollars, for an amount equivalent to 9.9% of the total balance of external public debt.

The 1997 tax burden was 10.8%, slightly below the 1996 figure. The current revenues of the non-financial public sector fell by 3.3%, whereas tax revenues rose by 5.7% in nominal terms, despite tariff reductions and the sluggish performance of the economy the previous year. VAT accounted for 54% of tax revenues, income tax for 27%, tariffs for 11.8%, and from property transfer duties and taxes on consumption for the remaining 7.2%. VAT and income tax rose by 10.1% and 7.2% respectively in comparison with 1996, while import taxes fell by 10.6%.

Another factor contributing to difficulties in raising revenue in 1997 was the delay in the collection of capital revenue from the sale of assets and the privatization of public enterprises, such as electric power distribution companies, the National Telecommunications Administration (ANTED and alcohol plants. Only 41.5 million colones were collected, compared with the 167 million forecast in the programme for the period.

All these factors made it necessary to reduce spending by 4.9%, leading to a fall in gross investment and in consumption expenditure, including the operating costs of public enterprises. This reduction was achieved despite the fact that ANTEL had to make compensation payments to employees in December totalling 552 million colones.

The principal measures implemented in 1997 by the tax authorities to increase collection rates and reduce tax evasion were: (i) broadening of the tax base, (ii) introducing four bills in the

Table 1

EL SALVADOR: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
					Growth rates				
Growth and investment									
Gross domestic product	1.0	4.8	3.6	7.5	7.4	6.1	6.4	2.0	4.1
Per capita gross domestic product	-0.7	2.9	1.4	5.0	4.7	3.5	3.9	-0.2	1.7
National income	1.6	10.9	5.8	11.4	9.6	10.9	6.7	-1.2	7.9
Gross domestic product, by sector									
Goods	1.5	3.8	3.8	8.8	-1.4	4.1	6.0	1.8	5.0
Basic services	1.2	6.2	-2.9	9.1	6.8	5.9	5.5	1.3	3.7
Other services	0.5	5.2	3.7	5.8	3.9	6.3	7.2	2.4	4.0
					Percentages				
Contribution to growth of GDP[c]									
Consumption	1.5	13.9	3.2	7.7	7.8	8.0	9.7	0.9	4.9
Government	-0.2	-6.4	0.3	0.1	0.1	0.3	0.7	0.6	0.2
Private	1.7	20.3	2.9	7.7	7.7	7.7	9.0	0.3	4.7
Investment	3.6	-2.8	2.4	4.4	1.9	2.7	3.1	-4.6	1.0
Exports	-2.7	4.1	-0.1	1.3	5.6	1.4	3.6	2.3	5.2
Imports	-1.4	-10.4	-1.9	-5.9	-7.9	-6.1	-10.0	3.4	-7.0
					Percentages of GDP[b]				
Gross domestic investment	17.3	13.9	15.7	18.7	19.2	20.6	22.3	17.4	17.7
National savings	11.6	8.4	11.2	14.9	16.8	20.4	17.8	15.2	18.9
External savings	5.7	5.4	4.5	3.8	2.3	0.3	4.6	2.2	-1.2
					Percentages				
Employment and wages									
Labour force participation rate			51.6	52.2		53.4	52.4	51.3	51.1
Open unemployment rate[e]			8.7	9.3	9.9	7.7	7.6	7.7	8.0
Real minimum wage (index: 1990=100)[f]	106.3	100.0	103.1	104.6	104.6	102.7	103.1	99.4	95.1
					Growth rates				
Prices (December-December)									
Consumer prices	23.5	19.3	9.8	20.0	12.1	8.9	11.4	7.4	1.9
Wholesale prices	17.0	19.7	-3.2	8.0	1.4	5.0	9.2	4.0	
External sector									
Terms of trade (index: 1990=100)[b]	100.5	100.0	96.9	97.4	104.2	126.4	137.1	141.0	156.6
Nominal exchange rate (colones per dollar)	5.00	7.67	8.08	8.44	8.70	8.75	8.76	8.76	8.76
Real effective exchange rate of imports (index: 1990=100)	78.3	100.0	99.2	98.8	89.1	83.7	79.2	73.0	72.8
					Millions of dollars				
Balance of payments									
Current account	-370	-261	-212	-195	-118	-18	-322	-167	96
Trade balance (goods and services)	-704	-651	-717	-950	-1011	-1 212	-1 624	-1 333	-1 180
Exports	909	973	898	975	1 138	1639	2 049	2 230	2 880
Imports	1 612	1 624	1614	1 925	2 149	2 851	3 673	3 563	4 061
Capital and financial account[g]	259	288	65	61	177	131	471	332	267
Overall balance	-111	27	-148	-134	59	113	148	165	363
Variation in reserve assets (- indicates an increase)	-110	-165	70	-92	-112	-113	-148	-165	-363
					Percentages				
External debt									
Public debt (as a percentage of GDP)	38.2	49.0	42.0	43.0	28.6	25.6	22.8	24.2	23.3
Net interest (as a percentage of exports)	7.1	10.9	10.1	8.0	8.0	4.4	3.1	4.1	3.0

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
	Percentages of GDP								
Non-financial public sector									
Current revenue	10.3	12.5	13.0	13.6	14.3	16.0	17.1	17.4	15.3
Current expenditure	11.8	12.8	13.8	13.4	13.6	14.0	13.9	15.5	13.5
Saving	-1.5	**-0.3**	**-0.8**	0.2	0.8	2.0	3.2	1.8	1.7
Capital expenditure (net)	4.3	**2.5**	**4.1**	6.7	4.5	4.0	4.2	4.5	3.8
Financial balance	-4.2	**-0.4**	**-2.8**	-3.4	-1.6	-0.6	-0.1	-2.5	-1.8
Domestic financing	2.6	**-1.1**	**0.8**	0.6	-0.3	-1.5	-1.2	0.1	-0.1
External financing	1.6	**1.5**	**2.0**	2.8	2.0	2.1	1.3	2.3	1.9
	Growth rates								
Money and credit									
Monetary balances of banking system									
Net international reserves	69.6	92.6	**1.7**	26.1	13.7	10.3	-6.1	31.9	32.3
Net domestic credit	-32.6	10.4	22.7	37.5	45.5	26.2	39.5	14.1	8.2
To public sector	-28.1	37.5	23.2	14.3	3.8	-27.5	-27.6	9.5	-3.1
To private sector	12.3	**6.2**	12.8	31.0	37.5	27.1	55.4	14.4	19.2
Money (Ml)	12.8	**22.1**	**6.1**	31.8	12.4	10.3	4.4	17.5	-1.9
Local-currency savings and time deposits	-19.5	32.0	29.1	31.2	48.6	25.3	33.7	13.5	12.7
M2	-8.7	27.9	20.0	31.4	35.9	25.9	29.5	15.6	11.0
Dollar deposits		5.6	-34.4	99.0	1.7	58.3	21.9	48.3	40.4
	Annual rates								
Real interest rates (annualized, %)									
Deposit rate	-5.8	-0.5	5.9	-6.2	2.7	4.3	2.8	6.2	9.7
Lending rate	-3.9	2.2	9.2	-2.5	6.4	9.3	7.1	10.6	13.9
Equivalent interest rate in foreign currency '	16.3	-11.4	15.5	-0.8	22.4	12.5	14.3	14.0	11.7

Source:: ECLAC, on the basis of official figures.
″ Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Percentages of the working-age population. [e] Percentages of the economically active population (EAP). Real minimum wage in the manufacturing and services sectors in San Salvador. [g] Includes Errors and omissions. Refers to net interest as shown on the balance of payments, divided by exports of goods and services. ' Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
EL SALVADOR: MAIN QUARTERLY INDICATORS

	1995				1996				1997[a]				1998[a]	
	1	11	111	IV	I	11	III	IV	I	II	III	IV	I	II
Consumer prices (12-month variation, %)	8.7	9.2	12.0	11.4	10.6	11.0	8.7	7.4	7.4	4.9	2.1	1.9	1.5	3.1
Exports (millions of dollars)	285	252	249	220	296	243	247	239	387	418	263	292	422	342
Imports (millions of dollars)	768	863	850	722	662	710	625	675	671	784	758	761	948	1 024
Real effective exchange rate [b] (index: 1990=100)	80.5	81.5	78.7	75.9	74.1	73.0	71.7	73.0	71.9	72.5	72.9	73.8	73.1	72.1
Real interest rates (annualized, %)														
Deposit rate	0.5	4.4	-4.4	10.9	5.5	3.3	2.9	13.1	1.6	10.3	12.8	14.0	2.8	
Lending rate	5.9	8.4	-0.8	14.8	10.3	7.3	6.7	18.0	5.9	15.0	17.0	17.9	6.9	

Source: ECLAC, on the basis of official figures.
Preliminary figures. Refers to the exchange rate for imports.

Legislative Assembly to regulate relations between the tax authorities and taxpayers, and (iii) taking legal action against smuggling and tax evasion.

(b)Monetary and exchange rate policy

In 1997, as in 1996, the nominal exchange rate remained stable and pressures on the real exchange rate were kept under control; the authorities continued with the monetary policy of sterilizing foreign exchange inflows through open market operations.

Monetary policy can be said to have achieved its main goal of cutting the inflation rate to a record low and adjusting the money supply to match demand, despite pressures on liquidity arising from financial problems during the year and the influx of foreign exchange due to increased exports.

Growth in money supply was controlled by regulating the growth of the monetary base, which grew by 9% over the year. The main factor in this growth was a 33% increase in net reserves as a result of growth in export earnings, increased family remittances and official capital flows. In addition, there was a 19.2% increase in private sector credit, which reached 40.5% of GDP, three points higher than in 1996. Credit was used for construction and housing, personal loans and services and, to a lesser extent, other sectors such as commerce, manufacturing and agriculture. These growth factors made it necessary to neutralize excess liquidity by issuing monetary administration certificates.

Broad money as measured by M3 was 12.7% higher than in 1996, mainly because of the increase in investment certificates (49.3%) and foreign-currency deposits (40.4%). As for its components, Ml money was 1.9% lower, mostly owing to a fall in demand deposits, while M2 in national currency was 11% higher, owing to the rebuilding of financial asset portfolios.

Despite falling inflation, interest rates remained high. The average nominal short-term lending rate was 16%, 2.6 percentage points lower than in 1996, and the average real lending rate rose to 13.9%. An average nominal rate of 11.4% was applied to 180-day deposits, 3.6 percentage points lower than in 1996. Lastly, the real deposit rate averaged 9.7%, 3.5 percentage points higher than the average for the previous year.

New draft legislation was proposed, to provide the system with more complete legal instruments, increasing its competitiveness and improving the regulation of the capital market.

(c) **Trade policy**

Under the tariff reduction programme, the customs duty applicable to capital goods and inputs was cut to zero in December 1996 and, beginning in July 1997, tariffs on intermediate and final goods began to be reduced progressively by one percentage point every six months. The goal of the programme is that, by July 1999, tariffs on intermediate goods should be between a floor of 5% and a ceiling of 10%, and tariffs on final goods should not exceed 15%.

In 1997, negotiations continued between Mexico and the Northern Triangle countries of Central America (consisting of El Salvador, Guatemala and Honduras), particularly regarding the list of tradable goods, with a view to determining deadlines for tariff reductions on those goods and the corresponding rules of origin. The process began in September 1996 and considerable progress has been made in drafting the basic texts of an agreement. Progress was also made in negotiations with the Dominican Republic, and the corresponding agreements were signed in April 1998.

1 These were bills relating to the tax code, reform of VAT and income tax legislation, and the suppression of smuggling.

2 Amendments to the laws on banks and finance companies, the charters of the Central Reserve Bank and the Federation of Savings and Loan Associations, and the law on the Office of the Superintendent of Securities; and bills concerning consolidated supervision of financial conglomerates, money-laundering and deposit insurance. A law regulating the El Salvador commodity exchange was adopted recently.

(d)Structural reforms

The main structural reforms have progressed unevenly and with varying degrees of success. In the area of tax reform, consisting of a series of measures to broaden the tax base and reduce tax evasion, new draft legislation is currently under consideration, including a new tax code and amendments to the laws on VAT and income tax. Efforts to improve trade openness are progressing more slowly, but steadily; they include negotiations at the subregional level regarding the Free Trade Area of the Americas (FTAA) and between Mexico and the Northern Triangle. Thirdly, liberalization has brought significant growth to the financial sector, although there are some weaknesses in the system of monitoring and control, owing to continuing gaps in the existing legalstructure.

Fourthly, privatizations have taken much longer than had been originally planned. Capital revenues in 1997 were therefore lower than expected, especially from the sale of ANTEL. The sale of the electric power distribution companies provided a much greater sum ($ 586 million) than that originally estimated in the Monetary and Financial Programme. In 1998, capital revenues from the sale of assets are likely to exceed $ 320 million.

As for the pension system reform, the pension superintendency began to operate in 1997 and started the process of creating the first five pension fund management companies; the new system of funded pensions is expected to bring about a significant increase in net savings.

3. The main variables

(a)Economic activity

1997 saw a major upturn in economic activity after the modest growth of 2% in 1996, but the growth figure was still below the 5.9% average for the previous five years. The real GDP growth rate was 4.1%, thanks to the improved performance of the manufacturing industry (8.2%), construction (6%), the financial sector (4.6%) and commerce (4.5%). However, according to information supplied by the national authorities, agriculture was badly affected by the El Niño phenomenon, although this was offset by good sugarcane harvests, so the downturn in the sector was only 0.3%.

The construction sector was faced with labour problems which led to wage rises. The financial sector was affected temporarily by the reaction of public opinion to the conflict mentioned earlier; the commercial sector grew by 4.5%, a much lower rate than the almost 9% and 10% which had been achieved in 1994 and 1995 respectively.

Overall demand grew by 7.5%, as a result of increases of 19% in external demand and 5% in domestic demand. This was due to increased exports of goods and services, and also to higher gross domestic investment, particularly public-sector investment in infrastructure works and roads. The higher demand was also influenced by increased consumption.

The index of manufacturing value added rose by 8.2%, 6.6 points more than in 1996. The growth of the manufacturing sector was mostly due to the expansion of *maquila* industry services, whose growth rate increased from 12.6% in 1996 to 30.3% in 1997. The metals manufacture and machinery sector grew by 11.5%; wood and paper products, by 7.8%; textiles, clothing and leather products, by 7.7%; and food, beverages and tobacco, by 6.2%.

(b) Prices, wages and employment

The inflation rate for 1997 (December to December) was 1.9%, one of the lowest figures in recent years and well below the expected level of between 5% and 7%. The average inflation rate for the year was 4.5%, much lower than the 1996 figure of 9.8%, and one of the lowest in Latin America.

The downward trend in the yearly variation of the consumer price index (CPI) was due to a fall in food prices, the largest component of the index, and to a lesser extent in clothing and housing prices. The decrease in food prices was due to the fact that bean prices, which had risen sharply in 1996, fell back to their previous levels in 1997.

Gasoline prices also fell, owing to the fall in oil prices; this had a significant impact on production costs for enterprises. Also, the gradual decline in lending rates and the removal of tariffs on inputs and capital goods helped to hold down costs and the associated pressure on overall price levels. Another highly significant factor was the monetary policy of the Central Bank concerning the sterilization of excess liquidity.

The wholesale price index, which excludes coffee prices, continued the downward trend noted since mid-1996; prices of goods produced domestically rose during the early part of the year, but at the end of the third quarter they were 3.4% down on an annual basis. The annual rate of price increases also fell in the case of imported goods, and prices of export products, apart from coffee, continued the downward trend begun in July 1996.

Minimum wages have not changed since 1995 in nominal terms. However, in real terms they have fallen since 1996, when they experienced negative growth of -3.7%, followed by -4.3% in 1997. Preliminary employment figures also show a slight deterioration in the employment situation, with a total annual unemployment rate of 8.0% for the year; the rate was 7.5% in urban areas, 8.7% in rural areas and 7.4% in the metropolitan area.

(c)The external sector

The external sector showed improvement in 1997. For the first time in the 1990s, the current account showed a surplus, amounting to $ 95.9 million. However, the balance of trade in goods and services was still seriously in deficit (-10% of output), although this was an improvement over 1996 because the rate of growth of exports (29%) exceeded that of imports (14%).

Family remittances continued to increase, but more slowly than in previous years; in 1997 they totalled $1.2 billion. The external sector also benefited from increased export volumes of coffee and sugar and from excellent coffee market prices. Terms of trade in the main tradable goods also improved, from -2.5% in 1996 to 6.1% in 1997. Another positive factor was the boom in maquila exports (up 38.3%), the value of which increased from $ 764.1 million to $ 1,056.8 million. These exports made up 43.7% of the total, non-traditional exports accounted for 31.3% and traditional exports 25%. The main non-traditional exports to countries outside the region were raw materials for medicines; bed linen and table and kitchen linen; underwear, clothing accessories and outer wear; cotton yarn; and aluminium products. As for traditional products, exports of coffee and sugar increased by 52.7% and 52.9% respectively.

Growth in imports was higher than in 1996; those of the *maquila* industry increased by 39.1%, followed by consumer goods (15.9%), capital goods (10.8%) and intermediate goods (8.6%).

In the area of intraregional trade, El Salvador achieved balance-of-trade equilibrium with the other Central American countries thanks to a 25.6% increase in exports, while imports rose by only 14.4%. There was an increase in the proportion of trade with Honduras, Guatemala and, to a lesser extent, Costa Rica.

Official transfers fell by 10.2%, ending the year with a balance of $ 55.2 million. Current transfers increased by $ 106.8 million (8.5%); family remittances constituted a major element, increasing by 10.4%, equivalent to 10% of output.

The positive balances of the current and capital accounts were reflected in a $ 362.6 million balance-of-payments surplus, $ 200 million higher than in 1996.

The external debt stood at $ 2,667 million at the end of 1997, an increase of 5.9% over 1996 and equivalent to 93% of total exports of goods and services. Interest payments fell to 4% of the value of exports.

GUATEMALA

1. General trends

Guatemala's gross domestic product grew by 4%, a percentage better than the 3% achieved in 1996 and consistent with the original expectations of the authorities. Important factors in the expansion were the good performance of exports -especially coffee- and the easing of monetary policy during the course of the year. Moreover, inflation slowed to 7.1%.

During the reporting period, Guatemalan society evolved under the influence of the Agreement on a Firm and Lasting Peace, signed in December 1996, which put an end to over three decades of internal armed conflict and concluded the peace process in Central America. As a result, much of government policy, particularly economic policy, was shaped by the commitments entailed by the peace accords.

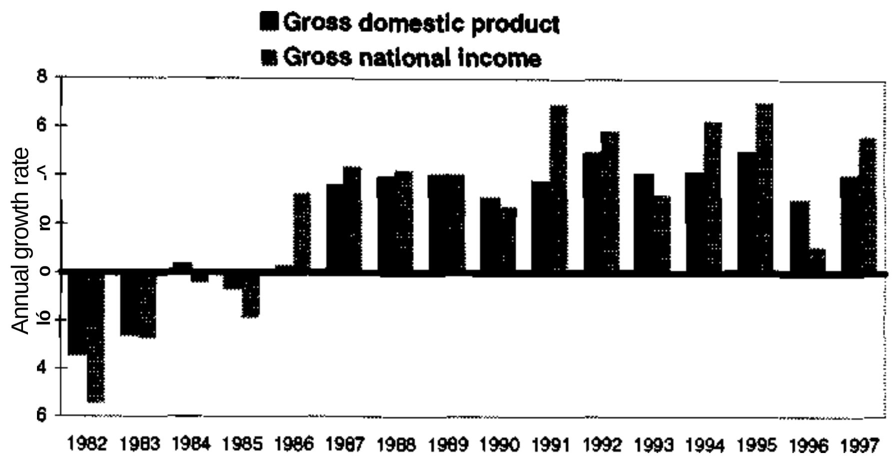
Both central government and private-sector investment increased. Enhanced private investment was due primarily to lower interest rates and tariff reductions on imports of inputs and capital goods. Central government investment was boosted in particular by increased spending on road repair and maintenance.

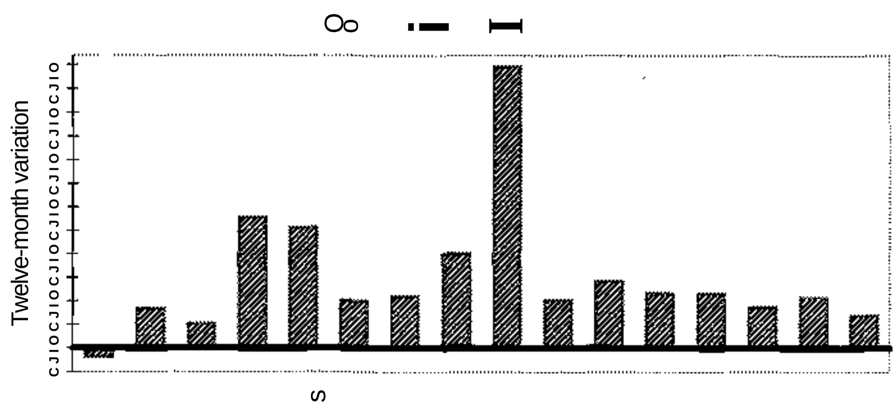
Growth expectations for 1998 include continued good export performance, and trends in central government and private sector investment comparable to those for 1997. However, it is anticipated that agriculture will show the negative repercussions of the El Niño phenomenon. Nonetheless, the authorities have set a goal of 4.5% growth and 8% to 10% inflation. Although the overall public-sector deficit is expected to be 1% of GDP, 1998 will be a politically sensitive year because of the run-up to elections; moreover, constitutional reforms will be undertaken that will have a profound impact on the political structure of the country.

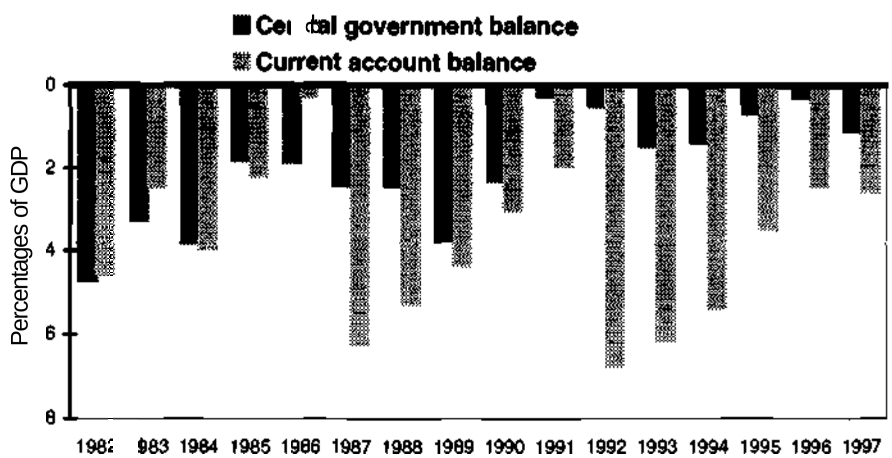
2. Economic policy and reform

The tendency of economic policy was to adopt monetary and fiscal measures less restrictive than those of the previous year. As a result, the overall public-sector deficit was equivalent to 1.4% of GDP, compared with 0.6% in 1996. For the second consecutive year, economic policy was implemented without the supervision of the International Monetary Fund (IMF). Although the authorities proposed signing a stand-by arrangement with IMF in 1997, this did not materialize, primarily because of a lack of agreement on tax matters.

As mentioned above, 1997 saw the start of implementation of the Agreement on a Firm and Lasting Peace, which embraces a series of complex social and economic issues. The end to internal armed conflict has allowed the country to work on building a more open and democratic society. A number of substantive goals set forth in the Agreement have already been realized. The international community promised its backing


Gross domestic product
Gross national income
Annual growth rate
1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997


Twelve-month variation


Central government balance
Current account balance
Percentages of GDP
0
2
4
6
8
1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997

for the peace process at a meeting of the consultative group held in Brussels early in 1997 and confirmed its support in the follow-up meeting that took place in August of the same year in Antigua, Guatemala.

(a)Fiscal policy

Fiscal policy was obliged to deal with disparate goals during 1997. In order to comply with the peace accords, the authorities made an effort to meet tax revenue targets, while stepping up spending and reorienting it towards social sectors. At the same time, they saw the need to support monetary policy aimed at controlling total liquidity, and this entailed maintaining fiscal balance.

The central government deficit was around 1% of GDP, higher than the figure for 1996. The tax burden net of tax credit refunds was approximately 8.7%, owing to continued collection of the emergency solidarity tax. Value added tax (VAT) revenues rose by 22.8% as a result of revived economic activity and increased imports. Despite the implementation of a tariff reduction programme, customs revenues also rose because of the disproportionate expansion of imports.

Government expenditure increased considerably (by around 20% in real terms), largely because of the costs entailed in implementing the peace accords and ensuring public safety. In general, Government continued to redirect its spending towards social sectors; nevertheless, inadequacies were reported even in areas in which government spending increased strongly.

The Government financed its increased expenditure to a great extent by contracting new public debt, both foreign and domestic. It successfully placed a US$ 150 million bond issue in the international market, an operation that also served to reinforce a monetary policy directed at reducing domestic interest rates. The domestic debt did, however, increase by some 800 million quetzals, a figure exceeding the previous year's figure by roughly 15%. Efforts continued to restructure maturities and interest rates on the domestic debt, consisting largely of securities issued with maturities of one (77%) or two (15%) years.

Tax laws underwent major changes. Measures intended to improve collection included eliminating various exemptions created by earlier legislation. Important amendments to the tax law applicable to mercantile and agricultural enterprises were introduced, aimed primarily at ensuring payment of a minimum tax by such enterprises. In addition, taxes on beverages, petroleum products and travel fares abroad were raised. Lastly, other legal provisions were changed in order to sharpen the penalties for tax fraud. Early in 1998, a law was passed creating a superintendency of tax administration to ensure efficacy and professionalism in that area.

Other changes were made that could work against increased revenues. One such change was the plan to cut the maximum corporate and individual income tax rate gradually from 30% to 25% ; another was the implementation of the above-mentioned tariff reductions on inputs and capital goods. The changes introduced in 1997 to the uniform real estate tax with the aim of increasing collections were eliminated in February 1998. Even more importantly, the solidarity tax, an important source of revenue in 1996 and 1997, will not be collected in 1998, and the new commercial and agricultural enterprises tax act, despite its revenue potential, will be in effect only until April 1999.

(b)Monetary policy

In 1997, monetary policy was less restrictive than in 1996. The monetary authorities virtually suspended open market operations to sterilize excess liquidity, but received substantial support from the fiscal side, as the balance of negative net credit to the central government increased to 2,805 million quetzales (compared to 674 million

1 These exemptions included tax incentives to the tourist industry and private producers of electricity, and exemptions benefiting the armed forces.

2 The maximum tax rate was 30% in 1997 and is due to be reduced to 27.5% in 1998 and 25% in 1999.

Table 1
GUATEMALA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
					Growth rates				
Growth and investment [b]									
Gross domestic product	4.0	3.0	**3.7**	4.9	4.0	4.1	5.0	3.0	4.0
Per capita gross domestic product	1.5	**0.5**	1.1	2.2	1.3	1.4	2.2	0.3	1.3
Gross national income	4.0	**2.7**	**7.0**	5.9	3.2	6.3	7.0	1.1	5.7
Gross domestic product, by sector									
Goods	3.1	**2.6**	**2.8**	4.7	2.2	2.5	3.9	2.6	3.4
Basic services	10.0	6.1	**5.7**	8.3	5.5	4.4	7.7	4.0	7.5
Other services	3.6	**2.8**	4.0	4.4	5.1	5.3	5.1	3.1	3.6
					Percentages				
Contribution to growth of GDP [c]									
Consumption	3.3	**1.2**	3.1	7.4	4.6	6.1	5.3	2.7	6.5
Government	0.3	**0.2**	0.1	0.4	0.5	0.2	0.1	0.1	0.1
Private	3.0	0.9	3.0	7.0	4.0	5.9	5.2	2.7	6.4
Gross domestic investment	0.1	**-0.2**	3.1	4.8	-1.1	0.3	-0.2	-2.7	0.0
Exports	2.2	1.8	**-0.8**	1.9	2.5	0.3	2.3	1.4	2.7
Imports	-1.5	0.3	**-1.7**	-9.1	-1.9	-2.6	-2.4	1.5	-5.3
					Percentages of GDP [b]				
Gross domestic investment	14.2	13.6	16.1	19.9	18.0	17.6	16.5	13.4	12.9
National savings	9.3	10.6	13.9	11.9	10.3	10.2	11.8	9.3	7.3
External savings	4.9	3.0	2.2	7.9	7.7	7.3	4.7	4.1	5.6
					Percentages				
Employment and wages									
Labour force participation rate [e]	6.1	6.0	4.0	1.5	2.5	3.3	3.7	4.9	
Real average wage (index: 1990=100)	122.2	100.0	93.6	107.6	115.2	115.9	129.8	144.7	
					Growth rates				
Prices (December-December)									
Consumer prices (nationwide)	20.2	59.6	10.2	14.2	11.6	11.6	8.6	10.9	7.1
External sector									
Terms of trade (index: 1990=100)"	97.1	100.0	104.3	103.8	97.7	106.7	115.5	105.7	115.9
Nominal bank exchange rate (quetzales per dollar)	2.82	4.49	5.03	5.17	5.60	5.80	5.81	6.05	6.07
Real effective exchange rate (index: 1990=100)	85.5	100.0	89.0	87.7	89.2	84.7	80.9	77.1	73.2
					Millions of dollars				
Balance of payments									
Current account	-367	-233	-184	-706	-702	-700	-511	-387	-454
Trade balance (goods and services)	-438	-244	-341	-955	-947	-938	-920	-763	-884
Exports	1424	1568	1689	1898	2 024	2 287	2 801	2 771	3 237
Imports	1861	1812	2 029	2 853	2 970	3 224	3 721	3 534	4 121
Capital and financial account	283	-10	815	692	901	760	354	563	741
Overall balance	-84	-243	631	-14	200	60	-157	176	287
Variation in reserve assets (- indicates an increase)	-59	42	-551	52	-121	-60	157	-176	-287
					Percentages				
External debt									
Public debt (as a percentage of GDP)	29.2	31.2	25.5	21.6	18.3	16.6	14.4	13.1	12.1
Net interest (as a percentage of exports) [8]	10.3	10.7	5.7	7.5	4.9	4.2	3.4	4.8	3.4

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997"
				Percentages of GDP					
Central government sector									
Current revenue	9.4	7.9	9.0	10.1	9.1	7.7	8.5	9.0	9.4
Current expenditure	10.1	8.5	7.6	7.8	7.5	6.9	6.6	6.5	6.8
Saving	-0.6	-0.6	1.5	2.4	1.6	0.8	1.9	2.5	2.6
Capital expenditure	3.1	1.7	1.5	2.9	3.1	2.3	2.6	2.6	3.8
Financial balance	-3.8	-2.3	-0.1	-0.5	-1.5	-1.4	-0.7	-0.1	-1.1
				Growth rates					
Money and credit									
Monetary balances of banking system									
International reserves				57.6	19.2	-15.8	-13.9	16.9	49.6
Net domestic credit	9.9	20.5	15.1	11.2	5.8	39.6	18.3	11.8	21.2
To public sector	23.5	-1.1	94.7	-31.0	-34.4	-47.4	-74.9		
To private sector	9.6	16.6	18.4	35.1	15.3	14.2	32.3	112	18.7
Money (Ml)	20.7	33.9	18.3	5.4	21.1	34.9	22.8	118	31.3
Local-currency savings and time deposits	14.8	13.7	64.1	27.4	3.4	20.1	6.6	12.2	20.8
M2	17.1	21.7	44.1	19.5	9.0	25.3	12.7	12.4	25.2
				Annual rates					
Real interest rates (annualized, %)									
Deposit rate	-5.2	-23.9	13.1	-3.4	1.0	-1.7	-0.8	-2.9	-1.5
Lending rate	-2.7	-20.6	22.0	4.6	11.8	10.2	11.6	10.7	10.9
Equivalent interest rate in foreign currency [h]	-5.4	-1.7	22.7	6.2	1.9	12.8	2.4	7.0	2.5

Source: ECLAC, on the basis of official figures.
* Preliminary figures. Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population of (EAP). Includes Errors and omissions. [8] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. Nominal interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
GUATEMALA: MAIN QUARTERLY INDICATORS

	1995				1996				1997°				1998*	
	i	ii	in	iv	i	n	in	iv	i	ii	in	iv	i	ii
Consumer prices (12-month variation, %)	8.4	8.2	8.4	8.6	10.7	11.1	11.8	10.9	11.5	9.1	8.3	7.1	6.1	7.5
Real effective exchange rate [b] (index: 1990=100)	80.0	81.6	81.7	80.5	80.6	78.2	76.6	73.0	73.3	72.4	73.0	74.0	73.5	73.1
Real interest rates (annualized, %)														
Deposit rate	6.0	-6.8	2.0	-4.4	-3.3	-2.2	-3.4	-2.5	-7.4	7.2	-3.8	-2.1	-4.6	
Lendingrate	19.2	5.2	14.9	7.1	10.7	11.4	10.5	11.6	5.9	21.3	8.2	8.4	5.4	

Source: ECLAC, on the basis of official figures.
Prelim ¡nary figures. Refers to the exchange rate for imports.

in 1996), a figure unmatched in recent years. The variation in negative net credit (2,131 million quetzales) was larger than the increase in net international reserves (1,980 quetzales) and hence made it possible to sterilize the liquidity from that source.

Nonetheless, there was a sudden expansion of liquidity when the monetary authorities refrained from renewing monetary control instruments as they matured. That expansion, combined with a drop in financial yields, put upward pressure on the exchange rate. The authorities showed themselves willing to sacrifice international reserves in order to ease the pressure. The suspension of open market operations also had the effect of reducing the losses of the Banco de Guatemala (which performs the functions of a central bank).

Despite this turn of events, the monetary authorities showed no signs of deviating from their decision to pursue a less restrictive monetary policy. Towards the end of the year, they announced a series of measures designed to reduce the effective bank reserve requirement from 24.6% to 19.1% over a period of seven months ending June 1998. As a result, net international reserves in February 1998 were down by more than 500 million quetzales from their level in December 1997.

The effect of the monetary measures was to lower interest rates. Yields on government debt paper dropped to 10.5%, compared to 15.5% in 1996. The average bank lending rate declined from 22.4% at the end of 1996 to 16.4% in December 1997. In the second half of the year, lending to the private sector increased; indeed, bank loan portfolios expanded by over 60%, reflecting in particular an increase in loans to the wholesale and retail trades and to consumers. There was a decline in interest rates on deposits similar to the decline in lending rates. As a result, the intermediation spread (approximately 10 points) remained wide.

Early in 1998 the monetary authorities announced their decision to authorize the opening of accounts in dollars and the issuance by the central bank of bonds payable in dollars as additional means of controlling liquidity.

(c) Foreign exchange and trade policies

The average nominal rate of exchange hardly varied, so that the problem of an appreciating real exchange rate persisted. The Banco de Guatemala made net sales of some US$ 200 million.

On the trade front, the tariff reductions scheduled for the period 1997-1999, in coordination with the other Central American countries, began to take effect.

As part of the subregional integration process, negotiations began concerning the rules that were to govern such matters as trade in services, settlement of disputes, sanitary and phytosanitary measures and rules of origin. In addition, negotiations proceeded between the countries of the "Northern Triangle" (El Salvador, Guatemala and Honduras) and Mexico concerning the establishment of a free trade area, and Guatemala also participated in meetings at the ministerial and technical levels in relation to the Free Trade Area of the Americas (FTAA). Early in 1998, a proposal was put forward to establish a free trade agreement between the Central American countries and the Dominican Republic, and in March these same countries signed a trade and investment framework agreement with the United States with the aim of promoting freer interchange in those areas.

(d)Structural reforms

An important reform was the passage of the new civil aviation act upholding the "open skies" principle. A new mining act was also passed to provide a regulatory framework for exploration and development of mines and oil and gas deposits. On the other hand, efforts to privatize the telephone and electricity companies did not come to fruition.

Concessions were granted, however, for railway and mail services, some state enterprises were sold and progress was made in putting together a programme of port and airport concessions. In addition, the first highway built under concession to a private firm was opened.

Activities carried out under Guatemala's National Competitiveness Agenda produced some significant results in 1997. For example, tourism was identified as one of the economic clusters that would receive priority attention from both government and the private sector. In 1998, the maquila industry was identified as another strategic sector, the goal being to turn Guatemala into a regional centre for textiles and apparel. The hope is that the sectors just mentioned, plus forestry and frozen fruits and vegetables, can develop strategic industrial clusters in the years to come.

So far in 1998, a new foreign investment act has been passed that extends national treatment to foreign investors, and it is hoped that the privatization of the telephone and electricity companies can be put through during the course of the year.

3. The main variables

(a)Economic activity

In 1997 the Guatemalan economy grew by 4%, improving upon its performance in the previous year (3%). A number of factors contributed to this result. First of all, private consumption expanded more rapidly (7%) than in the year before (3%). Exports also did very well, expanding by 12% in real terms. Moreover, investment increased by 5%, whereas it had declined in 1996.

The agricultural sector achieved a rate of growth (2.8%) that was modest but slightly better than the figure for 1996, thanks primarily to the increase in production for export. Another positive factor was the availability of more grazing land in areas previously affected by the internal conflict.

On the negative side, El Niño weather patterns hurt coffee production somewhat and caused major harm to corn crops. Rice and bean crops were also affected to a lesser extent. Other agricultural exports showed a slight increase, except for sugarcane, which was actually benefited by the El Niño drought conditions that allowed for an extended harvest, with excellent results.

Mining output continued to show strong growth as a result of increased petroleum production. Construction grew by 5.5%, an improvement over its performance the previous year, thanks to road repair and housing construction programmes. The sector was also given a boost by continued expansion and modernization of the country's hotel infrastructure.

The manufacturing sector also improved its performance, increasing output by 2.6%, compared with 1.9% in 1996. Major factors in the growth of this sector were the revival of private consumption and the dynamic expansion of manufacturing exports to other Central American countries. Maquila exports, especially textile products, also showed a positive trend, but smuggling and a lagging exchange rate continued to act as a drag, especially on the food and beverage subsectors.

Basic services showed a notable growth of 7.5% due in part to the realization of a plan to extend electricity lines into the interior of the country and in part to the qualitative and quantitative increase in telephone lines and equipment.

(b)Prices, wages and employment

The average annual rate of increase in consumer prices remained in the single-digit range (9.2%), despite significant increases in local telephone and electricity rates. The pace of inflation gradually slowed over the course of the year, so that the annualized rate in December was just 7.1%. In part, the slowdown was due to the delayed effect of highly contractionary monetary and fiscal policies applied in 1996 and to the stability of the nominal exchange rate.

In the areas of education and of transportation and communications, price increases were substantially higher than the average rate of inflation. Education costs were influenced by the insufficiency of State-provided education services and the absence of adequate regulation of private educational facilities. The increase for transportation and communications resulted from higher telephone rates and new taxes on petroleum products.

The employment situation took a negative turn in the first half of the year, but in the second half the employment rate improved somewhat in the private sector, as the livelier economy created new jobs. The Government authorized hiring for education and security but adhered to its policy of cutting public-sector jobs in areas considered low-priority.

Minimum wages were held at the same level for the second consecutive year because of failure to reach agreement on new wage levels. Contractual wages continued to be set by labour-management negotiations in each separate company. In the public sector, the Government granted its employees a 10% wage increase.

In 1998, the minimum wage in industry and agriculture was raised by 12%, and government workers received another 10% raise. Nevertheless, in the first quarter of 1998 there were reports of strikes by workers on two banana plantations over wage demands.

(c)The external sector

The balance-of-payments current account deficit widened to US$ 450 million, topping the figure for 1996, and equalled 3.4% of GDP, compared with 2.9% in 1996.

The deterioration in the current account was due to a deficit of some US$ 811 million in merchandise trade. Exports showed good growth (16%), but imports, stagnant in 1996, outpaced them in 1997 (22.4%), with the result just indicated.

The negative impact of the merchandise trade balance was offset to some extent by transfer income of US$ 630 million, including remittances by Guatemalans residing abroad estimated at US$ 400 million. Moreover, the tourism and maquila sectors recorded a surplus of US$140 million.

Exports of sugar and coffee recorded a positive trend, thanks to some growth in volume combined with favourable international prices. There were significant increases in the volume of petroleum exported (10%), in exports to other Central American countries and in exports of the maquila industry. Some non-traditional exports were hurt by the unilateral application of sanitary andphytosanitary standards by the United States, the chief destination for these products.

The strong growth in imports involved all categories of goods but was most striking in the case of capital goods (35%), partly owing to tariff reductions. There was also a substantial increase (24%) in imports of consumer goods, whereas external purchases of intermediate goods expanded at a rate of 16%. The value of petroleum purchases declined by nearly US$ 60 million, because of lower prices in international markets.

In 1997, Guatemala achieved good trade balances with all the Central American countries, for a combined surplus of roughly US$ 256 million on its subregional trade.

A notable feature of the external situation in 1997 was that capital inflows were primarily the result of official borrowing (around US$ 460 million) from international organizations and private lenders; the stock of public external debt increased from US$ 2,075 to US$ 2,131 million. Total capital flows made it possible to increase international reserves.

With respect to external debt policy, in 1997, for the first time in the 1990s, disbursements to central government exceeded its debt service payments, changing the net transfer of funds in that regard from negative to positive. Nonetheless, for the public-sector as a whole, the net transfer remained negative, primarily because the central bank paid off US$ 115 million in its continuing effort to reduce its external indebtedness.

A significant event was the successful placement of a US$ 150 million government bond issue in international capital markets with a maturity of 10 years and a fixed interest rate of 8.5%. The external funds received in 1997 in support of the peace process proved to be less than hoped for, and this situation is not expected to change in 1998.

HAITI

1. trends

In fiscal year 1997, the performance of the Haitian economy was quite mediocre, with overall growth barely exceeding 1%. Dissension between the executive and legislative branches of government hampered the implementation of the reforms agreed upon at the beginning of the year with the International Monetary Fund (IMF). This cut deeply into inflows of official finance from abroad and held up the progress of the development plans that had been designed to spur the economic recovery.

This situation had serious repercussions in terms of the level of activity, since almost all sectors experienced a slowdown in their rate of expansion, while some even recorded negative growth. On the other hand, trade picked up after its decline of the year before, with the volume of exports and imports increasing by almost 8% and 3%, respectively. Once again, Haiti had a huge trade deficit (US$ 513 million), which it bridged by using the transfer payments that have been pouring into the country ever since the embargo was lifted.

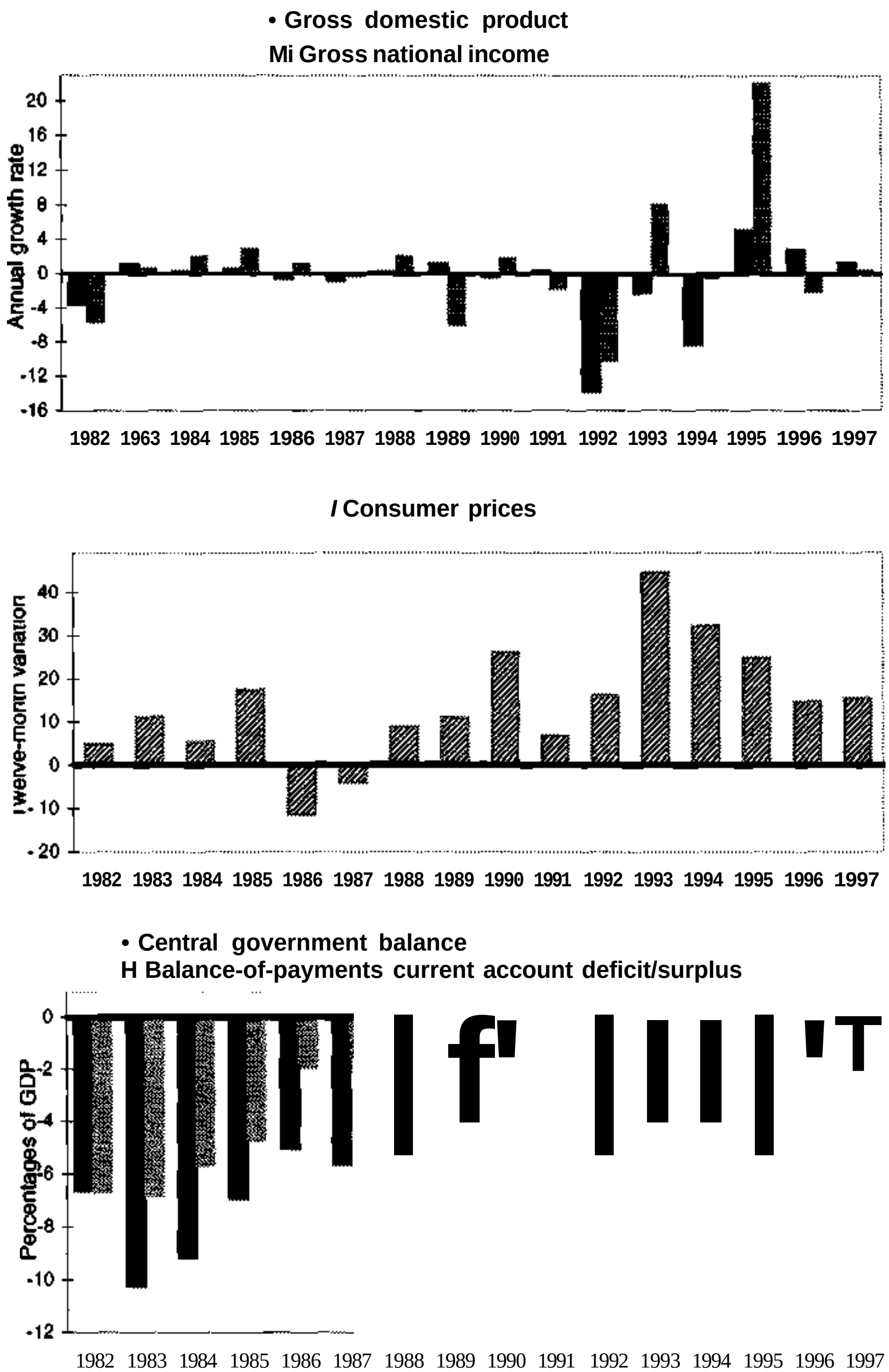
These transfers also made it possible to build up the country's international reserves, which the Banque de la République d'Haïti (BRH) was then able to draw upon in order to satisfy the increased demand for dollars and thus maintain a stable nominal exchange rate. This bolstered the effect of the measures adopted to forestall any excessive expansion in domestic liquidity such as might result from the increase in bank credit. Consequently, both inflation and the local currency's rate of depreciation gradually abated. The average annual variation in domestic prices totalled 16%, which was lower than in previous years, while the average exchange rate remained close to that of 1996 at approximately 16.2 gourdes to the United States dollar.

The fiscal deficit expanded, but only by a fairly moderate amount (2% of GDP) thanks to a significant increase in tax collections at a time when, despite financing constraints, current expenditure was outpacing inflation. Although the public investment programme was strengthened in the areas of rural development and education, it did not have the catalytic effect it was expected to have on other government programmes.

The prospects of resolving the country's political crisis are quite bleak, and the longer Haiti remains without an authority who has the necessary capacity and resources to take action, the more remote the chances of achieving the 2% target set for GDP growth for the forthcoming fiscal year.

1 The review period is the fiscal year beginning in October and ending in September 1997.

Figure 1
HAITI: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

2. Eeoii ic policy

The performance of the country's economic authorities in 1997 was constrained by their inability to make any headway in the implementation of the enhanced structural adjustment facility (ESAF) agreement signed with the International Monetary Fund for a total of 91.1 million special drawing rights (SDRs). These funds were to have been disbursed gradually over the three years covered by the programme. Early in 1997, fiscal policy ran into trouble due to the delay in securing authorization for the privatization of State enterprises and, subsequently, to the absence of any competent authority (i.e., a Prime Minister) to implement the economic programme so long as the political confrontation between the President and the majority in Congress remains unresolved.

Furthermore, the use of external funding to finance the bulk of expenditures put upward pressure on liquidity, thereby compounding the effect of the pressure generated by the increase in bank credit to the private sector. Monetary policy was aimed at counteracting these pressures and maintaining a stable exchange rate.

(a)Fiscal policy

In the absence of congressional approval, the fiscal budget had to be drawn up along the same lines as the previous year's, with total disbursements divided up proportionately (one-twelfth of the total per month). Accordingly, budget performance involved restrictions on the payment of wages and subsidies; development projects were hit the hardest, however. The Government's operating budget, which for the first time was consolidated with the investment budget, was not approved until the third quarter of the fiscal year. With two thirds of the budgeted financing at its disposal, the Government tended to relax its fiscal discipline, and the fiscal deficit therefore widened to 2% of GDP.

Grants from external sources amounted to 695 million gourdes, or the equivalent of close to 70% of the deficit. As net repayments were made on foreign loans, total domestic financing, consisting mainly of extrabudgetary funds and the deferral of domestic payments, exceeded financing from abroad. In keeping with its strategic objective of controlling expenditure without bank financing, the Government paid out 104 million gourdes as part of its **BRH** debt consolidation programme. The decentralization process being conducted in the case of nine State enterprises was suspended since, with no Prime Minister in office, there was no one to authorize the transfer of public assets.

The increase in fiscal revenue (39%) again overshot the estimated levels, this time owing to the effect of a number of measures adopted during the previous financial year, including the establishment of a flat rate for the turnover tax of 10% and the application of this tax to all goods across the board, including staples. This measure, combined with stricter enforcement, accounts for the 27% real increase in tax revenues and the ascent of the tax burden from 7.9% to 9.2% of GDP.

Taxes on foreign trade also showed an improvement, with revenue under this heading more than doubling. This increase is attributable to the steps taken to curtail tax evasion, the extension and simplification of import duties (for which the maximum rate was set at 10%) and the application of a single, across-the-board levy of 4% for import control purposes. No less significant was the introduction of a 10% excise tax on imported vehicles. Since imports were robust, the clamp-down on tax exemptions had the effect of more than doubling receipts from taxes on external transactions.

Despite the freeze on the disbursement of external funds, current outlays were almost 28% higher than they had been the previous fiscal year and represented approximately 10% of GDP. These expenditures consisted primarily of operational expenses and wages. Staffing cuts, accomplished in part through voluntary and early retirement schemes as part of the public sector's reform process, were temporarily suspended.

Table 1

HAITI: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997"
				Growth rates					
Growth and investment									
Gross domestic product	1.2	-0.1	0.1	-13.8	-2.2	-8.3	5.0	2.8	1.3
Per capita gross domestic product	-0.9	-2.1	-1.9	-15.6	-4.2	-10.1	2.9	0.7	-0.8
Gross national income	-6.1	1.9	-1.9	-10.3	8.2	-0.6	22.2	-2.2	0.5
Gross domestic product, by sector									
Goods	0.4	-1.2	-2.8	-14.1	-5.7	-9.9	-0.8	3.8	1.3
Basic services	3.4	3.0	-7.4	-12.1	-2.4	-13.2	13.1	5.3	-0.2
Other services	1.1	1.6	3.1	-11.0	1.0	-4.6	7.4	1.0	0.5
				Percentages					
Contribution to growth of GDP [c]									
Consumption	-5.4	-0.1	-1.2	-3.8	15.7	-10.4	26.3	0.4	2.1
Gross domestic investment	-1.0	-0.6	-0.5	-5.8	-0.7	-0.7	8.6	-0.3	-0.3
Exports	-4.5	2.2	1.8	-10.1	0.5	-2.1	6.4	1.2	1.4
Imports	12.0	-1.6	0.1	5.9	-17.7	5.0	-36.2	1.5	-2.1
				Percentages of GDP [b]					
Gross domestic investment	15.7	15.1	14.6	10.1	9.6	9.7	17.4	16.7	16.2
National savings	11.6	13.8	13.0	6.4	0.0	10.6	13.7	9.6	8.0
External savings	4.2	1.3	1.6	3.7	9.6	-0.9	3.7	7.1	8.2
				Percentages					
Employment and wages									
Real minimum wage (index: 1990=100)	120.3	100.0	86.4	76.0	61.5	44.4	83.8	70.2	60.5
				Growth rates					
Prices (December-December)									
Consumer prices	10.9	26.1	6.6	16.1	44.4	32.2	24.8	14.6	15.6
External sector									
Terms of trade (index: 1990=100)[b]	98.5	100.0	84.1	73.3	74.2	76.4	78.9	73.6	79.7
Nominal bank exchange rate (gourdes per dollar)	6.30	7.40	7.70	9.10	12.80	13.00	15.30	15.75	16.68
Real effective exchange rate for imports (index: 1990=100)	97.0	100.0	94.2	96.1	114.4	91.8	81.0	68.9	59.2
				Millions of dollars					
Balance of payments									
Current account	-63	-22	-30	-42	-78		-38	-74	-86
Trade balance (goods and services)	-211	-197	-234	-184	-236	-150	-560	-525	-513
Exports	237	318	341	148	154	131	241	257	289
Imports	448	515	575	332	390	281	802	782	801
Capital and financial account	49	-13	58	14	36	-38	226	24	104
Overall balance	-13	-35	29	-28	-41	-33	188	-49	18
Variation in reserve assets (- indicates an increase)	4	39	-12	-4	1	-8	-176	49	-34
				Percentages					
External debt									
Gross debt (as a percentage of GDP)	35.4	32.2	34.4	57.0	55.8	42.5	38.5	33.2	33.0
Net interest (as a percentage of exports) '	9.5	7.9	7.7	5.5	8.4	6.5	11.1	4.0	4.2

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
			Percentages of GDP						
Central government									
Current revenue	9.7	**9.2**	**8.4**	7.0	5.9	2.6	6.4	7.4	9.2
Current expenditure	10.6	10.5	**8.7**	10.8	8.6	5.7	10.9	9.1	9.8
Saving	-0.9	**-1.3**	**-0.4**	-3.7	-2.7	-3.1	-4.5	-1.8	-0.6
Capital expenditure	4.4	**0.3**	**0.2**	0.6	0.6	0.2	0.8	0.3	1.4
Financial balance	-5.3	**-1.0**	**-0.3**	-4.4	-3.3	-3.3	-4.8	-1.6	-2.0
			Growth rates						
Money and credit									
Monetary balances of banking system									
Net domestic credit	17.3	**7.0**	**-7.7**	26.4	26.3	27.9	-2.1	13.2	17.6
To central government	12.2	**9.4**	**14.1**	16.1	7.7	30.9	-4.6	21.7	-3.4
To private sector	30.6	**3.5**	-18.3	4.6	40.0	8.7	59.2	17.0	42.7
Money (Ml)	10.5	**1.2**	**5.1**	24.8	26.7	21.1	25.9	0.6	11.8
Local currency savings and time deposits	18.3	13.8	**7.2**	28.6	35.1	25.8	8.5	1.9	16.3
M2	14.2	**7.4**	**6.2**	26.8	31.3	23.8	15.9	1.3	14.2
			Annual rates						
Real interest rates (annualized, %)									
Deposit rate	-7.9	-5.5	-19.1	-22.0	-18.7	-3.2	-9.1		
Lending rate	1.1	-4.1	-17.8	-13.6	-9.5	1.9	2.1		
Equivalent interest rate in foreign currency [8]		-8.4	3.1	-11.6	-25.7	-11.7	7.0		

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Includes Errors and omissions. [e] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. Figures to September of each year. [8] Interest rate on deposits, deflated by the variation in the exchange rate over the fiscal year.

Contrary to plans, the government payroll grew by 4.5% and the wage bill by just over 14%, although this was, in any event, below the rate of domestic inflation.

Extrabudgetary expenditures, which accounted for almost one fifth of total spending and included the country's heavy debt-service burden (395 million gourdes), rose more steeply. In fiscal years 1996 and 1997, public investment amounted to just barely over 0.8% of GDP, which was only one third as much as during the 1980s (when it had averaged 2.3% of GDP).

(b)Monetary and foreign exchange policy

The principal factors in the expansion of liquidity were the increases in international reserves and in credit to the private sector, both of which were influenced by decisions taken by the BRH.

The legal reserve requirement for commercial banks was reduced in stages from 48% in October 1996 to 26% by mid-1997; at the same time, the process of standardizing the required cash ratio for different types of deposits, which had been initiated a year earlier, proceeded. As a means of countering the expansionary effect on the money supply of this reduction in the reserve requirement, the Government issued what came to be known as "BRH bonds", which were intended for bank portfolios and provided higher returns than time deposits. Nevertheless, the banking system significantly expanded its private-sector lending. Almost 27% of this credit went to private individuals, while the agricultural sector received barely 1%; the remainder was distributed mainly among wholesale and retail commercial enterprises (almost 40%) and manufacturing companies (close to 25%).

In a bid to reduce the pressure being put on the exchange rate by increased liquidity and stronger demand for dollars, monetary authorities also sold off foreign exchange, which led to a growing dollarization of the economy. In the first quarter of 1997, they auctioned off US$ 39 million (the equivalent of 652 million gourdes) and, late in the second quarter, instituted a standard 12% reserve requirement on dollar deposits.

As a result of these measures, the money supply (Ml) swelled by 12%, boosted by a 43% increase in private credit and a 19% expansion in international reserves. On the other hand, in line with the Government's policy of reducing its debt with the BRH, credit to the public sector contracted by more than 5%. Owing to the increase in time deposits, local-currency liquidity (M2) expanded by 14% and the broad money aggregate (M3) by 18%, reflecting a strong upswing (34%) in dollar deposits, which came to account for more than one fifth of M3. The exchange rate underwent numerous fluctuations, but ultimately averaged out at 16.7 gourdes to the dollar, which represented a 14% appreciation in real terms.

(c) Trade policy

In 1997, the authorities were unable to make any progress in the implementation of trade liberalization measures, and the proposed rationalization of import duties, which was to entail a reduction of the schedule to just three tariff rates (0%, 5% and 10%), remained pending. On the other hand, Haiti's membership in the Caribbean common market (under the aegis of CARICOM) could lead to a revision of its 10% maximum tariff rate for agricultural goods, since the other countries apply a tariff ceiling of 20%.

(d) Public external debt

Financial stringency in the disbursement of funds, which amounted to only 68% of the annual average for the preceding biennium, and arrears in service debt payments were major factors affecting Haiti's external debt position in 1997. At the end of the fiscal year, the external debt stood at US$ 1.025 billion (US$ 110 million more than in September of the preceding year).

Most of the funds received during the year were provided by the International Monetary Fund (IMF) in the form of balance-of-payments support, although the US$ 21.3 million earmarked for that purpose corresponded to less than 17% of the total amount agreed upon under the enhanced structural adjustment facility (ESAF) for the three-year period 1997-1999.

The transfer of responsibility for external debt servicing from the Treasury, via the central bank, to the entities that had actually incurred those external obligations resulted in delays in loan payments. On the other hand, Haiti benefited from Argentina's decision to forgive US$ 15.6 million (85% of the total) of the debt owed to it by Haiti and to reschedule the remaining balance of US$2.8 million.

(e) Structural reform

The Management and Fiscal Control Unit was created to support the inter-ministerial administrative reform effort. A council on modernization of State enterprises was also set up to oversee the privatization of such enterprises. The General Tax Bureau was equipped with a computer and information system to help it cut down on tax evasion, and foot patrols were established to control smuggling. In addition, land was handed over to peasant farmers in February and November 1997 as part of a reform programme designed to change the country's agricultural profile.

3. Them variables

(a) Level of activity

Economic activity increased by a scant 1.3% of GDP but, since imports climbed by almost 3%, aggregate supply expanded by 1.9%. On the demand side, the main source of momentum was exports, which were up by almost 8%. Although the increase in trade may be regarded as insufficient when viewed in the context of the ongoing deterioration of the external sector that occurred up until the time the economic embargo was lifted, it nonetheless marked a turning point in the downswing observed the previous year.

On the other hand, domestic demand cooled off (1.2%) as a result of the decline in gross investment and the slow rate of increase in consumption relative to the rate of population growth. Delays in the passage of the budget and cutbacks in disbursements by external donors re-introduced a climate of uncertainty which daunted investors (-1.5%). Stability of the nominal exchange rate and a more abundant credit supply, bolstered by the availability of dollars, shored up private consumption, which actually strengthened somewhat.

In terms of the various sectors of the economy, the largest contribution to overall GDP growth came from the production of goods (1%) and, within that sector, particularly the construction industry (11.5%), which brought mining along with it. Since 1994, construction has nearly doubled its share in the overall value added by the economy. In 1997, building activity was concentrated in the private residential and commercial sectors, since the Government confined its activities to the continuation of a number of projects that were already in the pipeline.

Agricultural production again suffered a setback (-2.5%), even though farming continues to be the economy's most important sector and is being treated as a priority area by the Government. A drought in the north-western region of the country severely damaged export crops and some traditional subsistence crops, but production figures were up for rice, a staple in the Haitian diet.

Manufacturing, which had begun to recover from the damage done by the trade embargo, stalled once again (0.8%), with an uneven pattern of development being observed among the various industries in the sector. Food processing, which accounts for over one third of the sector's total output, was flat (0.1%). The harvesting and processing of some agricultural products, such as sugar and flour, have been almost entirely discontinued and these goods now have to be imported, reflecting an increasingly marked trend in relation to staple foods. Sectors that performed well included non-metallic minerals and smelting (with growth rates of 15% and 6.7%, respectively), in both cases as a direct result of the buoyancy of the construction industry, and beverages (5.4%).

The reopening of 12 firms and the establishment of 11 others confirmed the turnaround in the *maquila* industry, which apparently helped to boost the growth of the garment sector (2.7%).

The services sector was sluggish. Among basic services, the drought experienced in the middle of the year led to water shortages and, hence, supply problems. Electrical power generation continued to expand, however, despite the fact that illegal connections and unmetered consumption (54% of electricity generation) represent a severe drain on the system. Almost two thirds of the overall increase in electricity use may be attributed to higher consumption by the commercial and industrial sectors. Other basic services, transport and communications posted slower growth rates.

Growth was weak in commerce and the hotel industry (0.6%). Tourism grew by 1.9%, but the number of visitors, which had slumped to one third of its former level during the embargo, was less than 65% of the average recorded for the 1980s, despite an increase in the frequency of visits by nationals living abroad.

The financial sector was one of the fastest growing areas of the economy (a growth rate of 4.3%) as a result of the expansion of existing institutions made possible by mergers between local and foreign-owned enterprises. Home ownership also generated a higher level of value added (1.8%) in response to intense demand pressure in the country's capital city. Community services remained stagnant owing to budgetary constraints.

(b) Prices, wages and employment

Consumer prices rose by an average of 16.2% in 1997, down from 20.6% in 1996, and a gradual decline in inflation was observed towards the end of the period, thanks in part to the stability of the nominal exchange rate. The improvement would have been even more marked had it not been for the difficulties encountered in the production of foodstuffs, which are the largest component of the general index. The cost of housing exerted a similar influence, owing to the housing shortage existing in Haiti's overcrowded capital, where almost a quarter of the country's entire population lives. Nevertheless, the increase in this variable slowed in the final quarter following a drop in the price of charcoal, an important household fuel.

A 140% adjustment in 1995 notwithstanding, the minimum daily wage continued to lose purchasing power, since no adjustments were made in nominal terms. As a result, this wage was 40% lower in real terms than it had been in 1990; in fact, it reached its lowest level for the entire decade, with the sole exception of 1994, the last year of the trade embargo. Currently, the daily wage paid in *maquila* industries is estimated at less than half the minimum wage, although workers also benefit from a supplementary allowance that covers their social security contributions.

On the emp] oyment scene in 1997, in addition to the new jobs created in construction and financial services, the upturn in the *maquila* industry had a considerable impact. Employment in this sector climbed to approximately 23,000, a significant improvement however remote from the figure of 40,000 recorded during the previous upswing. New hirings in banking, insurance and real estate establishments continued, although at a slower pace than the year before, while 2,180 new civil servants (4.5%) were hired. The suspension of the early retirement programme, did, nevertheless, ease pressure on the job market.

(c)The external sector

The balance of payments showed a net accumulation of US$ 18 million in reserves. This was partly attributable to the narrowing of the merchandise trade deficit, which in turn led to some improvement in the overall trade balance (-US$ 513 million). The current account deficit was slightly higher than in 1996 and, at approximately -US$ 86 million, was the highest to be recorded thus far in the decade; the financial account registered a decrease in net capital inflows.

The value of imports rose by almost 3%. The greater supply of consumer credit and business loans was reflected in a 44% increase in total imports of manufactures, but the other categories of imports contracted. Imports of food products and edible oils, which constitute the largest category (38% of the total), fell by almost 8% due to a sharp decrease in imports of flour and of some types of rice, since local production of this item was higher.

Merchandise exports posted a spectacular increase of slightly over 30% in terms of value, chiefly thanks to the recovery of the *maquila* industry and to brisk sales of handicrafts. Taken together, these two activities accounted for over half of the increase in the value of total exports. Among agricultural products, coffee and mangos performed well on the export market; in the case of coffee, this was because of the rise in international prices (45%) and in that of mangos, it was due to producers' success in meeting strong demand from the United States market during the picking season.

In 1997, the purchasing power of exports improved significantly (33% over 1996), largely as a result of increased shipments. Nevertheless, the balance for travel and transport services appears to have deteriorated, and this, together with higher interest charges, caused the current account deficit to widen. Another equally important factor in this regard was the US$ 22 million decrease in external transfers. On the one hand, official grants and donations, which amounted to US$ 185 million in 1997, were down by US$ 126 million from the previous year; on the other, private remittances from the United States and Canada climbed by US$ 104 million (a 68% improvement compared with 1996).

The financial account registered a notable increase in the banking sector's commitments to external lenders (almost US$ 16 million) for letters of credit drawn upon by importers, but this fell far short of what would have been needed to offset the decline in the net resources received by the public sector and the rest of the private sector. Although direct investment (US$ 5 million) was still less than half its peak level, it nonetheless provided an indication of the gradual recovery being made by the *maquila* sector, as well as reflecting the arrival in the country of a number of gasoline distributorships which are subsidiaries of Elf, the leading French petroleum company.

HONDURAS

1. General trends

In 1997 the Honduran economy developed in an increasingly stable environment, thanks to a conjunction of domestic and external factors which reversed its unfavourable performance of the previous year. Gross domestic product (GDP) increased by 4.5%, inflation slowed significantly, and progress was made in fiscal consolidation. The current account deficit was reduced by almost than half, while capital inflows continued to increase, contributing to an accumulation of almost US$ 300 million in international reserves. In the labour market, although there were high levels of underemployment, real wages made a strong recovery.

Inflation and interest rates dropped, thanks to a smaller public-sector deficit and exchange-rate stability during the second half of the year. Favourable external factors included improved terms of trade due to lower international oil prices and increased export prices for coffee, meat, shrimp, tobacco and zinc.

Higher consumption and increased private investment contributed considerably to growth in production, and, unlike the previous year, agricultural supply was sufficient to avoid the need for imports. Mining continued to expand on the strength of export products; manufacturing maintained strong growth, as did the *maquila* industry, which generated value added of more than US$ 300 million. The building of hotels led the expansion of private construction, while public construction declined for the fourth consecutive year.

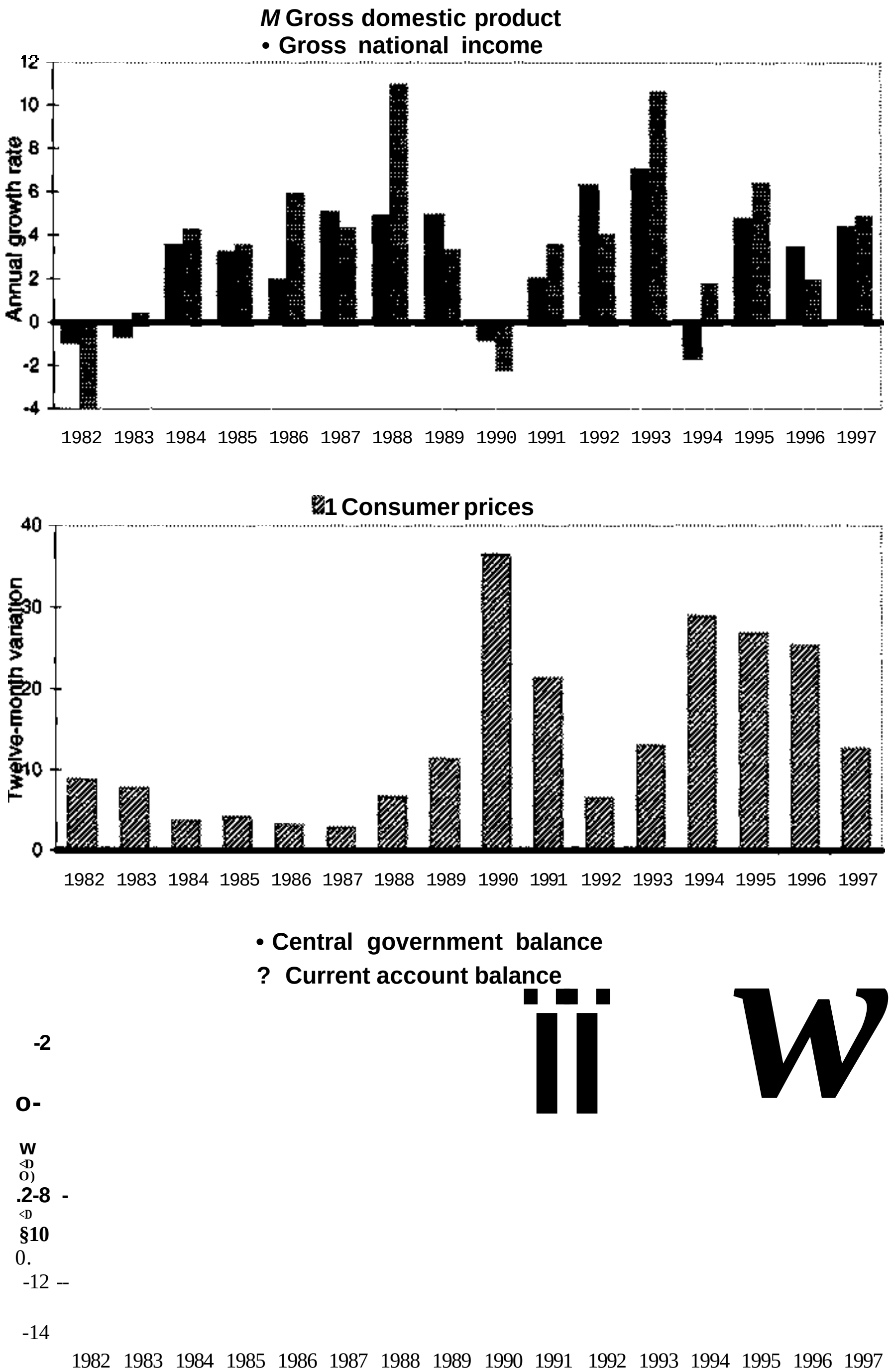
Overall, macroeconomic indicators showed improvement, although there was little growth in per capita output because the rate of population increase remained high and economic growth was not sufficient to cause an appreciable improvement in the overall standard of living. The sharp contraction in public investment in recent years is also significant, owing to its effects on economic and social development.

The outlook for 1998 includes economic growth of about 4%, inflation close to 1997 levels, falling real interest rates and a marginal increase in international reserves; the real exchange rate is expected to be unchanged. It is anticipated that the budgetary commitments for 1998 inherited by the current Government will make it difficult to maintain the trend towards fiscal balance. The probable reduction in the income tax rate, major wage increases in certain occupations, the lowering of tariffs and the strengthening of national security structures could constitute obstacles to fiscal consolidation.

2. Economic policy and reforms

The Government's economic policy was designed to consolidate stabilization through tight, disciplined management of public finances and monetary aggregates. At the same time,

Figure 1
HONDURAS: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

progress was made in lowering tariffs and applying market-oriented measures. Economic policy goals were incorporated into a monitoring programme agreed with the International Monetary Fund (IMF); its fulfilment in respect of variables such as GDP, inflation, fiscal deficit, exchange rate and international reserves was very satisfactory, although domestic credit increased considerably owing to foreign capital inflows.

In 1998, the new Government is expected to maintain the overall thrust of economic policy, with emphasis on controlling public spending, strengthening revenue, and deepening structural reforms.

(a)Fiscal policy and public finance

Fiscal policy was characterized by efforts to increase revenue and to improve discipline in spending, despite wage demands from certain occupational groups and the threat to fiscal austerity from the November elections. The central government deficit fell from 3.8% in 1996 to 2.5% in 1997.

Overall central government revenue increased by 5.1% in real terms, whereas overall spending rose by only 1%. The increase in revenue was influenced by higher non-tax revenue; there was only a modest rise in tax revenue. A new tax code came into effect, designed to improve tax collection; for the first time, severe penalties were imposed on offenders and smuggling and tax evasion were defined as criminal offences.

As for spending, investment in real terms remained limited, except for certain areas such as road building and repair, irrigation works, and hospital improvements. Under current expenditure, which increased moderately (2.3%), the greatest increases were in wages and salaries and the payment of interest on debt, which together made up 68% of current expenditure. The central government deficit was financed mostly with external resources from structural adjustment loans, investment certificates issued by the Central American Bank for Economic Integration (CABEI) and other borrowing.

It is anticipated that some problems may arise in 1998 which would make it difficult to keep the public-sector deficit within reasonable limits, in the light of commitments to raise minimum wages and wages for various occupations as of 1 January 1998. The rate of corporate income tax will probably fall. During the first few months of 1998, pending the adoption of the new budget by Congress, public expenditure was contained. It is quite possible that there will be cuts in current expenditure and investment, and tariffs will continue to be reduced, including the elimination of export taxes on marine products and sugar.

(b)Monetary policy

The Central Bank resorted to open-market operations to ensure that the excess liquidity caused by the considerable capital inflows would not cause excessive growth in credit (although it did not succeed in that objective), or exert inflationary pressure. Open-market operations were also intended to replace reserve requirements as the main tool for managing monetary aggregates. Thus, Central Bank and central government securities were issued by public auction. These debt instruments were well received by the public thanks to their attractive yields (an average annual rate of over 35%) in the first half of the year, although in the third and fourth quarters there was a downward trend, and they ended the year at 22%.

Lending by the banking system to the private sector rose by 35% in real terms. Most of that lending was for investment, and foreign-currency financing continued its rapid growth (56%), representing 29% of the overall amount of domestic credit. The dollarization of deposits also continued to rise owing to high yields. In contrast, lending to the non-financial public sector by the financial system diminished because of decreased demand from central government. Intermediation margins remained high (up to 30%); however, owing to increasing competition, the average margin fell to 14% in mid-year.

A single reserve requirement rate of 12% (for deposits in both national and foreign currency) was established for commercial banks, savings and loan associations and finance companies. For deposits in national currency, additional percentages of mandatory investments in

Table 1

HONDURAS: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
					Growth rates				
Growth and investment									
Gross domestic product	4.9	**-0.8**	2.0	6.3	7.0	-1.7	4.7	3.4	4.4
Per capita gross domestic product	1.8	**-3.7**	-1.0	3.2	3.9	-4.5	1.8	0.5	1.5
Gross national income	3.4	**-2.2**	3.6	4.1	10.7	1.8	6.5	2.0	4.9
Gross domestic product, by sector									
Goods	8.4	**-0.8**	3.5	8.0	4.8	-2.8	6.5	2.6	3.1
Basic services	5.9	**6.8**	2.2	3.1	4.8	-3.2	8.7	8.1	4.9
Other services	1.5	**-2.3**	0.4	5.3	9.9	-0.1	2.2	3.3	5.5
					Percentages				
Contribution to growth of GDP [c]									
Consumption	4.7	**-2.6**	**0.5**	3.2	1.7	-1.0	6.8	0.5	1.9
Government	0.4	**-2.0**	**-1.3**	1.5	-1.1	-0.5	-0.2	0.4	1.4
Private	4.3	**-0.6**	1.8	1.8	2.8	-0.4	6.9	0.1	0.4
Gross domestic investment	-0.9	**0.7**	**4.1**	3.3	8.2	2.5	-4.0	1.5	1.5
Exports	1.5	**0.2**	**-0.6**	2.4	-0.3	-2.8	3.4	2.2	0.3
Imports	-0.4	1.0	**-2.0**	-2.6	-2.5	-0.4	-1.5	-0.9	0.7
					Percentages of GDP [b]				
Gross domestic investment	22.1	23.0	26.6	28.1	33.9	37.0	31.5	32.0	32.1
National savings	16.9	17.4	20.0	19.6	26.4	29.6	28.2	28.8	30.7
External savings	5.2	5.6	6.6	8.5	7.6	7.4	3.3	3.2	1.4
					Percentages				
Employment and wages									
Open unemployment rate	4.4	4.6	4.5	3.8	3.8	2.8	3.7	4.5	4.0
Real minimum wage (index: 1990=100)	85.4	100.0	96.6	108.7	110.2	94.8	89.6	86.0	91.4
					Growth rates				
Prices (December-December)									
Consumer prices	11.4	36.4	21.4	6.5	13.0	28.9	26.8	25.3	12.7
Wholesale prices	20.4	41.3	20.4	9.6	14.0	35.1	21.1	23.0	14.7
External sector									
Terms of trade (index: 1990=100) [b]	101.0	100.0	105.2	95.6	105.6	122.0	128.2	111.8	123.4
Nominal exchange rate (lempiras per dollar)	2.00	4.04	5.60	5.51	6.50	8.60	9.54	11.71	13.00
Real effective exchange rate for imports (index: 1990=100)	58.3	100.0	109.5	103.6	116.0	128.8	111.6	113.4	107.4
					Millions of dollars				
Balance of payments									
Current account	-180	-186	-213	-298	-327	-349	-177	-190	-101
Trade balance (goods and services)	-125	-94	-124	-192	-320	-345	-179	-207	-177
Exports	1061	1033	1016	1041	1211	1370	1734	1911	2 190
Imports	1 186	1 127	1 139	1 233	1531	1715	1 913	2118	2 367
Capital and financial account [e]	-188	-124	54	51	135	342	219	294	311
Overall balance	-368	-311	-160	-247	-192	-8	42	104	210
Variation in reserve assets (- indicates an increase)	29	-20	-67	-92	106	-17	-136	-174	-294
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	97.6	127.9	113.9	106.0	110.3	117.9	107.1	100.9	86.7
Net interest (as a percentage of exports)	16.6	17.2	20.2	25.0	14.5	14.0	11.5	9.9	7.2

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
				Percentages of GDP					
Central government									
Current revenue	14.7	16.4	17.4	17.4	16.9	16.0	18.2	16.6	16.8
Current expenditure	17.9	17.2	16.5	16.6	18.4	16.5	15.5	16.0	15.6
Saving	-3.1	-0.8	1.0	0.8	**-1.5**	**-0.6**	**2.6**	**0.6**	**1.2**
Capital expenditure (net)	4.2	5.6	**4.3**	**5.7**	8.8	**7.2**	**7.7**	5.1	**4.3**
Financial balance	-7.4	-6.4	**-3.3**	**-4.9**	**-9.9**	**-7.0**	**-4.2**	**-3.8**	**-2.5**
Domestic financing	4.1	-1.2	**-3.3**	**-2.9**	**0.9**	**2.2**	**-0.3**	**0.6**	**-0.2**
External financing	3.2	7.5	6.6	**7.8**	**9.0**	**4.8**	**4.5**	**3.2**	**2.8**
				Growth rates					
Money and credit									
Monetary balances of banking system									
Net international reserves				109.8	-62.9	79.1	252.4	133.8	82.3
Domestic credit	12.5	39.7	2.6	18.1	25.8	28.6	7.3	17.3	28.1
To public sector	19.7	-61.0	-12.0	-26.6	16.3	14.5			
To private sector	8.6	12.5	10.3	24.8	14.9	24.7	21.1	34.6	47.5
Money (Ml)	20.3	25.2	16.8	14.3	13.0	37.0	18.3	27.3	33.8
Local currency savings and time deposits	11.2	58.0	8.1	28.6	6.1	17.1	16.5	18.4	62.6
M2	15.2	43.1	11.6	22.6	8.8	25.1	17.3	22.3	49.2
				Annual rates					
Real interest rates									
Deposit rate	**-2.6**	-20.0	-7.6	5.5	-1.1	-13.2	-11.4	-7.0	
Lending rate	3.5	-13.9	1.1	14.3	8.1	-3.1	0.4	3.5	
Equivalent interest rate in foreign currency [e]	8.6	-50.1	8.6	4.9	-9.6	-12.8	**2.7**	6.1	

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Open unemployment rate in Tegucigalpa. [e] Includes Errors and omissions. Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [g] Interest rate deflated by the variation in the average bank exchange rate (selling rate) for banknotes.

Table 2
HONDURAS: MAIN QUARTERLY INDICATORS

	1995				1996				1997[a]				1998[a]	
	1	II	III	IV	1	II	111	IV	I	II	III	IV	I	II
Consumer prices (12-month variation, %)	33.8	29.3	28.3	26.8	21.5	23.2	25.7	25.5	26.0	21.7	17.1	12.7	12.3	14.2
Real effective exchange rate (index: 1990=100)	114.0	112.0	110.8	109.6	112.0	112.5	115.3	113.8	109.9	108.7	105.9	105.0	102.3	98.7
Real interest rates (annualized, *%)*														
Depositrate	-22.3	-9.6	-7.3	-6.5	-3.4	-11.2	-11.6	-1.7	-1.8	9.3	8.5	16.2	-2.3	
Lending rate	-12.1	2.4	5.5	-6.0	6.5	-0.3	-0.3	8.2	6.1	17.7	18.5	28.6	8.0	

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Refers to exchange rate for imports.

government securities were fixed: 19% for commercial banks, 9% for savings and loan associations and 3% for finance companies. An additional obligation was created for foreign currency deposits: 38% must be kept in investments at foreign banks of recognized financial soundness. Although the reserve requirement is still considered high, it should be borne in mind that the danger of excess liquidity due to the major inflows of foreign capital would have been even greater if the reserve requirement had been reduced.

Exchange-rate stability, particularly in the second half of the year, and the downward trend in inflation, brought about an increase in real interest rates, although these began to decrease in the last six months, when the excess liquidity in the economy prompted a downward adjustment of nominal yields. The leading interest rate for government bonds reached 38% in mid-year, but from July onwards it decreased (in line with falling inflation) to around 20%.

(c) **Foreign exchange and trade policy**

The goal of foreign exchange policy was to maintain a neutral real exchange rate, and the means continued to be the system of public foreign-exchange auctions was continued. This system entails weekly auctions with a reference price relative to which the exchange rate is determined within a band not exceeding 5% of the reference price. Since April 1997, the reference price has been adjusted every five weeks in line with the expected differential between domestic inflation and the rate of inflation in the country's main trading partners.

Thanks to capital inflows, the foreign exchange market was stable in the second half of the year. The average price of the dollar rose by 11% in 1997 (the December-to-December slippage was 2.2%), resulting in a real appreciation of the lempira of 7.6%. The currency also appreciated in real terms during the first few months of 1998. However, a nominal devaluation of 12% is expected in 1998, equivalent to the anticipated rate of inflation.

The tariff reduction programme begun in 1996 continued, in accordance with the relevant Central American plan, but dates for the reduction of tariff rates on certain products were also brought forward, a decision consistent with the objective of generating conditions of competitiveness similar to those in the rest of the subregion. Thus, the rates for capital, intermediate and final goods were reduced, and additional reductions were provided for in the medium term. Import quotas, permits and licences and other quantitative restrictions were also abolished.

(d)External debt policy

The overall amount of the country's external debt was slightly less than in 1996, standing at US$ 4,095 million, equivalent to 87% of GDP. Progress was made in the restructuring of the external public debt (80% of the total), relieving pressure generated by its servicing (32% of the value of exports); the country obtained bilateral debt cancellations totalling US$ 90 million with the Paris Club and US$ 75 million with the Government of France.

Positive macroeconomic performance made possible disbursements totalling US$ 247 million in 1997, of which 31% was in the formal structural adjustment loans to support the balance of payments, 20% was for investment in roads and airports, and 19% for social development projects. The main sources of financing were multilateral financial institutions. With the Central American Bank for Economic Integration (CABEI), debts totalling more than US$ 400 million were restructured, enabling Honduras to reduce its debt servicing by as much as 50% in the next few years (the saving under this heading amounted to US$ 6.5 million for 1997).

New borrowing declined from US$ 375 million in 1996 to only US$ 123 million in 1997, owing to the provision adopted in 1996 requiring that loan should be taken out only on concessional terms, except for high-priority projects. The loans went to agriculture (US$ 83 million), the financial sector (US$ 14 million), health (US$ 7.5 million) and energy (US$ 2.7 million). The financial conditions of the loans were somewhat less favourable than in the previous year: on average, the loan maturity was

29 years, the grace period 8.8 years and the interest rate 1.8%.

(e) **Structural reform**

The reforms introduced in the law on the Central Bank of Honduras came into effect, giving the institution greater autonomy in the management of monetary policy; important aspects include the Bank's responsibility for maintaining the value of the currency, its function as lender of last resort, limitations on its involvement in determining interest and exchange rates, and the elimination of automatic financing of the public deficit by the bank of issue.

Although studies and laws relating to the process of divestiture, concession or privatization of public enterprises and utilities were complete or at an advanced stage, no great progress was seen in economic reforms, partly owing to the fact that the outgoing Government had left the new Administration to decide the direction that the process should follow.

Divestiture of the Honduran telecommunications company (HONDUTEL) and the national electric power company (ENEE) is expected to be completed in 1998. As for the four airports, currently leased to private companies, the draft laws concerning civil aviation and concessions are still awaiting debate and adoption.

3. The main variables

(a)Economic activity

Domestic demand was the main factor in economic growth. Consumption increased by 3% and investment by 8%; the latter was mostly due to a 18% increase in private investment, increasingly concentrated in tourism, tobacco, mining, construction, the *maquila* industry and certain manufacturing sectors. By contrast, public investment fell by 11%.

The agricultural sector grew at a slightly faster rate than the population; the production of basic grains reached record levels and helped to consolidate both sufficient supply and an overall fall in prices. The lack of rain associated with the El Niño phenomenon did not greatly affect activity in the sector; in fact, the absence of tropical storms in the Caribbean, attributed to El Niño, produced favourable conditions for agriculture in the Olancho valley and on the northern coast, although in early 1998 some negative effects were observed for shrimp farming and other products.

Mining, sustained by silver, lead and zinc -all export products- continued to show great vitality. A new mining code is expected to be adopted soon, to modernize the regulatory framework with respect to prospecting, concession, exploitation, and the fiscal regime for mining, and to make the sector more attractive for foreign direct investment.

The manufacturing sector grew by more than 6%, thanks to the performance of the chemical industry (12%), paper (9%), textiles and apparel (8%) and non-metallic minerals (8%). The *maquila* industry remained very vigorous, and considerable investments are expected in future, particularly by domestic investors and in the garment sector; the incorporation of new areas into the free trade zone regime will encourage growth in the *maquila* industry.

Construction continued to decline as a result of the contraction in public works and also, in the private sector, because of high real interest rates. However, there was much activity in the construction of tourist infrastructure, encouraged by foreign investments mostly from El Salvador and Guatemala. Twenty-two hotels are currently under construction, involving a total investment of about two billion lempiras. When the hotels are finished, the availability of rooms will increase to 12,500, 16% more than in 1996.

Low rainfall is also affecting hydroelectric power generation and the drinking water supply. More than half of the country's electricity comes from hydroelectric plants, and the water in their reservoirs is at very low levels.

(b)Prices, wages and employment

The rate of price increases slowed significantly in 1997, thanks to the neutralization of the inflationary factors which had been active in 1996. Fiscal prudence, the relative stability of the nominal exchange rate, falling fuel prices and sufficient supply of basic foodstuffs contributed decisively to holding back the inflationary trend in prices. The inflation rate was 12.7%, half the 1996 level.

Average growth in minimum wages in 1997 was 15% for the public sector and 33% overall. Real wages therefore rose for the first time since 1993. Congress passed amendments to the Minimum Wage Act that provided for periodic automatic adjustments: every six months if the inflation rate in June exceeds 12%, and yearly if it is lower. In addition, a Teachers' Code was adopted, providing for salary increases over the coming four years; and doctors succeeded in obtaining indexation of their salaries. With falling inflation, this wage policy seems likely to involve a considerable fiscal effort; there is also a danger that other occupational groups may try to obtain similar treatment in future.

The employment situation improved in 1997. The open unemployment rate is estimated to have fallen, but underemployment remained high. The *maquila* industry continued to be the biggest generator of new jobs, employing a total of 90,000 persons.

Inflation tended to remain stable in early 1998. The peak in February (2.8%) was due to seasonal factors, such as higher enrolment fees at the beginning of the school year, increases in teachers' salaries, and a sudden upsurge in the domestic price of coffee (80%). On the other hand, there was a fall in international oil prices, beginning in late 1997, and especially in early 1998. Inflation for the year as a whole is estimated at about 12%.

In January 1998, an increase in minimum wages averaging 17.1% was announced. The biggest increase was for those employed by firms in the financial sector (20.6%), and the lowest was in microenterprises in the service sector. Wage claims are expected later in the year, since improved wages for certain favoured groups have widened differentials in relation to other categories of workers.

(c)The externa] sector

The external sector was under less pressure than in 1996. The overall balance-of-payments surplus for 1977 stood at US$ 210 million (compared with US$ 103 million in 1996), resulting from a US$ 101 million current account deficit, a US$ 262 million surplus on the capital account, and errors and omissions totalling US$ 49 million.

The current account deficit fell by a little under half, owing to the narrowing of the trade gap, the significant rise in the value added of the *maquila* industry (US$ 300 million), the increase in the amount of transfers, and the reduction in the amount of interest paid on foreign debt.

The capital account reflected the surge in foreign direct investment (US$ 114 million, 26% higher than in 1996), mostly in tourism; a significant proportion of the investment was from Central American countries. Other recipient industries were sugar cane, African oil palm, other foods and beverages, banking, and paperboard. Short-term capital inflows (28% of total foreign investment inflows) were due to exchange-rate stability and attractive yields on the money market. Consequently, international reserves rose by almost US$ 300 million, contributing to a record increase of more than US$ 600 million over the past three years.

Exports of goods (not including the *maquila* industry) increased by 9.2% to more than US$ 1.4 billion. This result was influenced by improved export prices for coffee, tobacco, meat, shrimps and zinc. Notable among traditional exports was coffee (the biggest export product, representing 23% of the total), with an increase of 17%, which was entirely due to the 40% rise in price, since the volume exported fell by 16%. The volume of banana exports decreased but, unlike coffee, their price also fell, resulting in a 26% drop in the value of exports; even so, banana exports remained second in importance after coffee (14% of the total). Exports of mining products were very buoyant, but barely made up 4.5% of the total. Wood exports fell by half, and meat exports were stagnant. Sugar prices remained static, but larger export volumes (due to the increased quota allowed by the United States) produced a considerable increase in export value.

Non-traditional exports (56% of the total) increased by 18%. They are more diversified than traditional exports; with the exception of shrimps, which represent 20%, the market shares of the remaining products -lobster, pineapple, melon, and soap and detergent- are more evenly divided.

Imports of goods increased by 12%, bringing their value up to US$ 2 billion. The lower cost of petroleum and paper imports was compensated for by increased foreign purchases of capital goods, chemicals and products for the food industry. Imports of fuel and lubricants decreased in value owing to lower petroleum prices, the replacement of fuel oil (bunker fuel) by coal in cement plants, and lower demand from the national electric power company (ENEE).

Constraints on the external sector are anticipated for 1998, because disbursements of international loans are expected to be modest. If macroeconomic performance remains good, it is hoped that the terms of a new agreement with IMF may be agreed upon in 1998; among other objectives, this would facilitate future renegotiations and debt cancellations, helping to reduce the country's external debt.

MEXICO

1. General trends

The Mexican economy has continued to experience strong growth, with GDP advancing by 7.3%. An upswing in domestic demand and robust exports pushed down unemployment to a rate nearly as low as the level recorded before the 1994 crisis. On the other hand, real wages remained depressed.

The macroeconomic climate of stability and growth was reflected in declining inflation and nominal interest rates together with abundant inflows of foreign direct investment (FDI). These inflows contributed to a real appreciation of the peso and prompted the authorities to make adjustments in the way they were managing monetary policy in order to curb short-term capital inflows and thus avoid an excessive rise in the local currency. Capital inflows boosted international reserves, but the monetary impact of this increase was sterilized through the placement of government securities.

With tax revenues strengthening and with investment and social expenditure picking up, government finances posted a small deficit. The huge sums set aside to bail out faltering banking institutions drove up the cost of assistance programmes for the banking system and its debtors to 14.5% of GDP. The application of these measures helped to stabilize the ratio of non-performing bank loans and facilitated the capitalization of the banking system, but it was nonetheless unable to fully resume its intermediation functions.

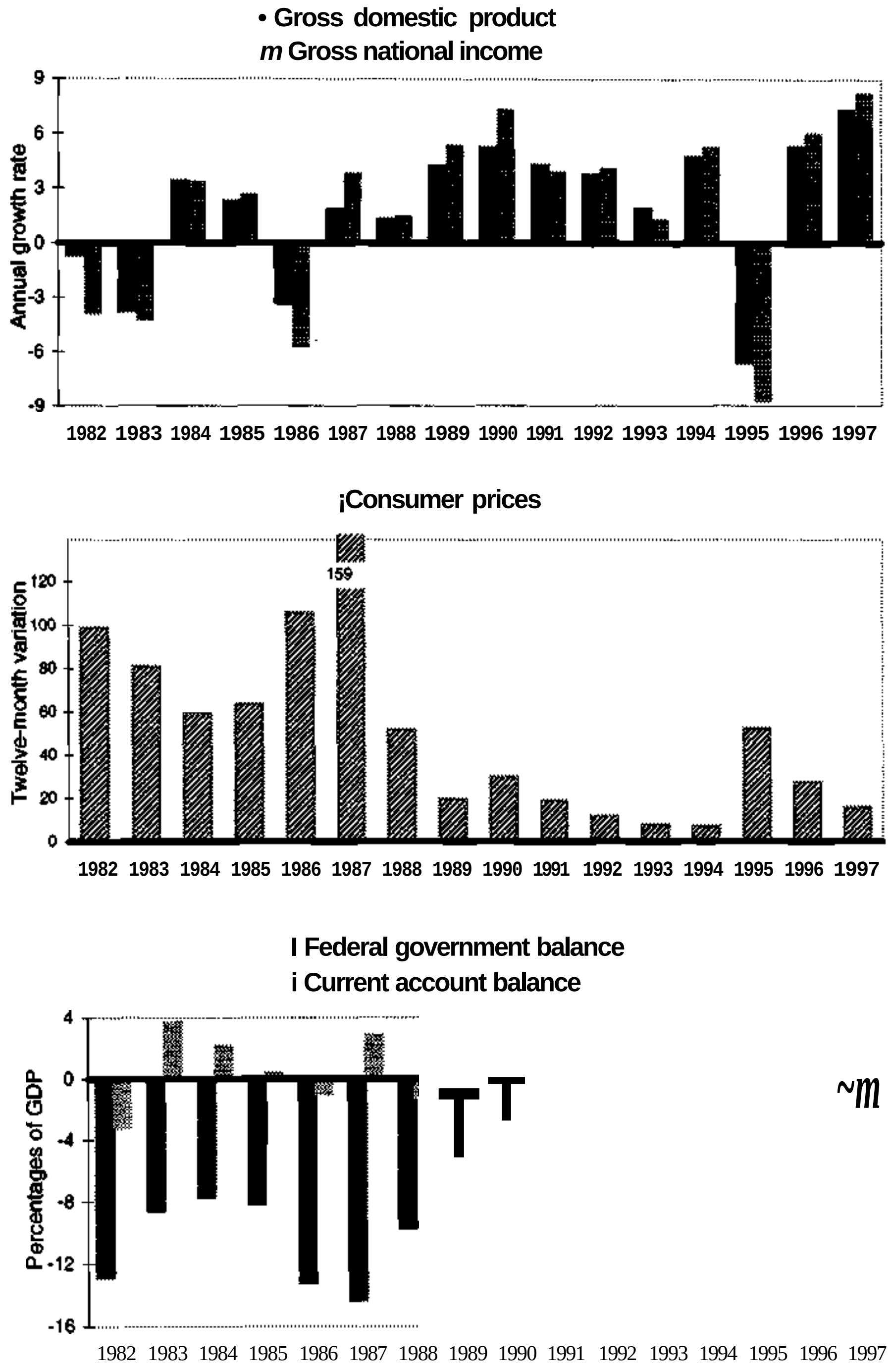
The real appreciation of the peso contributed to a slowdown in exports and a sharp surge in imports which narrowed the trade surplus and increased the balance-of-payments current account deficit. The Government successfully applied a policy designed to reduce and consolidate its external debt. Short-term maturities were refinanced through the placement of longer-term bonds on international markets.

These positive macroeconomic results stand out in stark contrast to the uneven performance of the production base; large firms, exporters and companies that have access to external financing have displayed a great deal of dynamism, but smaller businesses that are geared to the domestic market have had difficulty in obtaining financing and, hence, in regaining their former levels of activity.

The financial crisis which originated in South-East Asia has had repercussions (although so far the impact has been fairly slight) on financial markets in Mexico. Capital flows have slowed and this has prompted adjustments in the exchange rate and the securities market which, in any event, were regarded as being necessary even before the crisis. Interest rates have risen accordingly, but the fundamental trends in the country's financial markets, inflation and economic activity have not been altered. The downturn in oil prices has been a more influential factor in motivating the authorities to cut back on public spending in 1998 and in fueling expectations of slower economic growth.

With weaker growth forecast for Asia, the crisis' deflationary impact on oil prices may be expected to persist; for Mexico, this signifies a reduction in export earnings and, even more

Figure 1
MEXICO: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

importantly, in public-sector revenues. Oil sales account for 37% of the public sector's total budget revenue.

In short, growth for 1998 is expected to be below 5%. The balance-of-payments current account deficit could exceed US$ 15 billion (3.5% of GDP), with a trade deficit of US$ 7 billion. By year's end the exchange rate is expected to be over 9 pesos to the dollar, which implies an inflation rate on the order of 14%.

2. Economic policy and reforms

The aim of economic policy continued to be the restoration of macroeconomic equilibria. Priority was given to curbing inflation, strengthening the financial standing of the banking sector and stimulating economic growth; the system of floating exchange rates remained in place, as did the strategy for refinancing the country ' s external debt through the placement of issues on international markets.

(a)Fiscal policy and public finance

Fiscal policy-makers continued their efforts to balance the public sector's finances. As complementary measures, steps were taken to encourage domestic saving and productive investment. Incomes policy was directed towards boosting receipts by expanding the tax base and achieving a more equitable distribution of the tax burden, while policy measures regarding government expenditure focused on promoting public investment, production activities and social development programmes.

As a consequence of this latter policy, the public sector ran a deficit equivalent to 0.8% of GDP in 1997 (slightly above the official projection) after having balanced its accounts in 1996, and the primary surplus shrank from 4.4% to 3.5% of GDP over the same period. The Federal Government's financial deficit widened from -0.5% in 1996 to -1.4% of GDP in 1997.

Bolstered by brisker economic activity and stricter enforcement measures, tax receipts expanded by 12%; this was the main cause of the 2.3% real increase in budgetary revenues, since oil revenues stagnated owing to the downturn in export prices. This performance, together with the reduction in the financial costs associated with the public debt, brought in sufficient funds to cover the cost of the country's social security reforms and helped to boost physical investment expenditure, spending on social development programmes and the level of funds received by states and municipalities under the government revenue-sharing scheme. Government spending on social programmes included food assistance, the expansion of basic education coverage and employment programmes.

The Federal Government's net domestic debt increased substantially as a consequence of its placement of large volumes of government bonds; the value of government bonds outstanding equalled 81% of the total domestic debt, which amounted to 8.1% of GDP. However, if Congress passes the bill submitted by the Executive Branch in March 1998, under which the liabilities of the Bank Savings Protection Fund (FOBAPROA) (552.3 billion pesos or US$ 65,243, million as if 28 February 1998)[1] and the Federal Government's domestic debt would be consolidated, then this figure would rise to 811,532, million pesos or the equivalent of 21.8% of projected GDP for 1998.

For 1998, a deficit equivalent to 1.25% of GDP is anticipated. In the early months of the year, downward pressure on oil prices drove down earnings, and this in turn led to a 3% reduction in government spending as policy-makers sought to avoid revising their fiscal goal. In an effort to shore up international prices for crude oil, towards the end of the first quarter the

1 The Bank Savings Protection Fund (FOBAPROA), afundsetupintheBancode México, has boughtup banks' loan portfolios in the wake of the 1995 banking crisis in order to assist in their re-capitalization. Its assets currently amount to US$ 40 billion.

Table 1

MEXICO: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
					Growth rates				
Growth and investment									
Gross domestic product	4.2	5.2	4.3	3.8	1.9	4.7	-6.6	5.3	7.3
Per capita gross domestic product	2.3	3.3	2.3	1.8	0.0	2.9	-8.2	3.5	5.5
Gross national income	5.4	7.4	3.9	4.1	1.3	5.3	-8.8	6.1	8.3
Gross domestic product, by sector									
Goods	4.7	6.5	3.2	3.1	0.7	3.8	-5.9	8.9	7.6
Basic services	4.7	3.4	3.0	5.0	3.8	8.2	-4.1	7.6	9.0
Other services	3.9	4.8	5.2	4.0	2.4	4.8	-7.7	2.4	6.8
					Percentages				
Contribution to growth of GDP [c]									
Consumption	6.2	5.2	4.4	4.1	0.9	4.7	-8.0	1.0	4.6
Government	0.2	0.3	0.5	0.2	0.2	0.2	-0.1	-0.1	0.1
Private	6.0	4.9	3.9	4.0	0.7	4.4	-7.9	1.1	4.4
Gross domestic investment	0.4	2.5	2.3	3.2	-0.2	2.7	-9.5	4.9	5.2
Exports	1.1	1.1	0.9	0.7	1.5	2.8	6.6	5.5	4.4
Imports	-3.5	-3.6	-3.4	-4.4	-0.3	-5.4	4.4	-6.1	-6.9
					Percentages of GDP [b]				
Gross domestic investment	21.8	23.1	24.4	26.7	25.9	27.3	19.1	22.8	26.1
National savings	19.5	20.3	**19.0**	18.2	18.3	17.9	18.6	22.2	23.9
External savings	2.4	2.8	5.4	8.4	7.7	9.4	0.5	0.6	2.2
					Percentages				
Employment and wages									
Labour force participation rate	51.8	51.8	53.3	53.8	55.2	54.7	55.4	55.4	56.2
Open unemployment rate [e]	2.9	2.7	2.7	2.8	3.4	3.7	6.2	5.5	3.7
Real average wage (index: 1990=100) [f]	96.5	100.0	106.5	114.3	124.5	129.1	111.6	99.2	98.2
					Growth rates				
Prices (December-December)									
Consumer prices (nationwide)	19.7	29.9	18.9	11.9	8.0	7.1	52.1	27.7	15.7
Wholesale prices (Mexico City)	18.1	27.4	15.7	10.7	7.4	7.8	58.1	27.0	13.6
External sector									
Terms of trade (index: 1990=100) [b]	91.0	100.0	100.5	105.6	106.0	106.6	105.3	106.5	105.3
Nominal exchange rate (new pesos per dollar)	2.46	2.81	3.02	3.10	3.12	3.38	6.42	7.60	7.92
Real effective exchange rate for imports (index: 1990=100)	104.0	100.0	90.9	83.9	80.0	82.2	121.6	108.3	93.9
					Millions of dollars				
Balance of payments									
Current account	-5 825	-7 451	-14 888	-24 442	-23 400	-29 418	-1576	-1922	-7 450
Trade balance (goods and services)	-267	-3 110	-9 369	-18 618	-16010	-21 069	7 753	7 079	93
Exports	42 379	48 805	51 556	55 471	61402	71 202	89 207	106 779	121 701
Imports	42 646	51915	60 925	74 089	77 412	92 271	81 454	99 700	121 608
Capital and financial account [g]	5 614	9 669	22 861	26 187	30 632	11752	-14 793	4 246	17 960
Overall balance	-211	2218	7 973	1745	7 232	-17 667	-16 369	2 324	10510
Variation in reserve assets (- indicates an increase)	-542	-3 261	-8 154	-1 173	-6 057	18 865	-9 591	-1774	-10 510
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	42.6	40.6	37.2	32.0	32.4	33.2	57.3	47.6	37.2
Net interest (as a percentage of exports) '	15.9	13.6	12.4	13.6	14.9	13.2	11.8	9.5	7.1

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
				Percentages of **GDP**					
Federal government									
Current revenue	17.9	15.9	15.5	16.0	15.5	15.1	15.3	15.7	15.8
Current expenditure	21.0	16.1	13.3	12.4	13.0	13.3	14.1	14.2	15.2
Saving	-3.1	-0.2	2.2	3.6	2.5	1.8	1.2	1.5	0.6
Capital expenditure (net)	2.0	2.5	-1.6	-1.0	1.4	2.3	1.9	1.9	1.8
Adjustments	-	-	-0.4	-	-0.4	-0.3	-0.1	-	-
Financial balance	-5.1	**-2.6**	-0.2	1.4	0.4	-0.7	-0.8	-0.5	-1.4
			Growth rates						
Money and credit									
Monetary balances									
Bank of Mexico international reserves		71.3	79.9	7.3	31.8	-57.0	267.5	14.5	64.0
Net domestic credit	45Í6	41.7	35.6	21.4	11.5	29.2	31.1	2.6	-2.7
To central government (net)	13.5	17.7	-2.5	-51.9				-52.6	
To private sector	97.6	73.5	61.5	47.7	24.3	40.3	-4.8	-17.7	0^4
Money (Ml)	38.6	64.7	124.8	14.7	17.9	1.1	2.4	39.6	31.8
Local currency savings and time deposits	41.8	111.2	224.6	13.6	19.8	-7.0	-5.5	51.5	34.1
M2'	43.0	46.2	47.2	20.4	11.8	22.7	38.7	30.1	21.1
Dollar deposits							85.7	51.4	29.5
			Annual rates						
Real interest rates (annualized, %)									
Deposit rate (30 days)	13.8	1.0	-1.3	3.4	6.9	5.8	-7.7	-2.0	-0.8
Equivalent interest rate in foreign currency (30 days) [J]	18.2	17.2	12.2	14.0	15.9	-8.5	1.4	22.4	11.3

Source: ECLAC, on the basis of official figures.

* Preliminary figures. Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Percentages of the working-age population; urban areas. [e] Percentages of the economically active population (EAP); urban areas. Manufacturing industry. [g] Includes Errors and omissions. Refers tonetinterest as shown in the balance of payments, divided by exports of goods and services. ' Includes dollar deposits. [J] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

MEXICO: MAIN QUARTERLY INDICATORS

	1995				1996				1997[a]				1998[a]	
	i	ii	in	iv	i	n	HI	iv	i	ii	in	iv	I	II
Gross domestic product (change from same quarter of preceding year)"	-0.4	-9.2	-8.0	-7.0	0.1	6.5	7.1	7.1	4.9	8.6	7.9	6.7	6.6	4.3
Consumer prices (12-month variation, %)	15.0	33.8	41.7	48.7	43.8	31.0	30.0	27.7	24.6	20.4	18.7	15.7	15.3	15.2
Real effective exchange rate[c] (index: 1990=100)	133.1	118.8	111.2	123.1	115.7	108.3	105.0	104.1	97.4	95.2	91.4	91.6	90.7	89.9
Exports (millions of dollars)	18 787	19 631	20 087	21 036	21 870	23 607	24 247	26 275	25 099	27 440	28 176	29 716	28 226	29 886
Imports (millions of dollars)	18 190	17 033	17 873	19 258	19 935	21 409	22 835	25 288	23 529	26 800	28 485	30994	29 972	31 031
Real interest rates (annualized, %)														
Depositrate"	-21.2	-18.4	5.4	3.3	-3.8	-3.2	2.5	-3.6	-5.4	2.7	0.6	-1.2	-8.2	0.2
Money (MI) (change from same quarter of preceding year)	-13.8	-10.9	-6.2	7.0	35.2	44.6	45.1	40.7	41.6	39.3	36.0	29.6	24.8	20.9

Source: ECLAC, on the basis of official figures.

Preliminary figures. Based on series that have not been seasonally adjusted, at constant domestic prices. Refers to the rate of exchange for imports. 30-day deposits.

Government cut oil exports by 100,000 barrels per day.

(b)External public debt

The main policy objectives in relation to the external public debt were to reduce debt-servicing costs and to lengthen its maturity profile by refinancing short-term commitments. The necessary resources were generated primarily through the placement of bond issues on international markets.

The public sector's gross foreign debt (not counting the liabilities of the Banco de México) was reduced from more than US$ 98 billion in 1996 to just over US$ 88 billion in 1997. Thanks to the payments it made to the International Monetary Fund (IMF), the Banco de México was able to decrease its debt from US$ 13.3 billion in 1996 to slightly over US$ 9 billion in 1997. In contrast, the private sector's external debt swelled by US$ 6.6 billion to stand at US$ 52.2 billion. Thus, the country's total external debt diminished from US$ 157 billion to less than US$ 150 billion.

Government debt issues on international markets amounted toUS$ 8,904, million in 1997. The average maturity of these obligations was slightly under nine years, at a fixed rate of 8.2% and arange of 3.1%-11%. These terms were more favourable than those obtained for the placements made in 1995 and 1996. The funds obtained from these issues were used to refinance short-term maturities and to make prepayments on external debts. The servicing of the external debt absorbed over US$ 40 billion (10% of GDP), of which over US$ 33 billion corresponded to debt amortizations and close to US$ 7 billion to interest and commissions.

(c) Monetary and financial policy

Monetary policy continued to play an instrumental role in reining in inflation as well as helping to stabilize financial and foreign-exchange markets; this was reflected in interest rates, which settled at lower levels.

Owing to the large volumes of foreign exchange pouring into money and securities markets, net assets mounted to almost eight times their anticipated minimum level. This, together with the brisk pace of economic activity, drove the Banco de México to modify its targets for the monetary base and net domestic credit. The latter contracted more sharply than had been projected, while the monetary base was adjusted upwards by only a slight amount, since the authorities were already taking steps to sterilize capital inflows.

The Banco de México modified its monetary policy to help bring about a decline in interest rates as a means of staunching short-term capital inflows. Accordingly, central bank authorities announced a possible increase in the liquidity ratio of financial institutions effective from the end of September. The use of this mechanism could lead to a slower accumulation (or actual decrease) in international assets by diminishing short-term capital inflows. This would tend to curb the appreciation of the peso in real terms, an objective which appeared to be the underlying motivation for the Bank's manoeuvre.

Towards the end of the first quarter of 1998, however, the Banco de México switched from a neutral monetary policy stance to a more restrictive one by making it necessary for financial institutions to maintain a short daily position (a deficit of 20 million pesos) in their current accounts with the Bank. As this represented only 0.02% of the money in circulation at the close of April 1998, the restrictive impact of this measure was very slight. In fact, the main reason why the financial authorities took this step appeared to be their desire to alert the economy to the trend in the exchange rate, which they felt had depreciated more than was warranted by the relevant fundamentals; the Bank also appeared to be drawing attention to the effects of the movement in the exchange rate on real prices and interest rates.

The level of domestic credit made available to the private sector by the commercial banking system continued to decline in real terms in 1997, despite the economic reactivation and the upturn in bank deposit-taking and financial saving. This was probably a result of the banks' cautious lending policy, which was reflected in, among other factors, the large spread between deposit and lending rates.

Nominal interest rates descended except during short periods of moderate volatility. Thus, the benchmark 28-day Treasury Certificate (Cetes) rate was lowered from 27.5% in the last quarter of 1996 to approximately 20% in mid-1997, where it remained until the end of the period (except during October, when the financial crisis in some Asian countries triggered a bout of instability). The average annual 28-day Cetes rate was 19.8%, with a monthly high of 23.5% in January and a low of 18% in October.

Substantial foreign capital inflows, positive economic trends and abundant liquidity on international markets made for a bullish capital market in 1997. Equity placements by companies listed on the Mexican Stock Exchange picked up as well. The Index of Prices and Quotations (IPYC) climbed 56% in 1997, and this performance, in combination with the stability of the nominal exchange rate, provided investors with significant gains in dollars. The effect of the Asian crisis on the capital market has thus far taken the form of a downward adjustment in the IPYC, which was felt to be called for in any event, since this indicator had built up a cumulative yield of 62% between January and October 1997.

(d) Foreign exchange policy and markets

The system of floating exchange rates remained in force, with the Banco de México reserving the right to intervene under specific, previously announced conditions. The market's hallmark during the period was the nominal stability of the exchange rate, except for short episodes of speculation between February and March (as the market reacted to the increase in interest rates in the United States) and in late October (owing to the turmoil on Asian markets), but these interruptions did not alter the overall trend towards an appreciation of the peso in real terms.

The Banco de México continued to auction off foreign exchange to financial institutions as a means of building up its reserves and stabilizing the currency market. Thus, in July 1997 the monthly sum placed on auction was increased from US$ 130 million to US$ 300 million and, in August, the central bank again raised the amount -to US$ 500 million- in order to counter the persistent appreciation of the real exchange rate. It later reduced the amount to US$ 250 million in response to the financial volatility and currency speculation observed towards the end of October.

This practice contributed to the upward spiral of the Banco de México' s net international assets, which soared from just over US$ 6 billion at the end of 1996 to almost US$ 20 billion at the end of 1997. The build-up of reserves enabled the Bank to strengthen its position in anticipation of possible turmoil on the foreign exchange market and allowed it to obtain better terms from foreign lenders.

The persistence and intensification of the financial crisis in Asia in early 1998 increased the volatility of the foreign exchange market, causing a 9% nominal appreciation of the dollar in the first five months of the year. The Banco de Mexico's net international assets continued to climb, reaching just over US$ 22 billion by the end of May.

(e) **Structural reform**

Reforms to the social security system took effect in July 1997. Under the new pension system, the traditional pay-as-you-go system was replaced by a funded system that provides for a guaranteed minimum pension. Each Pension Fund Management Board (AFORE) will be able to operate a number of different pension funds for its members, although during the first four years, none will be allowed to have a market share greater than 17%. The funds will be invested by AFORE mutual funds (Specialized Retirement Fund Investment Companies, or siEFOREs), which will function as financial intermediaries, taking in savings deposits and then placing these funds in safe, profitable investment instruments.

After a slow start in the early months of the year, enrolments began to escalate, and by the end of 1997, over 10 million (out of a total of slightly over 11 million) workers had signed up with the system. Most of the AFOREs posted losses in their first few months of operation, even though their start-up expenses are to be amortized over a period of several years, and this situation has sparked expectations of future mergers.

Little headway has been made in the privatization of airports, railways and secondary petrochemical facilities of Petróleos Mexicanos (PEMEX). The motorway concession programme had to be modified substantially owing to a series of problems which made it necessary for the Government to intervene and take back 23 of the 29 toll road concessions that it had previously awarded.

Towards the end of the first quarter of 1998, the Executive sent a number of financial-system reform initiatives to Congress, and it is hoped that Congress will take action on these bills in the course of the year. These reforms seek to: (i) transfer responsibility for foreign- exchange policy to the Banco de México (this area of policy is currently in the hands of a foreign exchange board composed of three representatives of the Ministry of Finance and Public Credit and two from the central bank); (ii) give autonomy to the National B anking and Securities Commission, strengthen its regulatory and supervisory functions with respect to the financial system and change it into a decentralized organ of the Banco de México; (iii) do away with restrictions on foreign investment within the financial system as a way of increasing the capitalization of the country's commercial banking system; (iv) create two bodies to take the place of the Bank Savings Protection Fund (FOBAPROA), with one being responsible for guaranteeing the public's savings up to a specified limit and the second being put in charge of selling off the commercial bank assets bought up by FOBAPROA; and (v) consolidate the debts of FOBAPROA with the public debt of the Federal Government.

3. Level of activity, inflation and employment

(a)Economic activity

The reinforcement of the trends that had started to emerge in 1996 allowed production activity to continue its recovery in 1997. Private consumption picked up considerably (6.6%). The pace of exports slowed somewhat but still remained in the double-digit range and, with an increase of 21%, gross fixed investment was the most dynamic component of demand. Aggregate demand grew by 10% and this, given the weight of the import component in domestic spending, boosted imports by 22%.

The recovery in private consumption was uneven, since it was mainly a result of increased expenditure on consumer durables (a trend usually associated with spending patterns of middle- and high-income groups). Department stores -the main retailers of consumer durables- registered a much sharper increase in sales than self-serve establishments, which are predominantly suppliers of food products and other basic items. The higher demand for durable goods (a large proportion of which are imports) can be attributed both to the increase in private consumption and to the decline in the relative prices of such goods occasioned by the appreciation of the real exchange rate. Since the growth of disposable income is primarily a function of rising employment and/or real wages, it may be concluded that the upturn in private consumption was due to the increase in employment, since real wages remained static.

Following its recovery in 1996, the growth of the agricultural sector slowed to 1.4% in 1997 as a result of adverse weather conditions, thus falling below the rate of population growth. Sharp decreases in the harvest of major crops, such as corn, beans, sorghum, coffee and cotton, were contributing factors. In the early months of 1998, the problems caused by the drought affecting large areas of the country intensified, while other regions suffered from floods, leading to fears that unless conditions improved, it would become necessary to resort to imports to supplement domestic supply.

The 9.2% growth rate recorded for the industrial sector (mining, manufacturing, construction and electricity, gas and water) was driven by the buoyancy of the manufacturing sector (9.8%). The rise in consumption contributed to the recovery of industries that had been hit hard by the 1995 crisis, such as food products, textiles, clothing, footwear and wood, although their average rate of expansion was less robust than that of the export sector.

In the early months of 1998, domestic demand remained firm, and given the climate of financial volatility and the strong surge in imports (and therefore in the current account deficit), there were some signs that economic policy-makers wanted to cool it down. The Government has exhibited a great deal of ardency in signalling the need to rein in consumption, has cut back on public spending and has adopted a somewhat tighter monetary policy. In any event, economic growth is expected to be slower than in 1997.

With respect to the banking crisis, in 1997 the various programmes for bailing out the banking sector and providing support to its debtors remained in effect. The banking system posted improved capitalization and reserve indicators, and debtors were able to restructure their payment commitments. However the banking system is still a long way from resuming its role as an efficient financial intermediary. Credit institutions are faced with the challenges involved in cleaning up their portfolios, luring back reliable clients and competing to reduce the cost of financing; at the same time, however, they have yet to overcome the damage done to their loan receivables.

Non-performing loans increased from 21.4% of total portfolios in 1996 to 29.8% in 1997, largely as a result of the new accounting procedures adopted by the country's banks; for example, under the new regulations, the total debt is treated as a non-performing loan, rather than just the monthly payments that are overdue. The highest default rates are on loans for the purchase of consumer durables (55.6%) and housing (42%), in both cases probably as a result of the level of overindebtedness of many households, which had been building up in the years prior to the outbreak of the crisis in late 1994.

The cost, in net present value terms, of the programmes set up to bail out the banking system and its debtors rose from 8% to 11.9% of projected GDP for 1997. This increase was a reflection of the huge amount of resources used to shore up insolvent financial institutions, whose shareholders have lost both their capital and their control over these firms. By early May 1998, it was estimated that the cost of these programmes had risen to 14.5% of GDP as a consequence of the financial rehabilitation operations implemented in the case of four commercial banks.

(b)Prices, wages and employment

Inflation continued to subside in 1997, thanks mainly to the virtually stationary nominal rate of exchange, as well as to wage restraint and to policy-makers' monetary and fiscal stringency. The consumer price index (December-December) rose by 15.7%, approximately half of the increase recorded in 1996.

Real wages continued to descend -for the third consecutive year in the manufacturing sector and for the fifteenth year in a row in the case of minimum wages, in contrast to the sharp slumps recorded in 1995 and 1996, however, the declines in manufacturing and minimum wages in 1997 were less than 1%. contractual wages were the only category to show an improvement, and this was particularly the case in a limited number of export-based companies, the *maquila* (in-bond processing) industry and manufacturing firms. Nevertheless, the wage bill rose in real terms owing to the increase in employment.

Economic growth boosted job creation in 1997. Figures released by the Mexican Social Security Institute (IMSS) show an 11.3% increase in the number of workers registered with the Institute on a permanent basis, which means that close to one million individuals signed up for social security coverage in 1997. This indicates that formal employment now far exceeds the level attained prior to the 1995 recession. Construction and manufacturing (including the *maquila* industry) were the most dynamic sectors. Employment continued to soar in the *maquila* sector, bringing the total number of jobs in this industry to almost one million by the end of 1997; this was 20% more than the figure recorded at the end of 1996 and reflected the creation of around 160,000 additional jobs.

The favourable trend in employment was also reflected in a decline in unemployment throughout 1997. The rate of open unemployment stood at 3.1% of the economically active population in the fourth quarter and averaged 3.7% for the year as a whole, which was quite similar to the level recorded prior to the December 1994 crisis. In early 1998 unemployment rose as a consequence of seasonal factors, but it then resumed its downward trend.

Economic growth is still not fast enough to absorb all the people who enter the labour force every year, and as a result employment in the informal sector has continued to act as a cushion for the labour market. This situation has an adverse effect on working conditions, exerts downward pressure on wages and hinders productivity gains as well as access to social safety nets.

In the first five months of 1998, prices rose by 7%, which will make it difficult for the Government to attain its target figure of 12%. The surge in inflation seen in the first few months of the year was primarily due to the slippage in the nominal rate of exchange; other factors included the adjustment of minimum wages in January and increases in the prices of public-sector goods and services (gas, electricity, gasoline) and staple foods (chiefly milk and tortillas).

(c) The external sector

Financial inflows from abroad were quite substantial, as was the deterioration in the balance-of-payments current account surplus, although it was kept within manageable limits. Exports remained buoyant, growing by 14%, while imports gained momentum, expanding by 22%.

Foreign investors' favourable expectations regarding the country's economic outlook, together with the high rates of return available on Mexican financial markets within a context of exchange-rate stability, generated a strong inflow of foreign investment (close to US$ 17.5 billion). Unlike the situation the year before, the bulk of these inflows (almost US$ 12.5 billion) were in the form of direct investment; 60% of these funds went to the manufacturing sector and 25% to services. It is estimated that a significant portion of direct investment was channelled into the purchase of existing assets.

The balance-of-payments current account showed a deficit of almost US$ 7.5 billion, which was three times as high as in 1996, but still quite small as a percentage of GDP (1.8%). The deepening of the deficit was chiefly attributable to the fact that imports grew far faster than exports, a pattern which has been resulting in negative monthly trade balances since the second half of 1997.

The merchandise trade surplus narrowed from just overUS$ 6.5 billion in 1996 to only US$ 623 million in 1997, which, given the total volume of the country's trade flows (US$ 220 billion), was tantamount to a position of virtual equilibrium in its international merchandise trade. The deficit on the income account was similar to that of 1996 (slightly under US$ 13 billion) and was mainly the result of the amount of interest paid out on the external debt (US$ 12.5 billion).

In the wake of the December 1994 devaluation, exports had been extremely dynamic in 1995 and 1996; in the second half of 1996 their rate of growth began to slow, however, partly as a result of the real appreciation of the peso. The stronger peso also contributed to an upswing in imports which has also been supported by the economic reactivation that began in 1996. The total dollar value of merchandise exports exceeded US$ 110 billion, a 15% increase over the 1996 figure; for their part, imports swelled by 23% to just under US $ 110 billion. For the first time since January 1995, foreign trade transactions began to post negative balances in July 1997, and this trend has been deepening in 1998.

In early 1998, the trade deficit began to worsen; exports of manufactured goods continued to display great buoyancy (a growth rate of 17% was recorded in the first three months), but oil exports slumped 33% over the same period. This, together with the 23% increase in imports, led to a deficit of US$ 2,188, million in the first quarter of 1998. The trade balance is expected to remain negative throughout the remainder of 1998, and projections put the total deficit for the year at around US$7 billion.

NICARAGUA

1. General trends

In 1997 Nicaragua achieved Us highest rate of GDP growth of the decade (5.5%) thanks to abundant foreign capital inflows that underpinned private investment and consumption. The progress made in terms of well-being was even greater, as open unemployment fell, the inflation rate dropped to single-digit levels (7.3%) and the country's terms of trade with the rest of the world improved. However, the already excessive deficit on the balance-of-payments current account increased further, although only slightly, due above all to a widening of the merchandise trade gap.

Higher tax revenues led to a significant increase in primary saving by the non-financial public sector (NFPS). At the same time, a bigger current surplus and a decrease in capital expenditure meant that the overall NFPS deficit, before grants and donations, shrank to half (7% of GDP) of what it had been, despite higher interest payments.

Monetary policy focused on open market operations and the management of the legal reserve requirement as means of controlling liquidity in the market. The continued use of a crawling-peg system under which pre-announced adjustments are made in the exchange rate had a favourable effect in terms of inflationary expectations.

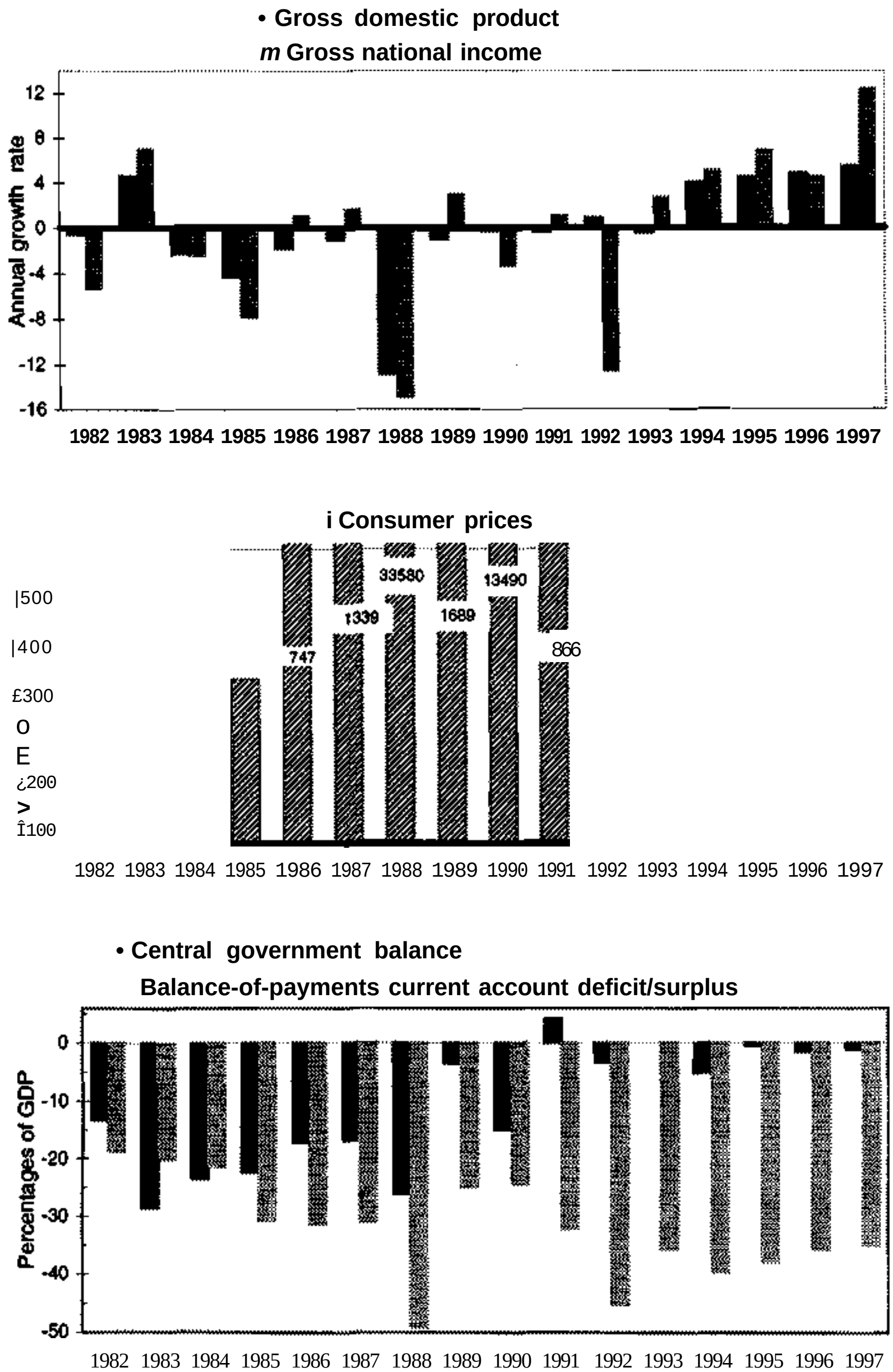
The country also made significant inroads in the area of structural reform in the course of the year, including the passage of new legislation on taxation, commerce, banking and property rights. In addition, at year's end a new agreement was signed with the International Monetary Fund (IMF) for a second structural adjustment loan.

2. Economic policy

In a bid to reduce both poverty and unemployment, the Administration that took office in January 1997 launched an economic and structural reform programme whose main objectives are to galvanize the production apparatus (giving priority to the reactivation of the agricultural sector), cut inflation and put public finances back on a sound footing. The programme calls for measures aimed at boosting the efficiency of the public sector and creating an appropriate economic climate for increased domestic and external private investment. One important development in this connection was the passage of the Fairness in Taxation and Commerce Act in July, a piece of legislation that simplifies the tax system, broadens the tax base and rationalizes the eligibility requirements for tax exemptions. It also includes provisions designed to encourage investment, especially in the agricultural and export sectors, and to roll back tariffs gradually.

During the course of the year the role played by State banks in the economy was scaled down significantly. In addition, a political consensus was reached on the issue of property rights, paving the way for the passage of a bill which is

Figure 1
NICARAGUA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

expected to resolve pending claims and speed up the issuance of land titles.

(a) Fiscal policy

Fiscal policy-makers sought to complement the objectives of monetary authorities by adopting measures to help strengthen saving and reduce the fiscal deficit.

Midway through the year, tax reforms were introduced which are designed to rectify the tax system's structural shortcomings and broaden the tax base by eliminating certain discretionary powers and reducing the scope of others while at the same time establishing a number of tax exemptions.

The central government's current revenues rose by 17.5% in real terms, thanks to a brisker pace of economic activity, the corrections introduced by means of tax reform measures, and improvements in tax administration, including customs procedures. The tax burden rose to 23% of GDP, which was nearly three percentage points higher than the year before, with revenues from excise taxes and customs duties registering the highest growth rates. Receipts of grants and donations fell by one third, however, and the central government's total revenues and total expenditure consequently slipped to 28.5% and 29.6% of GDP respectively (versus 28.9% and 30.4% in 1996). Current outlays were up by 6.3% in real terms, mainly due to a significant increase in interest payments on the foreign debt. Meanwhile, capital expenditure was down by 6%, measured at constant prices, as a consequence of delay s in the execution of various investment projects caused by the change in Administration. As a result, the central government's fiscal deficit shrank from 1.5% of GDP in 1996 to 1.1% in 1997; the strength of this trend is much more apparent if grants and donations are excluded from the calculations, however, since in that case the decrease was from 8.4% to 5.2% of GDP.

Primary saving generated by the NFPS in 1997 jumped to 12.7% of GDP (from the previous year's level of 8.7%). The rise in current saving was more modest (from 5.3% to 6.8% of GDP)owing to the heavier burden represented by interest payments. Thanks to the contraction of public-sector capital expenditure, in conjunction with the increase in its current surplus, the overall NFPS deficit -before grants and donations (14.2% of GDP in 1996)- was cut to less than half its former level in 1997 (7%), and the amount of external financing that was required was therefore reduced as well.

(b) Monetary policy

The fundamental goal of monetary policy in 1997 was to ensure the stability of domestic prices and external payments. In its efforts to fulfill the goals of the country's financial programme, the Central Bank of Nicaragua (BCN) concentrated on open market operations and the management of the legal reserve requirement as means of controlling liquidity in the money market in the face of voluminous private-capital inflows from abroad. In the area of foreign exchange policy, the authorities maintained the existing crawling-peg regime of pre-announced devaluations at a set monthly rate of 1%.

Total liquidity in the economy (M3) continued to soar (54%), primarily due to a striking 55% increase in foreign-currency deposits, which came to represent three fifths of the total money supply. Significant increases were also seen in fixed-term deposits denominated in the local currency, which doubled, and local-currency savings deposits, which grew by 51%. The BCN continued to sterilize additional liquidity via the sale of negotiable investment certificates known as CENIs, which are dollar-indexed government securities having terms of up to one year. This policy also made it possible for the country to service its external debt and build up its international reserves.

In mid-year the method of placing CENIs on the market was changed. The direct sale of these securities at a pre-set price was replaced by an auction system under which the amount of such securities to be placed on the market is determined on the basis of the level of excess liquidity that needs to be sterilized in order to meet the requirements of the country's monetary programme. The interest rate is set in the course of the auction itself.

In November the BCN standardized all legal reserve requirements, setting the ratio at 17% for

Table **1**
NICARAGUA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
				Growth rates					
Growth and investment [b]									
Gross domestic product	-1.0	-0.1	**-0.4**	0.8	-0.4	4.0	4.5	4.8	5.5
Per capita gross domestic product	-3.1	-2.5	**-3.0**	-2.1	-3.3	1.0	1.6	2.1	2.7
National income	3.0	-3.5	1.1	-12.7	2.8	5.1	7.0	4.6	12.5
Gross domestic product, by sector									
Goods	3.9	-1.0	**-0.7**	0.6	1.2	7.7	5.3	6.3	7.2
Basic services	-1.4	1.8	**3.8**	1.7	-2.8	0.3	5.3	4.9	5.4
Oher services	-6.2	0.8	**-0.4**	1.0	-2.0	0.0	3.3	2.9	3.1
				Percentages					
Contribution to growth of GDP [c]									
Consumption	-12.0	-0.9	5.6	-0.7	-3.2	3.3	1.2	-1.1	6.9
Government	-6.4	8.2	-11.1	-2.3	-0.6	-0.5	-0.6	-0.3	0.9
Private	-5.6	-9.1	16.6	1.6	-2.6	3.8	1.9	-0.9	6.0
Investment	-3.0	-2.5	**2.3**	-0.2	-2.5	4.2	3.4	3.8	3.2
Exports	4.1	2.1	**-1.9**	3.3	1.0	1.8	3.4	9.1	1.3
Imports	10.0	1.2	**-6.3**	-1.6	4.3	-5.3	-3.6	-6.9	-5.9
				Percentages of GDP [b]					
Gross domestic investment	17.6	15.1	17.4	17.1	14.7	18.1	20.6	23.3	25.1
National savings	-0.4	-2.9	**-7.4**	-18.9	-13.3	-11.7	-6.6	-1.2	2.8
External savings	18.0	18.0	24.9	36.0	28.0	29.9	27.2	24.5	22.3
				Percentages					
Employment and wages									
Open unemployment rate	8.4	11.1	14.2	17.8	21.8	20.7	16.4	14.8	13.2
Real average wage (index: 1990=100)	61.9	100.0	103.2	122.8	114.0	120.0	122.2	119.6	119.4
				Growth rates					
Prices (December-December)									
Consumer prices	1689	13 490	866	3.5	19.5	14.4	11.1	12.1	7.3
External sector									
Terms of trade (index: 1990=100) [b]	111.2	100.0	92.7	67.9	78.6	90.9	99.7	92.0	97.2
Nominal exchange rate [e]	15.66	689.96	4.27	5.00	6.12	6.72	7.53	8.44	9.45
Real effective exchange rate for imports (index: 1990=100) '	161.4	100.0	104.9	106.0	111.2	118.2	123.9	126.6	132.6
				Millions of dollars					
Balance of payments									
Current account	-362	-385	-534	-834	-644	-729	-719	-698	-708
Trade balance (goods and services)	•326	-290	-486	-610	-449	-504	-439	-493	-642
Exports	341	392	338	309	367	453	644	807	914
Imports	667	682	824	919	816	957	1083	1300	1556
Capital and financial account	•144	-310	-599	-478	-375	-55	24	215	747
Overall balance	•506	-696	-1 133	-1 312	-1019	-784	-696	-483	39
Variation in reserve assets (- indicates an increase)	-79	7	-42	-1	79	-81	9	-79	-212
				Percentages					
External debt									
Gross debt (as a percentage of GDP)	72.1	684.8	625.3	564.9	658.2	638.4	544.5	311.6	297.3
Net interest (as a percentage of exports) [8]	60.1	55.3	107.4	156.1	114.1	100.6	53.3	34.4	20.1

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
				Percentages of GDP					
Central government									
Current revenue	23.4	14.9	19.3	20.3	19.6	20.1	21.5	21.7	24.3
Current expenditure	26.7	30.7	23.5	22.1	20.6	21.3	19.3	19.7	20.0
Current saving	-3.3	-15.8	-4.2	-1.8	-1.0	-1.2	2.3	2.0	4.3
Capital expenditure (net)	3.4	1.3	3.3	5.9	6.3	8.7	11.1	10.4	9.5
Financial balance	-3.6	-15.0	4.1	-3.4	0.0	-5.1	-0.5	-1.5	-1.1
Domestic financing	3.4	-5.1	-4.6	-6.1	0.0	-1.2	0.7	-3.6	-0.4
External financing		20.1	0.5	9.4	0.0	6.4	-0.2	5.1	1.5
				Growth rates					
Money and credit									
Monetary balance									
Net international reserves			449.2	4.1	-51.6	132.7	-11.1	158.6	144.2
Net domestic credit	98.6	184.9	494.1	461.2	11.8	8.6	-1.0	-9.6	21.7
To public sector	98.1	191.9	295.5	794.4	7.9	5.0	-6.0	-10.0	17.2
To private sector	100.9	150.0	1 659.4	21.8	49.8	33.7	26.6	-8.2	39.4
Money (Ml)	-2.9	-2.6	850.8	16.4	-4.4	36.8	13.0	25.9	34.2
Local-currency savings and time deposits	195.7	67.5	808.0	39.9	48.7	99.4	24.6	28.3	77.2
M2		6.8	841.8	21.1	7.9	56.9	17.7	26.9	52.9
Dollar deposits	307.6	41.4	770.5	55.3	70.8	77.4	60.0	52.3	55.0
				Annual rates					
Real interest rates (annualized, %)[h ']									
Deposit rate (savings accounts)				8.5	8.9	8.8		-1.2	1.7
Lending rate (short-term)				19.7	20.1	20.3		6.1	13.1
Equivalent interest rate in foreign currency[J]				8.5	8.9	8.8		0.3	

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. 1989-1990: thousands of córdobas per dollar; 1991 on: gold córdobas per dollar, official exchange rate. [e] Official exchange rate. [f] Includes Errors and omissions. [8] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. [h] Interest rates are subject to a provision requiring the maintenance of dollar values; therefore, once the nominal interest rate has been adjusted by the index for the real effective exchange rate, it equals the real interest rate. For these purposes, the December-December variation in this index should be used. ' These figures represent a simple average of the floor and ceiling rates in the State and private banking systems. [J] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

NICARAGUA: MAIN QUARTERLY INDICATORS

	1995				1996				1997[a]				1998"	
			III	IV				IV		II	III	IV		
Consumer prices (12-month variation, %)	12.1	12.2	8.6	11.1	11.7	12.1	11.9	12.1	9.2	9.5	9.3	7.3	10.9	14.1
Real effective exchange rate (index: 1990=100)	120.3	125.7	127.8	121.7	124.0	125.0	129.2	128.3	129.5	131.4	135.5	134.0	133.7	133.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Refers to the exchange rate for imports.

all claims held by the public, including deposits, repurchase agreements and bonds; the net result of this measure was a further tightening of the money supply. At the same time, the BCN also ceased paying interest on all local-currency legal reserves.

Bank placements were apportioned on the basis of considerations of risk and rates of return; accordingly, portfolio investment in financial instruments accounted for the largest share of such funds, with 55% of the total. Another 30% was used for lending operations, which was 16 percentage points more than the year before. The balance took the form of liquid assets, such as cash holdings in commercial banks and finance companies. Net credit to the production sector totalled over 1.15 billion córdobas; this was a rise of nearly 40% in real terms and was primarily attributable to the expansion of net agricultural credit.

(c) Trade policy

The new Fairness in Taxation and Commerce Act passed in mid-1997 makes major changes in the foreign trade regime which have the effect of making Nicaragua's economy more open to the rest of the world. In July 1997 the stamp tax was merged with the temporary protection tariff (ATP), and the implementation of a schedule for the gradual reduction of both import duties and the ATP is to begin next January. In accordance with this timetable, in two years' time the ceiling tariff rate on final consumption goods will have been brought down to 10% and there will be a floor rate of 0% on raw materials, intermediate goods and capital goods not produced in Central America, with intermediate rates of 5% being levied on raw materials and intermediate and capital goods produced in the subregion. In the case of exports, the law provides for a system of drawbacks equivalent to 1.5% of f.o.b. values, as well as a streamlined scheme of tax credits for general value added taxes paid on the purchase of inputs and raw materials.

In September 1997, Nicaragua signed a free trade agreement with Mexico. This treaty opens up the Mexican market to Nicaraguan exports, particularly agricultural goods. For its part, Nicaragua is lowering its tariffs on Mexican products under the provisions of the Fairness in Taxation and Commerce Act. In addition, Nicaraguan businessmen will now be able to take out loans with Mexican financial institutions, and direct investment of Mexican funds in Nicaragua will be made easier.

(d) Structural reforms

In addition to the implementation of tax and trade reforms during the year, the new Administration launched a programme to restructure and strengthen the financial system. In order to reduce the State's involvement in the banking sector, steps were taken to close down the largest State bank, the Banco Nacional de Desarrollo (BANADES), and to hand over control of the Banco Nicaragüense de Industria y Comercio (BANIC) to the private sector.

In an effort to meet the borrowing requirements of small-scale farmers, the Government plans to set up a fund that will operate as a second-tier institution with the help of branch banks, credit unions and non-governmental organizations specializing in rural finance.

Midway through the year the financial system was strengthened by the passage of a reform bill amending the omnibus act that governs banks and other financial institutions. The new law authorizes such institutions to engage in new financial activities, including mortgage finance, trust fund administration, factoring and leasing.

As part of the civil service reform programme, measures were adopted to overhaul the institutional structure of the central government. To this end, in late 1997 the Government submitted a bill to the National Assembly which would, among other initiatives, reduce the number of ministries and agencies reporting directly to the President.

3. Them; variables

(a) Level of activity

In what constituted a consolidation of the recovery that had begun in 1994, GDP rose by 5.5% in 1997. Its momentum was associated with more vigorous domestic demand, which in turn was the outcome of growth in consumption (7.6%) and private-sector investment (53.4%). This trend was bolstered by an increase in credit and a reduction in unemployment, as well as higher foreign direct investment and capital repatriation. Remittances sent home to family members by Nicaraguans living abroad were also higher, and these flows helped to strengthen domestic purchasing power, as did the substantial drop in domestic inflation. Unlike the situation in 1996, the pace of growth in goods and services exports eased back to 4%, while import growth remained very strong (13%).

GDP growth was driven by increases in the output of both goods (7.2%) and basic services (5.4%), whereas community and government services contracted.

The agricultural sector, which generates 36% of GDP and is therefore the most important component of the production apparatus, boosted its growth rate from 6.6% to 8.5%. With the exceptions of sugar cane, bananas and tobacco, the production of exportable crops was down. Soybeans were the only crop intended for domestic consumption that suffered a setback, while the sorghum and rice harvests were much larger than before.

The livestock and poultry industries posted good results, registering increases in their real levels of value added thanks to higher levels of output for beef, poultry meat, milk and eggs. Fishery activities were also on an upswing, chiefly as a consequence of an expansion of shrimp production (counting both shrimp caught by trawling and those cultivated in shrimp farms). Lobster and fish catches turned in satisfactory performances as a consequence of an increase in fishing fleets.

Growth in the industrial sector firmed up (3.1%, compared with 2.4% the preceding year), but continued to lag behind the trend of overall GDP. The expansion of this sector was buttressed by upturns in it largest branches, including food products, beverages, tobacco, chemicals and non-metallic minerals. Taken together, these categories generated more than four fifths of the country's total industrial output.

The favourable trends in the production of beef, chicken, sugar and fishery products made a major contribution to the performance of the food industry. The production of beverages slowed as a downturn in rum sales caused demand to slip. Other products in this category, such as carbonated beverages and beer, did well, however.

A strengthening of demand for building materials made it possible to maintain the momentum of the non-metallic minerals industry. Construction receives the largest shares of both foreign investment and inflows of repatriated capital; a substantial portion of these funds are channeled into the construction of new hotels, which in turn helps to boost the tourism industry.

The output and value added of mining activities (both of metal ores and of non-metallic minerals) were higher thanks to investments aimed at reactivating a number of mines and introducing technological changes. In the mining of metallic ores, gold and silver production posted substantial increases due to a higher level of gold output, which rose to 79,800 troy ounces.

A 5.6% expansion in the total supply of electrical power was made possible by a significant increase in gross imports in response to an 8.2% reduction in power generation, whose most obvious cause was the irregular pattern of rainfall caused by El Niño. The sharpest increases in demand came from the commercial, industrial and residential sectors.

(b) Prices, wages and employment

The most outstanding economic policy achievement of the year was the reduction of inflation to single-digit levels. In 1997 the average rate of increase in price levels was 9.2% (versus 11.6% in 1996), with the December-December increase dropping to 7.3% (versus 12.1% the year before). The maintenance of the existing foreign exchange policy, the efforts made to regulate primary liquidity, the ratification of the tariff reduction policy and plentiful basic grain harvests provided the foundations for this moderation of domestic prices.

Average nominal wages kept pace with inflation and were thus virtually unchanged in real terms. The legal minimum wage, which had been frozen since 1991, was revised and updated on the basis of a new rate schedule; this schedule, which entered into force in November, sets wages at levels ranging from 300 to 700 córdobas per month.

The number of employed persons rose by 5.3%, which was comparable to GDP growth but higher than the rate of expansion of the economically active population (3%). Consequently, open unemployment fell by nearly 9%, although it was still quite high (13.2%). The 61,000 jobs that were created were primarily in agriculture, commerce, manufacturing and mining.

(c) The external sector

The merchandise trade deficit (f.o.b.) grew by 45%, since imports expanded (24%) more than twice as fast as exports (11%). The trade gap widened from nearly 20% to 28% of GDP, but despite this deterioration, the current account deficit narrowed slightly (from 36% to 35% of GDP). However, when unrequited transfers are excluded, then the deficit rose from 40% of GDP 1996 to 42% in 1997.

Driven by an increase in non-traditional exports (24%), most of which are manufactures, merchandise exports approached US$ 750 million. Sales of tobacco products, leather and leather products, wood and beverages were particularly buoyant. On the other hand, traditional exports, which account for around 45% of the total, dropped back (-0.9%), chiefly as a result of a slump in sales of bananas, gold and sesame seeds. The value of coffee exports climbed by nearly 13% thanks to a rise of more than 30% in the average price on international markets. Sugar prices, on the other hand, fell by 11%; nonetheless, a substantial increase in shipments (47%) drove up the value of these exports by more than 31%.

Total imports were 22.5% higher than the previous year (US$ 1.421 billion in c.i.f. terms) owing to the economic upturn, a strengthening of private investment and tariff reductions. Although this was equivalent to nearly 70% of GDP, it is important to point out that the highest growth rates were recorded in the intermediate and capital goods categories, which form the basis for a reactivation of the economy. In addition, lower prices for crude oil and petroleum products on the international market resulted in a smaller import bill for oil, fuels and lubricants.

In 1997 no significant new borrowing occurred, and the outstanding external debt balance was therefore kept in the range of US$ 6 billion. The cost of servicing this debt came to about US$ 340 million, up by US$ 100 million. This increase in debt service was a result of commitments assumed as part of the debt rescheduling process carried out in previous years. The expiration of the grace period granted by the Paris Club in the 1995 renegotiation was an additional factor.

The total cost of servicing the public sector's external debt was equivalent to 37% of the value of exports of goods and services, which was seven percentage points higher than the preceding year. However, when the service on the private external debt is added to this figure, then the coefficient for service payments verges on 50%.

In 1997 the country reached an agreement with the Central American Bank for Economic Integration (CABEI) for the reduction of its US$ 560 million outstanding balance with this institution. Under this agreement, US$ 100 million is to be forgiven and another US$ 300 million is to be retired via the placement of United States Treasury zero-coupon bonds; grants from the international community will be used to pay for these bonds. At the same time, the signing of this agreement has made it possible for CABEI to resume lending to the private sector.

At year's end the Government reached an agreement with the IMF that will permit the signing of a second two-year enhanced structural adjustment facility (ESAF) accord. This new programme will give the country access to significant amounts of balance-of-payments financing. At the same time, the approval of the ESAF will have a positive influence on meetings with grantor institutions in the run-up to the next Consultative Group meeting, at which Nicaragua will be seeking US$ 1.2 billion in financing for social projects, especially in rural areas, for the following three-year period. The new agreement with the IMF will also be helpful in the negotiations concerning the forgiveness of about US$ 200 million in service over a three-year period on Nicaragua's bilateral debt with its Paris Club creditors.

Along with the achievement of agreed targets, Nicaragua needs to sign the second ESAF in order to be eligible for the IMF/World Bank Highly Indebted Poor Countries (HIPC) Initiative. This initiative will make it possible for Nicaragua to secure debt cancellations which would reduce its debt service to the equivalent of less than 20% of its exports by the end of 1999.

PANAMA

1. General trends

The Panamanian economy picked up in 1997, posting GDP growth of 4.3%. This performance, a marked improvement on the 2.4% growth recorded in the previous year, may be attributed to a number of factors: the recovery in re-exports from the Colón Free Zone, the upsurge in capital expenditure -directed essentially to the development of production infrastructure- and the expansion in private consumption following increases in employment, wages and credit. The inflation rate, traditionally among the lowest in Latin America, was close to zero.

In general, the business climate improved appreciably. Practically all sectors showed an upturn compared with 1996. In particular, international services, especially trade and transport, expanded significantly, while tourist spending remained buoyant. The construction industry also rebounded owing to port and road works. Although the number of ships transiting through the Panama Canal was lower because of the decline in international trade in basic grains, toll rises resulted in higher revenues. On a less positive note, the severe drought associated with the El Niño phenomenon affected agricultural production for the domestic market, while lower European demand resulted in further cut-backs in banana production. Lack of rainfall also caused a reduction in hydroelectricity generation.

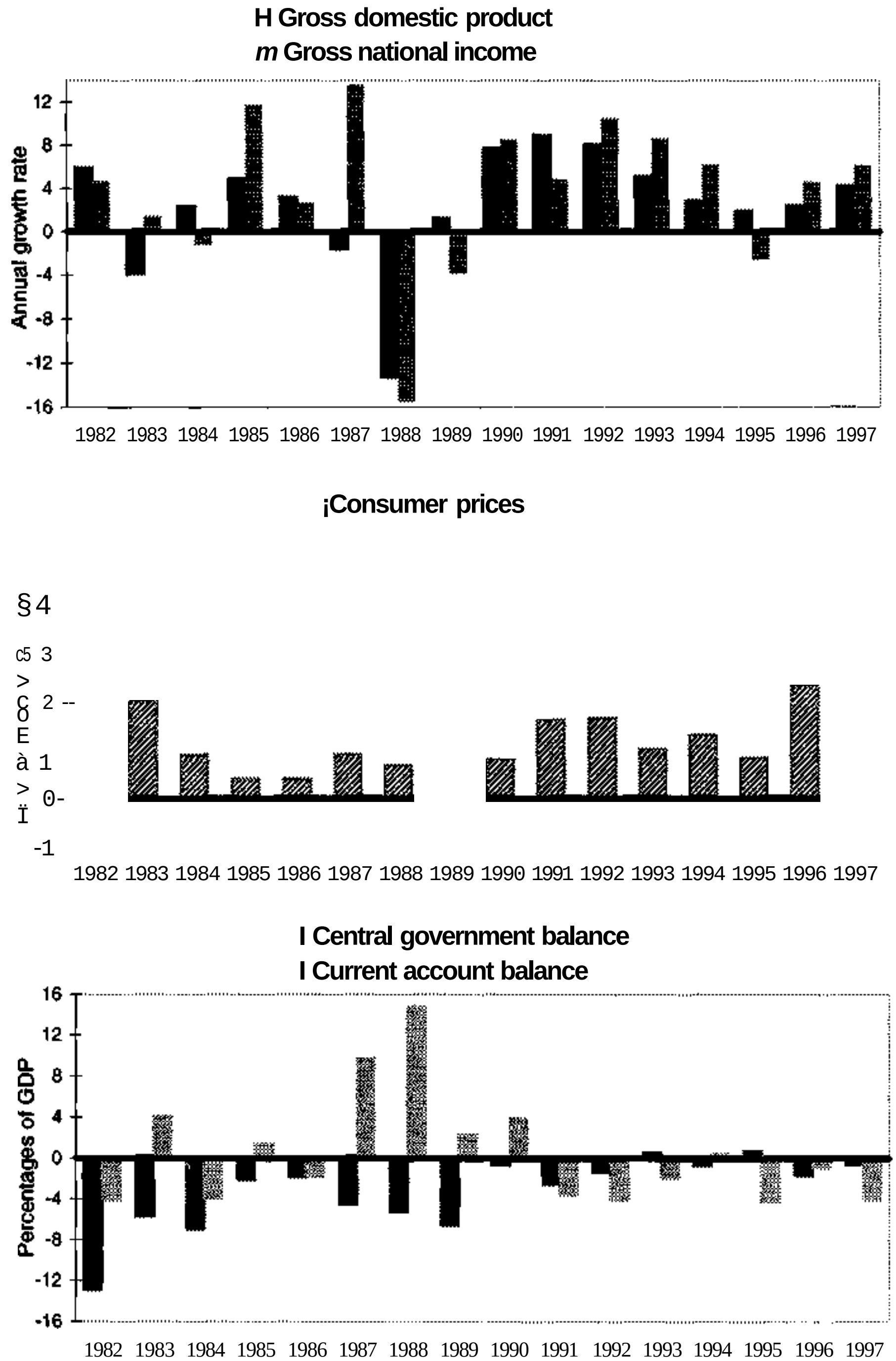
An infrastructure programme was boosted by sounder public finances and the renegotiation of foreign debt; this programme helped to revitalize the economy and facilitated moves into international financial markets with the aim of restructuring the country's debt on more favourable terms.

Current prospects for economic growth are much more promising, above all as a result of the positive effects of infrastructure projects in ports and on railway and highway systems and the concession of Panama Canal facilities and services that had reverted to Panamanian control. GDP is expected to grow by 5% to 5.5% in 1998, that is, at a faster rate than in the three-year period 1995-1997.

2. Economic policy

In 1997, economic policy was directed, on the one hand, towards maintaining fiscal balance and improving the state of public finances and, on the other, towards proceeding with structural reforms designed to deepen the country's integration in international markets. The country's accession to the World Trade Organization entailed the adoption of trade liberalization commitments and the strengthening of mechanisms for countering unfair trade practices. Privatization of State-owned enterprises led to the institutional strengthening of agencies in charge of regulating various industries and promoting competition in the domestic market.

Figure 1
PANAMA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

In December, the Government signed an agreement with the International Monetary Fund (IMF) on an enhanced structural adjustment facility for the disbursement over a three-year period of 120 million special drawing rights (SDR), equivalent to approximately US$ 162 million. The agreement entails economic policy commitments and structural reforms, including furthr privatizations, tariff cuts and a balanced fiscal budget.

Special mention should be made of the activities undertaken to turn to productive use the Panama Canal assets transferred in compliance with the 1978 Torrijos-Carter Treaty, which provides for the return of the Canal to Panama in December 1999. In 1997, the Government of Panama received from the Government of the United States a number of properties, including the Albrook air base, the Gorgas hospital and the Balboa school.

(a)Fiscal policy

In 1997, efforts continued to put central government finances on a sound footing and to keep public-sector accounts in balance. Despite the increase in tax revenues, these accounts showed a deficit equivalent to 0.6% of GDP, a percentage similar to the average for the period 1994-1996.

Boosted by the strong performance of the economy, central government current revenue grew by 5.6% in nominal terms. Tax revenues increased by 10.2% following a sharp increase in income tax collections (16.8%).

Indirect taxes increased in nominal terms as a result of an increase in the transfer tax on movables (ITBM) (7.9%) and increased receipts of import taxes (10.1 %) and excise taxes (5.7%). On the other hand, non-tax revenues decreased by 3.2%, since recent privatizations meant a decline in State ownership of utility companies.

Sales of State-owned enterprises in 1997 brought in proceeds of approximately US$ 700 million. The funds were deposited in the Development Trust Fund held by the Government in the National Bank of Panama.

Central government outlays increased by 8% in 1997. Wage and salary expense rose by 8%, purchases of goods and services by 32%. Interest payments on public debt amounted to US$ 292 million, 28% less than in 1996, when major foreign debt rescheduling had taken place. Outlays for the social sector -mainly for education, health, labour and housing- increased by 8.3%.

Public capital expenditure increased substantially. Infrastructure works accounted for a 48% increase in construction outlays and included road works, expansion and modernization of hydroelectric installations, health and education centres and building of low-cost housing.

Under the external debt renegotiation programme, the last instalment due to a United States bank was paid off in 1997. The private debt rescheduling in 1995-1996 under the Brady Plan reopened the country's access to international financial markets and improved foreign perception of country risk. In 1997, two important issues were placed on international markets on terms deemed favourable: a US$ 500 million issue of five-year Eurobonds at a rate of 7.875% and a US$ 700 million issue of 30-year "global bonds" at 8.875%. The proceeds from both placements were earmarked for the repurchase of Brady bonds, allowing for present value savings of just over US$ 100 million and an extension of the maturity schedule.

The country's foreign debt stood at US$ 5,051 million, US$ 18 million less than at the close of 1996. As a result of the retirement operations, total debt repayments in 1997 increased by close to US$ 300 million to US$ 656 million, while interest payments totalled US$ 264 million.

(b)Credit policy and the international banking centre

Operations of the international banking centre expanded significantly in 1997 in contrast with the contraction recorded in the preceding year. The centre's total assets climbed by 7.9% to total US$ 36,202 million, owing mainly to an increase in the assets of the national banking system (9.1%), since those of the banks operating under international licence barely expanded by 3% to US$ 6,469 million. Deposit-taking in these banks was very sluggish (1.5%) and foreign credit operations declined (-13.1%).

Table **1**
PANAMA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
	Growth rates								
Growth and investment									
Gross domestic product	1.3	**7.7**	**9.0**	8.1	5.2	2.9	1.9	2.4	4.3
Per capita gross domestic product	-0.7	**5.6**	6.9	6.1	3.2	1.0	0.2	0.7	2.6
Gross national income	-3.8	**8.5**	**4.9**	10.5	8.6	6.3	-2.5	4.7	6.1
Gross domestic product, by sector									
Goods	-0.3	**7.9**	12.8	10.5	8.6	3.4	2.0	-0.2	2.1
Basic services	-2.1	**2.4**	**0.8**	1.8	0.5	4.8	7.9	6.0	4.3
Other services	0.4	**8.4**	**7.2**	10.6	4.2	4.4	0.2	2.8	4.8
	Percentages								
Contribution to growth of GDP [c]									
Consumption	10.2	**-6.6**	11.6	3.5	3.3	1.0	-1.7	2.9	5.1
Government	-1.5	**0.2**	1.6	-1.4	0.4	-0.1	0.7	0.5	1.0
Private	11.7	**-6.7**	10.0	5.0	2.9	1.0	-2.3	2.4	4.1
Gross domestic investment	-1.9	13.1	1.8	6.6	3.0	3.4	2.8	-1.0	4.0
Exports	8.3	13.3	32.8	-8.9	-9.4	-4.3	7.5	1.5	6.7
Imports	-15.3	-12.2	-37.2	6.9	8.2	2.9	-6.7	-1.0	-11.6
	Percentages of GDP [b]								
Gross domestic investment	5.0	16.8	17.1	21.9	23.7	26.3	28.6	26.9	29.6
National savings	7.4	20.8	12.9	17.9	21.9	26.5	25.0	26.1	26.2
External savings	-2.4	**-3.9**	**4.2**	4.0	1.7	-0.2	3.5	0.7	3.5
	Percentages								
Employment and wages									
Labour force participation rate	58.9	58.9	57.5	60.2	60.4	60.7	61.7	60.6	61.6
Open unemployment rate [e]	16.3	16.8	16.0	14.7	13.3	14.0	14.0	14.3	13.2
Real minimum wage (index: 1990=100)*	100.7	100.0	98.9	97.4	108.8	107.3	106.6	111.1	109.8
	Growth rates								
Prices (December-December)									
Consumer prices	-0.2	0.8	1.6	1.6	1.0	1.3	0.8	2.3	-0.5
External sector									
Terms of trade (index: 1990=100) [b]	100.9	100.0	98.2	98.1	97.5	95.4	92.2	90.9	93.9
	Millions of dollars								
Balance of payments									
Current account	112	208	-212	-273	-143	22	-343	-73	-343
Trade balance (goods and services)	282	252	-51	-81	-36	60	-173	-105	-305
Exports	3 723	4 438	5 388	6318	6 692	7 419	7 592	7 426	8 276
Imports	3 441	4 187	5 439	6 399	6 728	7 359	7 765	7 531	8 580
Capital and financial account	-944	-361	-116	-44	-165	-362	6	358	918
Overall balance	-832	-152	-328	-187	-308	-340	-337	285	575
Variation in reserve assets (- indicates an increase)	-48	-356	-148	116	-93	-106	-75	-318	-815
	Percentages								
External debt									
Public debt (as a percentage of GDP) [8]	78.0	71.4	63.3	53.4	48.2	47.4	49.8	62.5	59.6
Net interest (as a percentage of exports)	8.5	5.6	6.0	3.7	1.3	0.2	3.3	-0.7	-1.7

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
				Percentages of GDP					
Central government									
Current revenue	11.4	17.4	18.5	18.3	18.7	17.7	18.6	18.4	18.6
Current expenditure	17.1	17.6	15.9	18.0	16.1	16.3	16.1	17.7	
Saving	-5.7	**-0.2**	2.6	0.4	2.6	1.4	2.5	0.7	
Capital expenditure	0.9	**0.4**	5.1	1.7	2.1	2.1	1.8	2.4	
Financial balance	-6.6	**-0.7**	-2.5	-1.3	0.5	-0.7	0.7	-1.7	-0.6
Domestic financing	6.6	**-2.9**	0.1	1.6	-0.1	0.7	-1.1	0.9	
External financing	-	**3.6**	2.4	-0.3	-0.4	0.1	0.3	0.7	
				Annual rates					
Real interest rates (annualized)									
Deposit rate	10.8	9.1	7.1	4.4	5.5	6.2	7.8		
Lending rate		12.1	11.5	9.1	10.5	9.6	10.0		

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1980 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population. [e] Percentages of the economically active population (EAP). Includes Errors and omissions. [8] Refers to the external debt contracted by the public sector; no adjustment has been made for currency fluctuations. [h] Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

Deposits taken in by the national banking system expanded by 12.6%. Demand deposits rose 10.5% and time and savings deposits by 12.4% owing to attractive interest rates for these instruments and their relative liquidity.

Credit showed greater buoyancy in 1997. Loans to the domestic market grew by 9.6%, compared with 5.8% in the preceding year. Commerce accounted for a larger proportion (12.8%), chiefly as a result of the increase in imports into the Colón Free Zone. Mortgage loans also expanded substantially (11.8%), bolstered partly by official housing programmes, while consumer loans increased by 15.7%.

The Panama stock exchange set up in 1990 maintained a strong bullish trend in 1997. The price index and quotations rose by 60%, following a 25% increase in 1996. On the other hand, the volume of transactions soared by 59%, totalling at year-end a market value of US$ 2.2 billion/

A new banking bill was drafted in 1997 and submitted to the Legislative Assembly for approval in early 1998. This bill amends the previous law passed in 1970 and introduces major changes in the regulation and supervision of the sector to bring it in line with Basel standards.

(c) Trade policy

In 1997, Panama became a member of the World Trade Organization and changed its system of tariff and non-tariff protection. Specific taxes were replaced by ad valorem taxes and, at the same time, quantitative restrictions, i.e., prior import licences, quotas and other restrictions, such as health regulations and official reference prices, were removed. In July, certain tariffs were reduced to 10%, and this had an impact on bread production and the construction industry. Subsequently, in January 1998, there was a general reduction in tariffs to 10% or 15%, except for industrial inputs, which continued to be subject to a rate of 3%, and for products such as rice and some dairy products,

1 Of the instruments traded on the Panama stock exchange in 1997, 45% were bonds, 22% government securities, 14% commercial paper and 8% shares.

for which exceptionally high rates of 50% and 40% respectively were maintained for a predetermined period. The average tariff therefore remained at 8.6%.

(d) Structural reform

In 1997, a number of large State-owned enterprises were privatized, including the Atlantic and Pacific ports, a 49% stake in the national telecommunications company (INTEL), the President Remón racecourse, the land transport terminals and the Laguna Alta water purification plant. Important measures were also adopted to ensure that the privatization programme would continue in 1998. The articles of association of the State-owned water resources and electrification company (IRHE) were amended to allow for the creation of six separate companies, subsequently to be put up for sale.

In addition to trade liberalization, steps were taken to prevent dumping, in accordance with the rules of the World Trade Organization.

3. The main variables

(a) Economic activity

Gross domestic product (GDP) grew by 4.3%, corresponding to a per capita increase of 2.7%. The main boost came from the recovery in foreign trade, especially in the Colón Free Zone, following a sharp drop in 1996. Consumption grew by 6.8%, with similar rises in both the public and private components, reflecting increases in employment, wages and government spending. Capital formation recovered (15%) -after plummeting in 1996- thanks to port and road infrastructure projects.

Apart from agriculture, which suffered a setback, practically all sectors of the economy performed better in 1997. International services -trade and transport- were the most buoyant, with government services close behind. The production sectors, on the other hand, recorded lower growth rates in 1997 due to the decline in agriculture.

Panamanian service industries posted gains of 4.6%, compared with 3.5% growth in 1996. Commerce in particular rebounded strongly (8.5%) from its downturn in 1995 and 1996. As indicated earlier, this trend was due in large measure to the strong upturn in activities in the Colón Free Zone (15.4%). Wholesale trade grew by 4.6% and retail trade by 3.4%, a marked improvement on the rates of 1.3% and 1.1% recorded a year earlier.

Transport, storage and communications expanded by 4.5% compared with 2.7% in 1996. Financial intermediation, on the other hand, slowed down considerably, progressing by as little as 3.3% in value added compared with 10% in the preceding year.

After three years of extraordinarily dynamic growth, total tonnage passing through the Panama Canal showed a 4.1% decline in the fiscal year ending September 1997, in comparison with the year ending September 1996. Nevertheless, toll receipts grew by 1.4%, reflecting the rate increases that took effect in January 1997. Both bulk and specialized cargo shipments were down. In this connection, it should be noted that in 1997 a major administrative restructuring of the Panama Canal took place; it ceased to be a non-profit agency of the United States Government and became a market-based enterprise. This new approach is reflected in the medium-term plans for expansion of the waterway, entailing an investment of approximately US$ 1 billion.

Government services expanded by 3.8%, compared with 1.8% in 1996, while the goods-producing sectors recorded an expansion of 2.1%, compared with a 0.2% drop in 1996.

Agricultural activity fell by 1.2%, as adverse factors, in particular the drought, reduced the production of certain farming and livestock commodities. Products for domestic consumption slumped sharply, especially rice (-30%) and corn (-40%). In the former case, a reduction in the area under cultivation, combined with unfavourable weather conditions, yielded lower production figures. Bananas, the main export, also declined for the third consecutive year (-5.6%). Production was adversely affected by high winds and drought, which came in the wake of weaker international demand due to import restrictions by the European Union on bananas of Latin American origin. These poor results were partly offset by the expansion in the production of other items: vegetables and legumes (11%), sugar cane (14%) and various fruit crops (2.4%).

Manufacturing rallied (3.6%), after remaining virtually at a standstill for two years. In general, consumer goods improved their performance. Manufactures for the construction industry also grew substantially, in particular non-metallic minerals (8.8%) and metal products (32.7%). Paper and paper products were down by 6.9%, while petroleum refining expanded by a mere 1.7% owing to technical problems at the refinery.

The construction sector expanded by 5%, in contrast with a 4.1 % contraction in 1996. Growth was due largely to the dynamism of public investment since, according to preliminary estimates, there was a slight downturn in private construction. Various road development projects, including work on the northern corridor, interurban roads and improvements to urban road systems, together with education and health infrastructure projects, gave a strong impetus to the construction industry in 1997.

Lastly, basic services were up 4.3%. In particular, net production of electrical energy increased by 6%, as a result of a substantial expansion in thermal energy, to which the new private electricity companies contributed significantly; on the other hand, there was a fall in hydroelectricity generation (-3.3%) due to the drought. On the demand side, consumption by the commercial sector increased by 13.4%, compared with 4.1% in 1996, as reflected in the brisker pace of economic activity.

(b)Prices, wages and employment

Consumer prices in Panama City declined by 0.5%. Clothing and footwear prices were down (-2%), while those of food and beverages rose by slightly less than the average (0.7%). The cost of a basket of staple foods declined as prices of various products fell: legumes -15.5%, rice -3.8% and fresh vegetables including greens -0.1%.

Wholesale prices declined by 1.7% in September compared with the same month of the preceding year. Imports and industrial products were cheaper (-3.4% and -0.4% respectively); on the other hand, prices of agricultural products rose by 0.6%.

The upturn in economic activity led to a significant increase in employment. According to the information provided by household surveys, the employed population had grown by 5.1% in August compared with the same period a year earlier, while the open unemployment rate had declined from 14.3% to 13.2% during the same period. The sectors generating the most jobs were construction and wholesale trade. In this last sector, employment rose by 2.9% compared with 1996.

Wage increases were granted in various sectors, 5.2% in manufacturing and wholesale trade, 1.4%, in retail trade and 1.2% in hotels and restaurants.

(c)The external sector

After a sluggish performance in the previous year due to setbacks in the Colón Free Zone, Panama's trade picked up considerably in 1997. The balance-of-payments current account deficit widened to US$ 343 million. Nevertheless, the financial account yielded a surplus of US$ 821 million, which was reflected in an increase in net international reserves of the order of US$ 575 million.

Total merchandise trade, including both locally manufactured goods and re-exports, expanded significantly, amounting to US$ 14 billion, a complete reversal of the contraction in the previous year. Total merchandise exports were up 13% and imports expanded at a similar rate, leading to a deficit of US$ 701 million on the merchandise trade account.

After two meagre years, re-exports from the Colón Free Zone bounced back, marking a 13.7% increase over the performance of the previous year to stand at US$ 5,832 million. This followed a recovery in the economic situation of its principal Latin America clients and the reinstatement in late 1996 of the previous tax system applied to firms operating in the zone.

Domestically-produced exports totalled US$ 657 million, a figure 15% higher than that of 1996. This was attributable to the increase in sales of shrimp (28%), coffee (19%) and sugar (27%), and to the substantial increase in exports offish meal (105%), fish oils and fats (474%) and beef (42.5%). On the other hand, banana sales declined by 2.3%.

Goods imported on a c.i.f. basis (cost, insurance, freight) into the Colón Free Zone amounted to US$ 5,513 million, 18% higher than the 1996 figure, which had represented a 10% decrease. This upswing is attributable to the recovery in re-exports and restocking. Moreover, imports for the domestic market expanded by 4.2% for a total of US$ 2,655 million.

Services yielded a positive balance bordering on US$ 400 million (US$ 120 million less than in 1996) as a result of the rapid growth of imports (19%) and hence transport services. Factor income showed a negative balance of US$ 201 million, compared with US$ 120 million in 1996.

Foreign direct investment (FDI) climbed from US$ 237 million in 1996 to US$ 1,030 million, largely as a result of proceeds from the privatization of the telephone company INTEL, which accounted for practically half of FDI inflows.

PARAGUAY

1. Recent trends

In 1997, the Paraguayan economy began to revive, recording 2.6% growth. However, per capita GDP remained at the same level as in the previous year. A recovery in the important agricultural sector sustained a moderate increase in domestic spending, although in a general context of financial instability and stagnant foreign trade.

A much larger soybean harvest more than compensated for a further reduction in the cotton crop, affected by bad weather conditions, and resulted in the agricultural sector posting a satisfactory performance. This permitted a slight increase in private consumption and heavier government spending, in spite of which the public accounts again showed a surplus, although a smaller one than in 1996.

The increased supply of agricultural products helped keep the rise in consumer prices to its lowest level in two decades. Also contributing to this result, which was better than expected, were the continuing relatively stable exchange rate and efficient sterilization of the increased liquidity injected into the system by the monetary authorities in order to rescue financial institutions in trouble.

The banking crisis which began in 1995 grew worse and the Government was obliged to intervene in the administration of the country's two largest banking institutions. The predicament of the banking sector, forthcoming controversial presidential elections and agents' lack of trust in the stability of the currency of Paraguay's main trading partner, Brazil, put downward pressure on the guaraní, especially towards the end of the year. Exchange operations and the heavy current account deficit of around 7% of GDP, which was not offset by capital flows, eroded the international reserves, to the extent that the Central Bank decided to allow the exchange rate to depreciate as of December 1997.

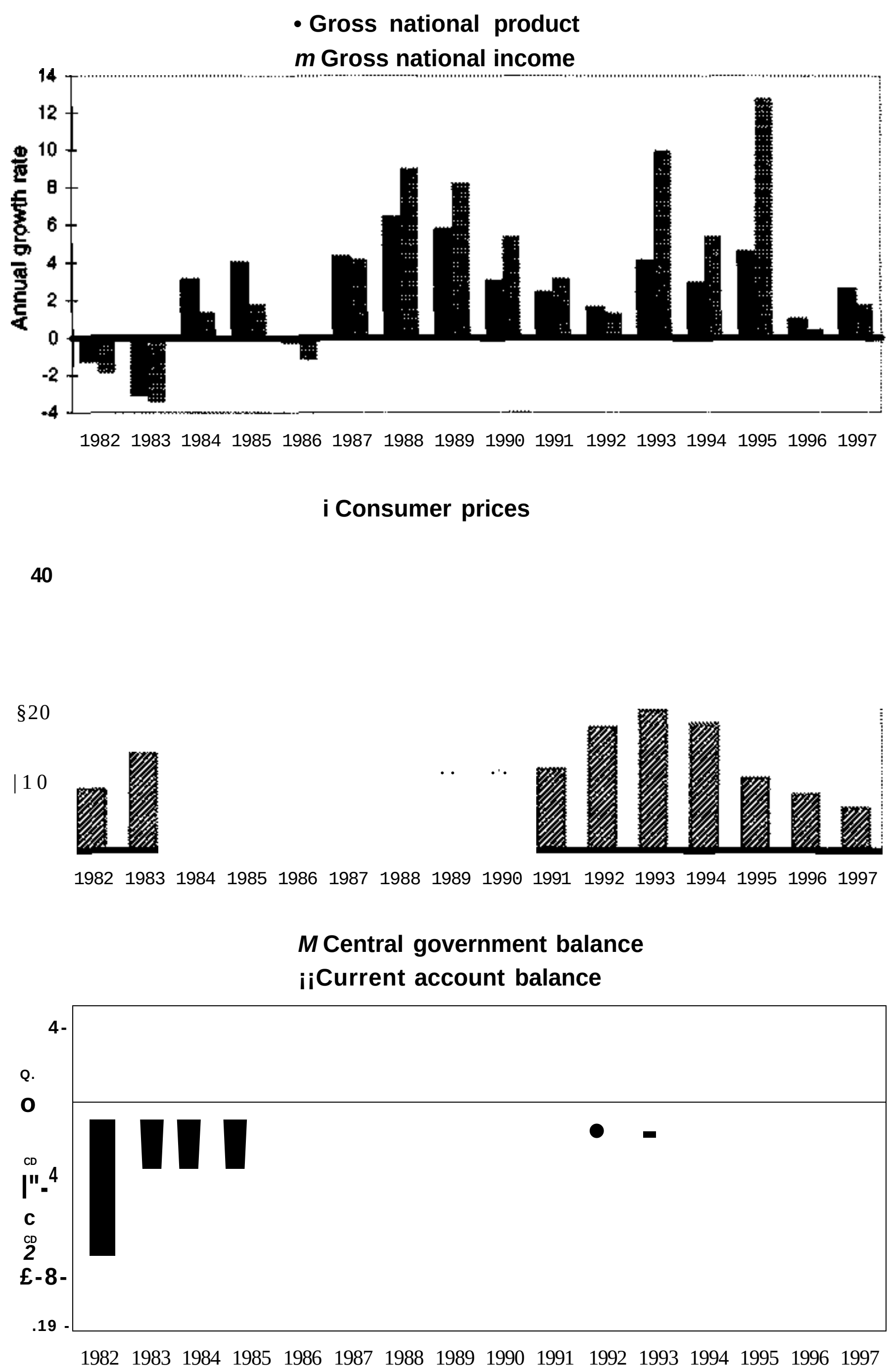
The financial and exchange rate situation deteriorated in the following months. At the end of May 1998, the guaraní had fallen in value by almost 20% compared with five months earlier, whereas the target set for the entire year was 9%. This led to a further round of inflation: the accumulated inflation rate had reached 12% by July, five percentage points higher than the official target for the whole of 1998.

In the meantime, the monetary authorities announced the closure and liquidation of two banks in which they had intervened in 1996. On the other hand, there are encouraging prospects in the agricultural sector, which would allow the Paraguayan economy to continue to grow, in spite of the precarious situation of the banking sector.

2. Economic policy

The main goal of economic policy was to make further progress in bringing down inflation. To this end, the Government strove to narrow the fiscal deficit and the monetary authorities to keep

Figure 1
PARAGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

the exchange rate stable and restrict the expansion of liquidity resulting from the aggravation of the 1995 financial crisis.

These targets were met at the cost of eroding international reserves. At the end of 1997, they fell to their lowest level since 1994. Economic instability, the deteriorating international economic situation and political uncertainty associated with forthcoming confrontational presidential elections combined to make it impossible to maintain the value of the currency in the face of a wave of speculation.

The situation grew worse during the first quarter of 1998 and the Central Bank therefore had to review its depreciation and inflation targets for the year. Half-way through the year, it became obvious that, unlike in 1997, monetary policy would not be propped up by fiscal policy, since the fiscal accounts of both the public sector and the central administration were, predictably, deteriorating, because of larger disbursements to implement investment plans.

(a)Fiscal policy

The central Government managed to reduce the size of its cash deficit from 0.8% of GDP in 1996 to 0.2% in 1997,[1] mainly on the basis of an upturn in revenues. Government savings increased to 3% of GDP and the primary deficit recorded in 1996 (0.3%) became a small surplus.

The increase in revenues of around half a percentage point of GDP was basically accounted for by non-tax income in the form of royalties from the Itaipu and Yacyretá binational hydroelectric plants. The moderate upswing in consumption and rises in the price and in taxes on the consumption of petroleum-based products resulted in increased indirect tax revenue.

Expenditures decreased slightly because of a cut-back in current disbursements. This was achieved by setting quarterly spending quotas for the government agencies and was facilitated by integrated resource-management systems. Outlays on consumption declined, although wages, which constitute the bulk of this item, increased as aresult of pay rises for civil servants. Capital investment, financed by bonds and external financing, recovered strength.

The cash surplus for the public sector as a whole shrank to 0.5% of GDP, owing to a deterioration equivalent to two percentage points in the operating balance of State enterprises. Their revenues were below forecast levels, while implementation of their investment projects meant that their capital expenditure more than doubled.

It is anticipated that, for the first time during the 1990s, the public sector will post a deficit in 1998, owing to planned increased investments. The central administration also expects that its deficit will widen, because of higher personnel costs and investments and because tax rates will be maintained at their current level, after being adjusted the previous year.

(b)Monetary and foreign exchange rate policy

The delicate financial situation grew worse in 1997 and dominated monetary policy. The expansionary effects of the increase in net domestic credit had to be offset by operations on the open and foreign exchange markets.

The financial crisis entered into its third year and in mid-1997 became more acute. The monetary authorities managed to prevent the problem spreading to the system as a whole by means of direct intervention. The Central Bank had to implement a rescue plan for two banks and five financial institutions, including the largest national bank and the largest financial institution in the country. Loans to the banking system as a whole increased by more than 30% in 1997, amounting to the equivalent of 6% of GDP. The main reason for this was the increased number of loans made under the plan established for the rescue of financial institutions and the recapitalization of banks in trouble. There was also a 70% increase in loans by the banking security network to financial institutions with temporary liquidity problems. In addition, net

1 This figure does not include payments made in 1997 for to suppliers incurred in fiscal year 1996. If these payments were included, the government deficit would increase to 1 % of and the non-financial public sector's financial results for 1997 would consequently show a slight deficit.

Table 1

PARAGUAY: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
					Growth rates				
Growth and investment									
Gross domestic product	5.8	**3.0**	2.4	1.6	4.1	2.9	4.5	1.0	2.6
Per capita gross domestic product	2.5	**0.0**	**-0.5**	-1.1	1.3	0.2	1.8	-1.6	-0.1
Gross national income	8.3	**5.4**	3.2	1.3	9.9	5.4	12.8	0.4	1.8
Gross domestic product, by sector									
Goods	6.5	**2.0**	**0.4**	0.8	4.0	0.6	5.8	0.3	3.0
Basic services	5.2	7.4	**6.7**	5.8	7.9	11.4	8.9	4.3	2.2
Other services	5.0	**3.6**	4.1	1.9	3.6	4.1	2.3	1.1	2.2
					Percentages				
Contribution to growth of GDP '									
Consumption	-4.4	11.7	4.0	8.6	5.6	8.6	9.6	2.4	2.4
Government	0.3	0.2	1.2	0.6	0.4	0.3	1.0	0.8	0.4
Private	-4.7	11.5	2.8	8.1	5.2	8.3	8.6	1.6	2.0
Gross domestic investment	2.1	2.0	2.0	-1.6	0.5	1.0	1.6	0.0	0.6
Exports	-4.6	4.3	2.1	-2.3	13.5	6.6	4.4	-6.1	-0.4
Imports	3.4	-15.0	-5.7	-3.1	-15.5	-13.3	-11.0	4.7	0.0
					Percentages of GDP				
Gross domestic investment	21.6	22.9	24.3	22.3	21.9	22.3	22.8	22.6	22.6
National savings	26.6	19.6	18.3	10.8	14.8	11.6	15.3	13.3	12.7
Externai savings	-5.0	3.3	5.9	11.5	7.2	10.6	7.5	9.3	9.9
					Percentages				
Employment and wages									
Labour force participation rate '	64.2	61.0	59.4			59.1	64.8	63.0	
Unemployment rate[e]	6.1	6.6	5.1	5.3	5.1	4.4	5.3	8.2	9.0
Real average wage (index: 1990=100)	108.9	100.0	104.7	103.6	104.5	106.1	114.0	117.5	117.0
					Growth rates				
Prices (December-December)									
Consumer prices	26.0	44.1	**11.8**	17.8	20.3	18.3	10.5	8.2	6.2
Wholesale prices[e]	26.1	67.2	12.4		14.8	15.1	13.9	7.1	1.1
External sector									
Terms of trade (index: 1990=100)[b]	101.7	100.0	99.5	98.6	91.2	96.1	96.1	99.8	106.6
Nominal exchange rate (guaraníes per dollar)	1 145	1230	1 325	1 500	1 744	1912	1971	2 063	2 191
Real effective exchange rate (index: 1990=100)	102.5	100.0	90.9	96.7	100.2	94.6	94.2	90.1	88.6
					Millions of dollars				
Balance of payments									
Current account	256	-172	-324	-626	-412	-627	-498	-638	-670
Trade balance (goods and services)	256	-214	-390	-644	-470	-739	-647	-741	-762
Exports	1 575	1880	2 024	1904	2 959	3 441	4 578	4 280	4 063
Imports	1 319	2 093	2415	2 548	3 428	4 180	5 225	5 021	4 825
Capital and financial account	-265	287	687	602	495	953	565	593	454
Overall balance	-9	114	363	-24	83	326	67	-44	-216
Variation in reserve assets (- indicates an increase)	-145	-219	-299	347	-86	-328	-47	40	216
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	46.5	32.2	26.7	19.8	18.2	16.3	15.2	14.2	14.9
Net interest (as a percentage of exports)[8]	4.0	1.4	1.4	5.0	1.6	0.8	0.2	0.5	0.7

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
				Percentages of GDP					
Central government									
Current revenue	11.4	12.4	11.9	12.6	12.3	14.5	15.3	14.9	15.2
Current expenditure	8.9	**7.8**	8.6	11.5	11.1	11.4	11.7	12.5	12.2
Saving	2.5	**4.6**	3.3	1.1	1.1	3.1	3.7	2.5	3.0
Capital expenditure (net)	1.0	**1.5**	2.5	2.4	1.9	2.3	3.9	3.3	3.3
Financial balance	1.5	**3.0**	0.8	-1.4	-0.7	1.0	-0.3	-0.8	-0.2
				Growth rates					
Money and credit									
Monetary balance of banking system									
Net international reserves			46.3	-11.4	28.3	41.3	-0.4	12.6	-20.5
Net domestic credit			-41.8	2 156.4	19.3	8.3	62.4	33.8	45.0
To public sector					-2.5	-82.8			
To private sector			59.6	39.2	35.7	36.7	18.3	22.8	15.3
Money (Ml)	46.1	27.7	27.5	30.5	17.7	32.4	21.0	2.1	13.8
Local-currency savings and time deposits	30.8	**-9.4**	53.0	25.0	4.1	59.3	22.2	39.4	0.5
M2	37.3	20.0	35.3	35.1	9.7	38.4	28.2	15.4	5.9
Dollar deposits	892.2	63.1	56.0	66.5	53.0	15.3	3.0	39.5	19.9
				Annual rates					
Real interest rates (annualized)									
Deposit rate		13.4	23.9	16.7	3.2	5.3	11.5	9.8	7.9
Lending rate		30.0	35.6	28.2	11.9	15.2	21.1	22.2	20.7
Equivalent interest rate in foreign currency '		-18.3	-9.1	5.0	9.1	17.9	19.8	11.0	4.0

Source: ECLAC, on the basis of official figures.
* Preliminary figures. Based on constant 1980 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. [d] Percentages of the working-age population in Asunción. From 1994, urban population nationwide. [e] Percentages of the economically active population (EAP). Up to 1993, this figure refers to the Asunción metropolitan area. Figures for 1994 and the following years refer to urban areas nationwide. Includes Errors and omissions. [8] Refers to net interest as shown on the balance of payments, divided by exports of goods and services. Figures for 1990-1992 are December-December rates; figures for 1993-1994 are annual averages. ' Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
PARAGUAY: MAIN QUARTERLY INDICATORS

	1995				1996				1997[a]				1998[a]	
	I	II	III	IV	I	n	III	IV	i	ii	m	IV	I	II
Consumer prices (nationwide) (12-month variation, %)	14.3	14.9	12.2	10.5	11.1	9.7	9.8	8.2	8.7	7.9	5.9	6.2	6.6	10.8
Registered exports (millions of dollars)	176	272	282	190	214	357	279	199	207	393	296	192	218	366
Registered imports (millions of dollars)	636	685	779	696	582	615	683	778	687	643	713	915	545	545
Real effective exchange rate (index: 1990=100)	95.6	95.8	93.2	92.2	89.9	89.4	90.3	90.8	88.2	87.2	88.1	90.7	97.4	102.2
Real interest rate (annualized, %)														
Deposit rate	5.8	12.1	17.1	11.1	-0.9	14.1	12.1	14.0	-6.2	12.4	15.6	9.8	-26.7	
Lending rate	12.8	21.4	28.1	22.1	9.5	25.8	26.1	27.4	4.3	24.6	32.4	21.6	-18.1	

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Refers to the rate of exchange for imports.

lending to the non-financial public sector grew, central government deposits being used to cover the deficit. And foreign currency debts expressed in local currency also increased, owing to the slight depreciation of the guaraní.

The Central Bank had recourse to operations on the open market in order to sterilize excess liquidity. During the first six months of 1997, the terms of most placements varied between one week and three months, at slightly lower rates (around 11%) than in 1996, in order to avoid harmful effects on the economy. The financial situation deteriorated in the third quarter and the Bank started to float larger amounts of monetary regulation instruments for terms of up to 12 months and with higher average rates of up to 14%. At the end of 1997, these flotations declined, because the general uncertainty had repercussions on the exchange rate and gave rise to renewed demand for foreign currency. At the end of December, the balance of these flotations was 40% higher than one year earlier.

Monetary regulation instrument issues with moderate yields proved unable to absorb all the liquidity injected into the system during the second and third quarters of 1997 or to restrain the rise in the exchange rate. The Central Bank therefore opted to intervene actively in exchange operations as a net seller of currency during the remaining quarters. As a result of this decision, by the end of 1997, the level of its international reserves had fallen to US$ 800 million, or the equivalent of just over two months of imports, a situation which led the Bank to relax its interventionist policy as of 9 December 1997. Economic agents reacted to this measure by increasing their demand for dollars, in view of the gloomy picture presented by the financial crisis and fears that the Brazilian *real* would be devalued. The interventions of 1997 resulted in an increase of some 6% in the nominal exchange rate and a slight real appreciation of the Paraguayan currency.

These operations overall translated into a 7.5% expansion of the monetary base in 1997, more than double the increase recorded the previous year. In turn, monetary supply, Ml, expanded by 14%.

The increase in money meant that the cost of borrowing continued to fall. Effective rates for on-sight deposits in local currency dropped significantly. Yields on term deposits and savings certificates also declined, in line with the rates for monetary regulation instruments. Lending rates in local currency did not fall to the same extent. Nonetheless, the rate for personal loans was 20% lower on average than at the end of the previous year. Lending and borrowing rates in dollars went down only very slightly.

Depositors' lack of confidence in the financial system and the decline in interest rates on guaraní operations meant that the rate of growth (6%) of M2, which includes quasi-money in local currency, lagged behind that of money supply. The preference for foreign currency was reflected in the 12% increase in the broad monetary aggregate, M3.

The exchange and financial situation of Paraguay deteriorated during the first quarter of 1998. The Central Bank began to sell foreign currency once again and as a result its reserves fell below US$ 750 million. In view of the extent of this erosion, the monetary authorities decided to raise the average rates on regulatory instruments to more than 20% and to issue these instruments on short terms, mostly of between 7 and 45 days, as a measure to strengthen the weakened guaraní. However, at the end of the first quarter, the currency had depreciated 11% compared with its value at the end of 1997, whereas the target for the entire year had been only 9%. It was hoped that seasonal strengthening of exports during the second quarter would reverse this trend. At the end of the first quarter, the closure and liquidation of the two banks in which there had previously been intervention was decreed.

(c) Trade policy

Important progress was made in 1997 towards strengthening the Southern Common Market (Mercosur) customs union. At the end of the year it was agreed to adopt measures to eliminate non-tariff barriers, a process which would now include the service sector, as well as merchandise trade. Agreement was also reached on facilitating the participation of construction firms in member countries' public tenders.

There was, however, a slight delay in the timetable for reducing tariffs. In order to address the possible effects of the Asian crisis on the trade balance of the Mercosur partners, it was agreed to raise the common external tariff; this resulted in an increase in the average tariff of Paraguay from 14% to 17%. However, the Government decided to exclude from this measure tariffs on capital goods and on telecommunication, computer and motor vehicle products, as well as the 399 exceptions that will converge in the common external tariff by the year 2006.

3. The main variables

(a) Economic activity

After a meagre 1 % increase the previous year, the economic growth rate quickened to 2.6% in 1997, thanks to strengthened domestic demand as a result of the upturn in agricultural production. External demand for domestic goods again contracted, while imports remained stagnant. Gross national income recovered, assisted by considerably improved terms of trade.

Private consumption expanded by a little more than two percentage points and served as the basis for the moderate recovery in absorption. The rate of expansion of government consumption slowed from 10% to 4%. Gross investment rebounded 3%, after a sharp fall in the previous fiscal year.

After virtually stagnating in the previous season, the agricultural sector was the strongest in the whole economy. It grew by 4%, mainly because of the soybean crop, which for the third year in a row was unprecedentedly large, with similar prospects for a fourth year. The cotton crop, on the other hand, again gave very poor yields (-60%) because bad weather conditions resulted in a smaller area being sown.

The production of other goods also recovered. Industrial output, chiefly of agroindustrial products, continued to grow slowly (2%). Construction expanded (3%) for the seventh consecutive year.

The basic services sector, used to average annual growth rates of around 6%, was affected by a decline in potable water and sanitation services and by a marked slow-down in electricity supply, so that its total growth fell to only 2%.

The remaining services also posted mediocre results (2% growth). Among them, trade advanced to some extent under the impetus of agricultural production, after declining in 1996.

Preliminary figures for the 1998 cotton harvest suggest that it will be of a similar level to two seasons ago, thanks to improved yields and the larger areas sown. Soybean production is expected to perform well again and will help the economy grow by 3%, and thus meet government projections.

(b) Prices and wages

The moderate increase in consumption, a relatively stable exchange rate, the increased supply of agricultural products and a private-sector campaign to reduce supermarket and other retail shop prices combined to restrict the increase in the consumer price index to 6.2% in the 12 months ending in December 1997. This was two percentage points less than in the previous year and the lowest for two decades. Prices of the tradable items (food, clothing and footwear) comprising two thirds of the basic basket went up by between 3% and 4%, while those of other items (housing, health services, transport and education) increased from 9% to 11%.

However, inflation took off again at the beginning of 1998, so much so that the accumulated increase in the first seven months of the year was as high as 12.1% (12.8% in the previous 12 months), as a result of seasonal increases in the prices of food and educational services and because of exchange rate pressures. The Central Bank target had been for price increases not to exceed 7% for 1998 as a whole.

Real average wages decreased by half a percentage point in 1997 because wages in the manufacturing industry, transport, communications and services rose at a rate equal to or lower than the consumer price index. On the other hand, nominal wages in the construction, basic services and trade sectors increased by more than 9%. The minimum wage was readjusted 10% upwards in January 1997, resulting in a real improvement of 5% compared with the 1996 average, and 12% in March 1998, to just over US$ 232 a month at the prevailing exchange rate.

(c)The external sector

At the end of 1997, the balance-of-payments deficit amounted to more than US$ 200 million, five times that recorded in 1996. Larger capital flows did not compensate for the heavy imbalance in the current account, which caused a sharp reduction in the international reserves.

The current account deficit widened to 7% of GDP as a result of a large increase in the trade deficit to the equivalent of 15% of GDP. Capital inflows went up by 12%, to the equivalent of 3% of GDP, thanks to a massive influx of direct foreign investment, mainly directed to the forestry and soybean sectors and the binational hydroelectric plants. The balance under the heading of errors and omissions, associated with short-term capital inflows, was halved, possibly in reaction to the fall in interest rates and the unstable financial situation.

The total value of exports declined 5%, owing to fewer re-exports and a drop in unregistered exports, which together accounted for 60% of the total. This decline is explained by new restrictions on border trade with Brazil. Registered exports stayed at almost the same level as in the previous year, since the large increase (37%) in the value of soybean exports did not make up for the decline in cotton fibre exports to only one third of their value in 1996. The most important destination for cotton fibre exports, accounting for 50% of the total, was Mercosur, with Brazil importing by far the largest share.

Imports also declined somewhat, with a reduction in unregistered imports intended for re-export, which represented 30% of the total. Registered imports especially of consumer goods, mostly non-durables, increased (4%). Imports of intermediate goods fell by 18%, because of reduced purchases of other products, not counting fuels. Capital goods imports remained at their previous level. The only import category which recorded an increase was transport equipment. Half of all imports were from the Mercosur countries, two thirds of that share from Brazil. Services also lost momentum, affected by the declining numbers of "tourists" involved in cross-border trade, interest having waned because of limits on purchases imposed by the Brazilian authorities.

The external debt grew by 7%, to the equivalent of 15% of GDP. Almost all of it was accounted for by public-sector commitments, the central Government being the main debtor, with three fifths of the total, followed by State enterprises, with one quarter. The continuous increase in the size of the external debt over the past five years is giving rise to concern. It reflects larger public project commitments, and has been aggravated by the depreciation of the local currency. International bodies, especially the Inter-American Development Bank, continue to be the main creditors, accounting for 60% of the total; the remaining creditors are Paris Club countries.

PERU

1. General trends

The Peruvian economy's performance has been in keeping with the economic model being implemented since 1990, which has included major structural reforms anda stabilization policy that has remained in place since the model's inception. Over the past five years, the economy has grown at an average rate of 7.5% per annum, while inflation has exhibited a downward trend, coming in at single-digit figures. The economy has continued to suffer from weaknesses in the external sector and on the employment front, however. Against this backdrop, the Peruvian economy in 1997 exceeded initial expectations, posting growth of over 7%; this was an improvement upon the modest performance recorded the previous year, when the Government's adjustment policy had been a dominant factor. The trend in inflation was also very positive, with the annualized rate falling to 6.5% by December.

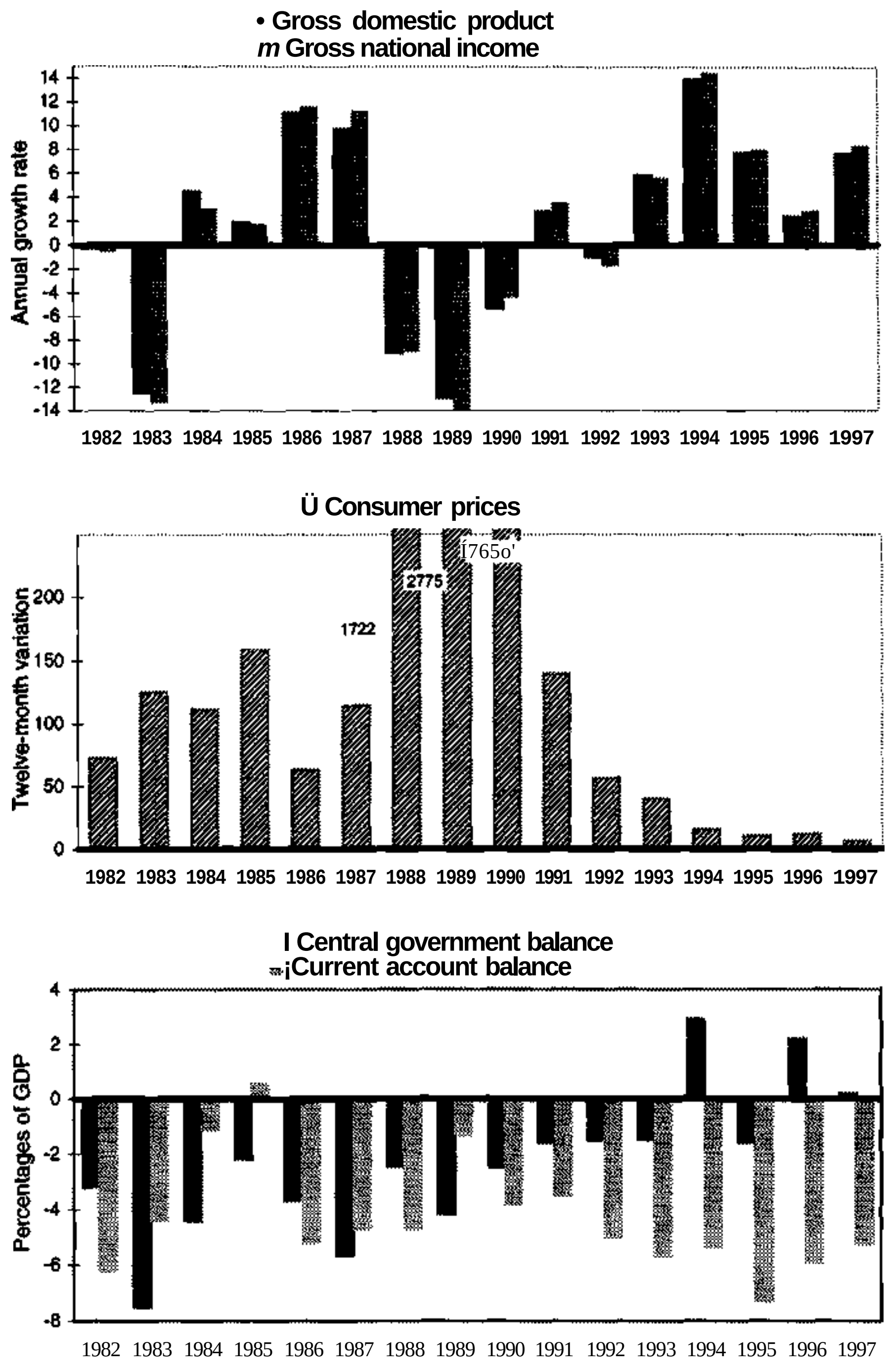
The Asian crisis had virtually no impact on Peru's economy in 1997, but El Niño caused both fishery exports and agricultural production to drop sharply in the final quarter of the year, as well as being responsible for serious damage to infrastructure. The national employment rate rose on the strength of GDP growth; the period saw a continuation of the trend towards higher employment in commerce and services, but job growth in manufacturing remained sluggish.

Macroeconomic policy played a somewhat contractionary role in terms of fiscal expenditure, while monetary policy was in step with the speed-up in the rate of GDP growth. The non-financial public sector recorded a surplus of close to 1% of GDP thanks to reductions in both current and capital expenditure. The fact that this surplus was lower than it had been the year before was attributable to the downturn in privatization revenues, which decreased by the equivalent of around 2.5% of GDP.

The expansion in total liquidity was attributable to the marked increase in foreign-currency credit. In keeping with the pace of GDP growth (7%) and the slowdown in inflation, monetary policy, which influences local-currency monetization ratios, was used to sterilize part of the rise in international reserves. The expansion in demand did not translate into inflationary pressures thanks to the country's greater import capacity and the stability of the real exchange rate. Another influential force in terms of stabilization was the impact of supply-related factors, such as the decreases seen in fuel and import prices, which were especially marked in the case of foodstuffs.

The balance of trade showed very positive results during the first six months, thanks to the upswing in fishery exports that was registered despite the effects of El Niño, and the trade deficit thus shrank by US$ 200 million. This drop, together with a slight decrease in financial servicing, made it possible to reduce the current account deficit to 5.2% of GDP. Quite apart from the privatization process, foreign direct

Figure 1
PERU: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

investment has continued to expand vigorously, and its role in financing the balance-of-payments current account has consequently grown significantly.

In 1997, the successful renegotiation of the external debt with the Paris Club and the signing of an agreement with international banks under the Brady Plan enabled Peru to bring its external debt service into line with its economy's payment capacity and to regain access to external credit flows. This renegotiation was instrumental in lowering Peru's external debt by the equivalent of more than 10% of GDP.

The devastating effects of El Niño carried over into the first quarter of 1998, sharply reducing the country ' s growth prospects for the year. As a consequence, the economy is expected to be sluggish during the first six months of the year, but should pick up in the second half. The urgent need to repair or replace damaged roadway infrastructure will boost public spending on investment. The steep decrease in fishery activities and the low prices that minerals (particularly copper) are expected to fetch have led forecasters to project slower export growth in 1998, which will hamper efforts to rein in the trade deficit. El Niño also had an impact on prices, especially of foodstuffs, which drove up the inflation rate. Thus, in April, cumulative inflation stood at 4%, twice the figure recorded the year before.

The Asian crisis, for its part, led to the suspension of a number of large mining projects, thus raising doubts as to the medium-term outlook for mining exports.

2. Economic policy

Despite cutbacks in public spending, macroeconomic policy ultimately had an expansionary effect in 1997, since monetary policy-makers did not seek to sterilize the sharp increase registered in credit to the private sector; this expansion of credit was derived from the short-term capital flows generated by borrowing from the private international banking system.

(a) Fiscal policy

Judging from the net financial balance, fiscal policy was clearly contractionary until the third quarter. Quarterly figures for central government spending showed a major downturn in current expenditure (especially in the second quarter), which was down by 2.5% of GDP with respect to the preceding year. Current revenue held steady at 14% of GDP.

Even though public spending was increased towards the end of the year in order to cope with the damage that El Niño was expected to cause, central government accounts (excluding privatization receipts) were nearly balanced (-0.8% compared to -1.5% in 1996).

Unlike previous years, capital receipts from privatizations were quite meagre (0.9% of GDP versus 3.5% in 1996), and this was the main reason why the surplus posted by the non-financial public sector was so much smaller in 1997 (0.8% of GDP, down from 2.4%).

(b) Monetary and foreign exchange policy

Given the economy's high degree of dollarization (only 34% of total liquidity was in local currency), monetary policy had fairly little manoeuvring room. Nonetheless, government actions with respect to primary money creation have had a strong impact on nominal domestic demand, since wages and private consumption expenditure are both in local currency.

In order to help offset the marked expansion in domestic credit fueled by foreign exchange inflows, during the first half of the year the authorities held the expansion of local-currency monetary aggregates to the slow rates of growth they had exhibited in 1996. This trend was reversed in July, however, when the rate of primary money creation picked up, bringing the cumulative increase for the year to 16% (four percentage points higher than the year before).

Table 1
PERU: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
					Growth rates				
Growth and investment									
Gross domestic product	-12.9	**-5.4**	2.8	-0.9	5.8	13.9	7.7	2.4	7.7
Per capita gross domestic product	-14.6	**-7.1**	0.9	-2.6	4.0	12.0	5.9	0.7	5.8
National income	-13.9	**-4.4**	3.5	-1.7	5.6	14.5	8.0	2.9	8.4
Gross domestic product, by sector									
Goods	-13.3	**-4.6**	4.5	-1.8	7.6	19.2	7.7	1.1	8.5
Basic services	-8.6	**-4.9**	2.2	2.1	6.0	7.3	10.5	6.1	7.8
Other services	-11.5	**-6.0**	2.3	-1.9	3.9	10.3	11.1	4.2	7.7
					Percentages				
Contribution to growth of GDP [c]									
Consumption	-9.3	**-4.7**	1.5	0.1	3.5	7.6	5.7	3.3	4.1
Government	-0.6	**-0.8**	0.2	0.2	0.3	0.7	0.8	0.2	0.3
Private	-8.7	**-3.9**	1.3	-0.1	3.2	6.9	5.0	3.2	3.8
Gross domestic investment	-7.4	**2.6**	2.4	-0.3	2.6	6.8	4.9	-1.9	3.8
Exports	1.6	**-1.9**	1.4	0.6	0.3	2.6	1.1	1.4	2.1
Imports	2.2	**-1.4**	-2.5	-1.4	-0.4	-3.1	-4.0	-0.4	-2.3
					Percentages of GDP [b]				
Gross domestic investment	17.7	21.4	23.1	23.1	24.2	27.2	29.8	27.2	28.8
National savings	16.1	17.5	18.9	17.2	18.1	21.4	21.7	20.6	22.9
External savings	1.6	3.9	4.2	5.9	6.1	5.8	8.1	6.6	5.9
					Percentages				
Employment and wages									
Labour force participation rate	61.2	61.3	57.2	58.8	60.8	59.7	62.4	60.3	63.3
Open unemployment rate [e]	7.9	8.3	5.9	9.4	9.9	8.8	8.4	7.9	8.3
Real average wage (index: 1990=100) [f]	114.5	100.0	115.2	111.1	110.2	127.4	116.7	111.2	110.3
					Growth rates				
Prices (December-December)									
Consumer prices	2 775	7 650	139	56.7	39.5	15.4	10.2	11.8	6.5
Wholesale prices	1920	6 534	96	50.5	34.1	10.5	8.8	11.4	5.0
External sector									
Terms of trade (index: 1990=100) [b]	95.4	100.0	96.1	95.1	89.0	90.7	94.0	94.4	100.3
Nominal exchange rate [E] (new soles per dollar)	0.003	0.19	1.33	1.50	1.74	1.91	1.97	2.06	2.19
Real effective exchange rate for imports (index: 1990=100)	123.6	100.0	83.1	83.7	93.1	87.9	87.7	86.4	86.9
					Millions of dollars				
Balance of payments									
Current account	-570	-1384	-1 509	-2 101	-2 302	-2 662	-4 298	-3 605	-3 415
Trade balance (goods and services)	939	33	-602	-916	-1 182	-1499	-2 943	-2 679	-2 553
Exports	4 369	4 120	4 232	4 497	4 353	5 662	6 722	7 268	8 372
Imports	3 430	4 086	4 834	5 413	5 535	7 161	9 665	9 947	10 925
Capital and financial account	-2 020	-1046	956	1306	2 397	4 083	3 745	4 561	5 880
Overall balance	-2 610	-2 455	-553	-795	95	1421	-553	956	2 465
Variation in reserve assets (- indicates an increase)	-242	-212	-837	-695	-724	-3 032	-950	-1 878	-1635
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	42.9	55.3	48.8	51.1	68.3	61.2	56.9	55.0	43.5
Net interest (as a percentage of exports) '	38.1	41.7	31.5	32.7	34.1	28.4	24.5	17.1	11.0
					Percentages of GDP				
Central government									
Current revenue		7.8	9.1	11.0	10.8	13.0	13.6	14.2	14.0
Current expenditure		9.1	9.2	10.0	9.8	11.1	13.2	12.7	11.7
Saving		-1.3	-0.1	1.0	1.0	1.9	0.4	1.5	2.3
Capital expenditure (net)		1.2	1.5	2.5	2.5	-1.1	2.1	-0.5	2.3
Financial balance	*-42*	-2.5	-1.6	-1.5	-1.5	2.9	-1.6	2.2	0.1
Non-financial public sector									
Financial balance	-7.1	-4.5	-1.5	-1.4	-1.2	3.0	-1.3	2.4	0.8
Domestic financing	4.6	2.0	-0.7	0.5	-0.3	-4.2	-1.0	-3.1	-0.3
External financing	2.5	2.5	2.2	0.9	1.5	1.1	2.3	0.7	-0.5

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
	Millions of new soles '								
Money and credit									
Monetary balance of banking system									
Net international reserves	2 873	352 297	1856	3 953	6 255	13 109	15 461	23 040	21659
Net domestic credit	18 125	742 327	1976	3 080	5 577	4 461	7 562	8 726	16 307
To non-financial public sector	3 135	170 845	-32	-391	-844	-5 754	-7 825	-14 709	-16 292
To private sector	11457	642 204	2 471	4 852	8444	13 934	19 834	29 314	38 724
Money (Ml)	8 904	420 884	945	1620	2 399	3 792	4 678	5 523	6 445
Local-currency savings and time deposits	7 193	159 898	591	845	1297	2 545	3 785	4 793	6 482
M2	16 097	580 782	1536	2 465	3 696	6 337	8 463	10316	12 927
Dollar deposits	4 901	513 842	2 295	4 568	8 258	11304	14 231	21060	24 615
	Annual rates								
Real interest rates (annualized)									
Deposit rate	-47.2	-54.3	13.7	-20.9	-16.9	-4.6	-0.5	-1.4	3.6
Lending rate	-31.2	-13.0	248.2	58.5	38.7	34.5	23.5	17.8	23.0
Equivalent interest rate in foreign currency	85.0	-33.8	83.0	12.7	-12.8	11.4	0.9	-1.2	5.6

Source: ECLAC, on the basis of official figures.

Note: The growth rates given for 1990 under the heading "Money and credit" have been revised since the pubication of the *Economic Survey of Latin America and the Caribbean, ¡994-1995,*

* Preliminary figures. Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Percentages of the working-age population. [e] Percentages of the economically active population (EAP). Up to 1994, refers to Lima. From 1995 on, refers to the nationwide urban total. Private-sector workers in Lima. [8] For 1989, the exchange rate is expressed in new soles per US$1000. Includes Errors and omissions. 'Refers to net interest as shown on the balance of payments, divided by exports of goods and services. ' Up to 1990, these figures are expressed in thousands of new soles. Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2

PERU: MAIN QUARTERLY INDICATORS

	1995				1996				1997"				1998[a]	
			III	IV			III	IV			III	IV		
Gross domestic product (change from same quarter of preceding year) [b]	12.8	8.7	6.8	1.2	0.3	2.5	2.1	4.9	5.7	9.0	7.4	6.5	2.1	
Consumer prices (12-month variation, *%)*	11.9	11.1	10.0	10.2	11.6	11.0	11.7	11.8	9.3	9.5	8.1	6.5	8.2	7.7
Real effective exchange rate[c] (index: 1990=100)	87.6	90.6	86.7	85.9	85.3	85.2	86.2	89.0	88.5	88.1	85.5	85.6	85.2	85.7
Exports (millions of dollars)	1293	1359	1498	1442	1427	1459	1494	1517	1602	1852	1770	1571	1 193	1 334
Imports (millions of dollars)	1797	1907	2026	2031	1792	2010	2 040	2055	1930	2 133	2281	2217	2 068	2 153
Real interest rates (annualized, *%)*														
Deposit rate	-3.1	-1.5	1.9	0.7	-6.8	1.4	-0.5	0.1	2.6	1.0	4.8	6.1	-4.1	2.8
Lending rate	22.2	22.5	26.2	23.4	12.7	20.9	18.0	18.9	21.9	20.2	23.9	25.8	14.2	22.7
Money (Ml) (change from same quarter of preceding year)	57.1	39.9	25.8	23.5	10.5	I5.Í	15.6	17.8	24.2	19.8	22.0	16.7	15.8	15.5
Central government financial balance (as a percentage of GDP)	-2.2	-1.3	-2.1	-1.0	-0.9	0.1	-1.0	-3.5	0.6	1.8	-1.3	-4.4	0.3	
Net international reserves (millions of dollars)	5 674	6 050	6 157	6 641	6 819	7 207	8 482	8 862	8 576	8 605	8 438	7 982	7 836	7 646

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. Based on figures expressed in the local currency at constant prices. Refers to the exchange rate for imports.

The variation in money creation, which amounted to 1.4 billion new soles, was external in origin and was not completely sterilized by the securities issued by the Central Reserve Bank of Peru and the increase in public-sector and Banco de la Nación deposits. This made it possible for GDP to grow by 7% while inflation was held to a similar level.

The monetization ratio (MI/GDP) remained unchanged at 3%, but total liquidity expanded by more than one point of GDP to 19%. The dollarization of the economy continued apace, with the share of local-currency monetary aggregates falling to one third. Credit to the private sector rose by 3% of GDP owing to an increase in short-term external capital flows.

The interest rate spread between local-currency bank loans and deposits remained at a very high 20%, which was quite similar to the figure for the preceding year. The real local-currency lending rate reversed its downward trend of recent years, rising to 23%. Because the economy is so heavily dollarized, however, local-currency rates mainly influence consumption, while foreign-currency rates are more relevant when evaluating corporate borrowing costs. At an average rate of 15.6% between September and December, the foreign-currency rate fell by one percentage point with respect to 1996. This provided a further indication that the Asian crisis has had no more than a limited impact on the country's commercial banking system.

In the area of foreign exchange policy, the authorities continued to implement a managed float of the currency, and the exchange rate therefore kept in close step with inflation. The real exchange rate for the dollar held steady, while the real rate as measured on the basis of the price indices of Peru's seven main trading partners showed an abrupt decline of almost 3% compared to 1996.

The positive performance of Peru's stock exchange ended in July with the onset of the crisis in Asia. The general index of the Lima Stock Exchange plunged by 18% in real terms, and the downswing was of a similar magnitude when expressed in dollar terms. The stock market began to rebound late in the first quarter of 1998, however.

(c) **Trade policy**

A policy package that had taken several years to develop and whose chief aim was to boost the competitiveness of Peru's exports was finally implemented in 1997. In April, the average tariff rate applying to most imported goods was lowered from 16% to 13%. This meant that the rates applying to some 97% of all import items under the country's two-tiered regime (previously rates were 15% and 25%) were reduced to 12%. In order to provide greater effective protection for some producers, in 1997 a 5% surtax was levied on goods deemed to be "sensitive"; in addition, the specific duty introduced in 1991 on imports of 20 agricultural products was raised from 20% to 25%. The net result of these measures was a reduction in the average tariff rate.

(d) Structural reforms

There were no major developments in the area of structural reform in 1997. The privatization process has been losing momentum for several years now, and 1997 saw a continuation of this trend. The Government's privatization programme earned it just US$ 143 million in receipts from abroad, sharply down on the figure of US$ 1.7 billion posted for 1996. Sales of equity in public-sector enterprises tapered off primarily as a result of institutional and political problems. Among the latter, a heated public debate arose in 1997 regarding the impact on the population of steep hikes in electricity rates and fuel prices following privatization. In response, the Government introduced changes in the use of operating contracts as a form of privatization in the oil and gas sector, and Congress passed Act No. 26844, under which the State will hold "golden shares" in such companies that will give it a say in their administration.

In the power sector, plans to auction off two generating plants -EGASA and EGESUR- were put on hold pending the enactment of new regulatory provisions concerning monopolies in power generation and distribution markets. The programme under which infrastructure operating contracts were to be awarded was postponed as well, owing to a lack of consensus within government ranks.

In an effort to enhance the benefits available to members of the civil service (40% of whom are now retired), as part of the privatization process the Government put forward a proposal to create a Public Savings MutualFund(FMAP) using a block of shares in privatized companies that the State still owns. The first stage of the plan calls for transferring US$ 500 million, out of a possible total of US$ 1.3 billion, to the FMAP.

3. The main variables

The upturn in economic growth seen during 1997 was spearheaded by construction, metallic mineral production and other non-primary processing industries, even though the pace of growth in the latter dropped off sharply during the second half of the year as a consequence of El Niño. Meanwhile, the downward trend in inflation firmed up, with a cumulative rate up to December 1997 of 6.5%, which was the lowest to be recorded in the past 25 years. At the beginning of 1997, the Government had set itself the goal of stabilizing the country's balance-of-payments current account position at 5% of GDP, and it succeeded in reaching that target thanks to a marked upsurge in exports, particularly during the first six months of the year.

(a)Economic activity

The upswing in domestic demand that had begun in the second half of 1996 peaked at 9.4% in the third quarter of 1997. This brought the overall expansion in demand for the year to 8%, which exceeding initial expectations. More than four percentage points of this increase can be attributed to the trend in gross domestic investment, which was spurred on by the behaviour of private economic agents in particular. Consumption grew more slowly than GDP, which was in keeping with the fact that the increase in employment was concentrated in poorly-paid activities, while real wages stagnated. Aggregate demand jumped by 10%; three points of this increase were attributable to higher exports, with a further three points due, once again, to investment, whose share of GDP rose to 30%. As a result, these two sectors took the lead in stimulating economic growth.

With respect to the financing of investment, it is interesting to note that the public sector made the greatest saving effort, increasing its share of savings by 1.5% of GDP; consequently, the domestic savings ratio reached 23.0% of GDP, while the external savings ratio dropped to 5.9%.

An analysis of the contribution made by the various sectors to GDP growth (7.7%) shows that construction was the best performer. This sector's 20% expansion was fuelled by a strong upturn in bank credit which spurred the construction of hotels, offices, large shopping centres and housing. Another major factor during the second half of the year, however, was government spending on infrastructure, which included the reinforcement of bridges and roads and the construction of drainage systems and floodwalls in an effort to mitigate the effects of El Niño.

The boom in the construction sector, in turn, galvanized the industries that produce its inputs (basic metals, cement, paint, and the like), thereby contributing to the 8.7% growth rate posted by non-primary processing industries (agriculture-, fishing- and mining-based products). Commodity-producing industries, for their part, expanded by just over 1%.

With mineral prices falling, the non-oil mining industry stepped up drilling in order to maintain the value of output, and volumes were consequently up 10% over 1996 levels. The Asian crisis hindered the implementation of new investment projects, however, and many therefore failed to progress beyond the financial assessment phase; this was especially true of projects in the copper industry, whose growth prospects suffered as a result.

(b)Prices, wages and employment

In 1997 inflation not only resumed the downward path which had been interrupted the year before, but actually fell to a 25-year low of 6.5%. A variety of factors were at work here. In terms of the relationship between supply and demand, the economy was able to cope with the rise in income levels because of its high rate of idle capacity (32%) and its ability (thanks to the country's abundant flows of external resources) to divert domestic demand pressures to imports.

Cost factors contributing to the slowdown in inflation included a stable nominal exchange rate, the relative absence of wage pressure (their nominal growth only amounted to 5.6%), and a downswing in the prices of basic services and fuels, which was especially visible because they are important components of the consumer basket (fuel prices fell by 9% over the preceding 12 months). A further factor was the drop in the prices of imported foodstuffs.

It is interesting to note that, according to the classification of prices of tradables and non-tradables prepared by the National Institute of Statistics and Informatics, non-tradables showed the largest increase; this was a reflection of rising prices for services, especially health care. Food prices and utility rates (most public utilities have been privatized) lagged behind inflation (4%).

During 1997, both wages and salaries remained unchanged in real terms. The level of idle capacity in the economy undoubtedly helped to keep wage increases in check, especially in the manufacturing sector.

Wage stability and the upturn in demand had a slight impact on employment in the formal sector, which grew by about 4%, according to the results of monthly surveys of firms having over 100 employees (including those hired through workers' cooperatives or bureaus). Commerce and services accounted for virtually all of this increase. The growth of the economically active population (EAP) outpaced the modest increase in the number of jobs, and unemployment therefore rose. The annual rate climbed from 7.9% to 8.3% of the EAP, and the job situation for women worsened as well. Underemployment, whether measured by income or hours worked, remained at the preceding year's high levels.

(c)The external sector

In 1997, efforts were again made to bring the external gap under control, and the deficit on the balance-of-payments current account stabilized at 5.2% of GDP, which meant that the Government succeeded in reaching the target set in its agreements with the International Monetary Fund (IMF). This achievement was made possible by an improvement in the merchandise trade balance equivalent to US$ 200 million. Imports surged, but exports grew even faster, reaching US$ 6.75 billion, and as result the trade gap narrowed to US$ 1.814 billion.

The first three quarters saw a steep rise in traditional exports, and this was especially true in the case of fishery and agricultural products, although sales of these goods declined towards the end of the year as a result of the poor weather conditions mentioned earlier. Wakening prices for metal ores, particularly copper (which was hard hit by the Asian crisis), did not significantly effect the value of exports, since volumes rose.

Exports of virtually all non-traditional products continued to expand; all told, non-traditional external sales increased by approximately US$ 500 million to US$ 2.035 billion. As a result, this category (which includes goods produced by the agricultural, textile, metal and machinery, chemical, and iron and steel sectors) increased its share from 27% to 30% of total exports.

In keeping with the major role played by investment in GDP growth, capital goods accounted for 60% of the US$ 671 million increase in imports. Of the remainder, 30% was attributable to imports of inputs, and just 10% to consumer goods.

On the services balance, the deficit in non-factor services rose by almost US$ 100 million, but this was offset by a decrease of a similar amount in the deficit in factor income, which shrank to US$ 1.497 billion. As a result, the current account closed out December with a deficit of US$ 3.415 billion.

On the financial account of the balance of payments, direct investment (net of the foreign exchange earnings from privatizations) held to the preceding year's level of over US$ 1.8 billion. This, together with the fact that portfolio investment showed no decline either and that short- and long-term credit expanded, points to the conclusion that the Asian crisis has not had any financial impact on the Peruvian economy.

The conclusion of bilateral negotiations with the Paris Club, the arrangements made under the Brady Plan and the renegotiation of debts with Russia all enabled Peru to reduce its external debt, as well as convincing international lending agencies to re-open their doors to the country. The resulting inflow of US$ 2.1 billion in short-term capital, combined with the inbound flow of US$ 2.753 billion in long-term funds, was more than enough to finance the current account deficit. Consequently, the net stock of international reserves rose by US$ 1.6 billion to US$ 10.169 billion, which is the equivalent of more than a full year's worth of imports.

DOMINICAN REPUBLIC

1. General trends

In 1997, the Dominican Republic achieved its highest growth rate of the decade (8.2%), and this helped to ease the problem of unemployment, which fell below 16%. Monetary expansion, fuelled by abundant foreign currency inflows, formed the backdrop for economic activity, which was boosted by private investment, total consumption and exports in a context of exchange-rate stability.

The ample liquidity of the financial system stimulated private spending and led to a steady decline in interest rates. The pattern of total consumption was also influenced by the reallocation of budgetary funds towards social spending, which was offset in the overall balancing of fiscal accounts by a corresponding cutback in capital outlays.

In this context of greater liquidity, inflation rose to just over 8% due, in part, to the higher fuel prices resulting from the unification of the exchange rate the year before, while the stability of the exchange rate tended to have just the opposite effect.

The current account deficit narrowed and was more than offset by capital inflows from abroad, which included a swiftly-growing stream of foreign direct investment.

The outlook for 1998 pointed towards an economic growth rate of 6% and a level of inflation similar to the figure for 1997.

2. Economic policy

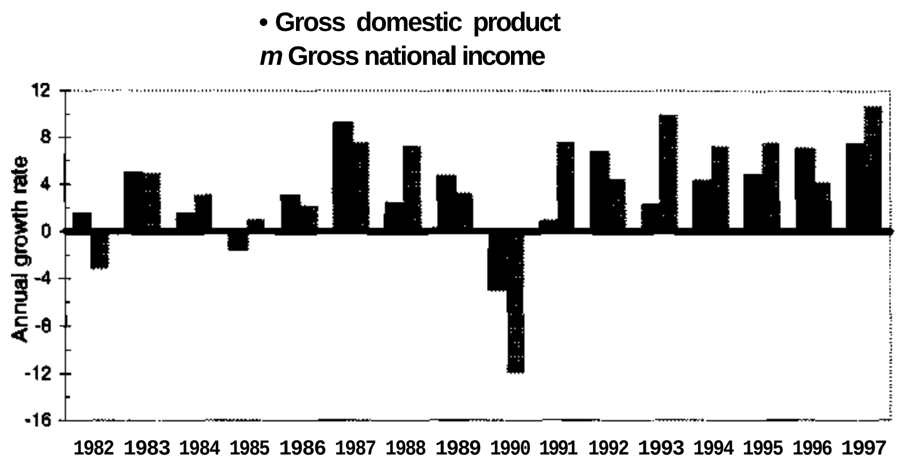
The thrust of economic policy was to reconcile social objectives and an improvement in income distribution with the maintenance of existing macroeconomic balances and efforts to strengthen the Dominican Republic's competitiveness on international markets.

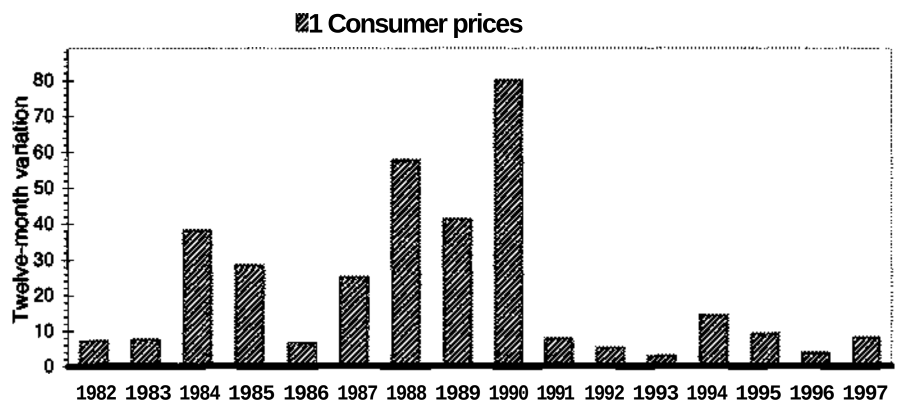
The Government's social goals were pursued through increased spending in that sector. Exchange-rate stability and fiscal restraint were the pillars upon which the maintenance of macroeconomic equilibria rested, since monetary management was subordinated to the effort to check the appreciation of the local currency, which was being driven up by foreign-exchange inflows. The money creation deriving from this policy and the maintenance of a fiscal balance made it possible to reduce interest rates and discourage inflows of speculative capital. To this same end, additional measures were taken to curb short-term movements on the foreign exchange market. Meanwhile, in an effort to achieve their objective of strengthening the country's external competitiveness, the authorities continued to pursue an open trade policy.

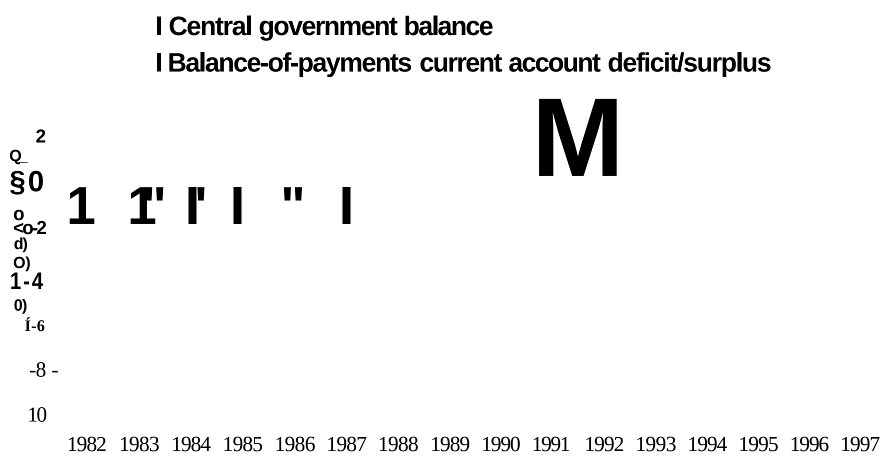
(a) Fiscal policy

The central government closed out the year with a budget surplus equivalent to 0.8% of GDP thanks to an increase in the tax burden (from 13.2% of GDP in 1996 to 14.8% in

Figure 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS







Source: ECLAC, on the basis of official figures.

1997) and to a major adjustment in public investment.

Total expenditure grew by 14% in real terms; this was attributable to a 47% increase in current outlays, since capital expenditure declined sharply (-29%).

The expansion of current expenditure was driven by spending on salaries and wages, which rose 49% in real terms as a result of salary adjustments awarded to civil servants in October 1996 and March 1997. A factor of only slightly less importance was the quantitative effect of the 54% increase in the volume of transfers to companies in financial straits; these transfer payments are expected to be lower in future, however, due to the recent passage of an omnibus act governing State-owned enterprises. Among the other items included in the current account, the most striking variation was the increase in social spending. On the other hand, the various items on the capital account, including the category of machinery and equipment, deteriorated considerably in real terms.

Total revenues rose by 22% in real terms, a higher rate than at any other time in the preceding five years. Current income was up by 21%, reflecting a more than twenty-fold increase over the growth rate for 1996. Under this heading, income tax receipts, which account for 96% of direct tax collections, jumped 18%. The results for excise taxes were influenced by a 42% increase in the oil price differential, partly because under the system currently in force, this indicator is incorporated as a constant in the retail price to the public, expressed in Dominican pesos per gallon of fuel.

Receipts from taxes on foreign trade showed a 47% improvement following the implementation of a prepayment system for clearing goods prior to their arrival in port and the computerization of the central office and of collection agencies located in ports and airports. The application of a zero tariff rate on imports of inputs and tools for the agricultural and textile sectors had a negative effect on tax receipts.

For 1998, total central government revenues are expected to decline, partly as a result of the fall in oil prices and the adverse effect this will have on the new tax collection scheme. Should this prove to be the case, the decline could be counterbalanced by a corresponding adjustment in current expenditure and a reinforcement of the tax administration system based on the modification or elimination of low-yield items and the introduction of adjustments designed to make the tax structure a more neutral one.

(b) Monetary policy

Monetary policy was subordinated to the achievement of exchange-rate stability within an economic context marked by an abundant supply of foreign exchange. As a result, the monetary base grew more than originally planned (by 20%), and liquidity expanded by a slightly higher percentage. The expansion of domestic credit also contributed to this increase in the monetary base.

The build-up of international reserves was the result of Central Bank intervention aimed at stabilizing the exchange rate. Net issues of monetary participation certificates rose by a scant 6% and were thus not sufficient to counter the resulting expansion of the monetary base, which translated into fairly similar increases in the money supply and in commercial bank deposits with the Central Bank.

Peso deposits in the commercial banking system rose by a slightly higher percentage, reflecting the high degree of liquidity in the financial system and the effects of the modification of the base used for calculating the legal reserve requirement, whose purpose was to release a portion of these funds and make them available to the commercial banking system. Consequently, the narrowly defined money supply (Ml) and the broad money aggregate (M2) grew by 23% and 24% respectively.

The strong liquidity position of the commercial banking system pushed down lending rates from a weighted average of 23%

Table 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
				Growth rates					
Growth and investment									
Gross domestic product	4.6	-4.9	0.8	6.7	2.2	4.2	4.8	7.0	7.4
Per capita gross domestic product	2.4	-6.9	-1.2	4.6	0.3	2.3	2.9	5.2	5.6
Gross national income	3.2	-12.0	7.6	4.4	9.9	7.2	7.5	4.1	10.7
Gross domestic product, by sector									
Goods	4.6	-7.3	-0.4	8.9	0.4	5.5	4.0	8.0	7.8
Basic services	5.6	-6.6	6.8	15.8	7.0	4.9	9.2	10.8	12.0
Other services	4.5	-2.6	1.0	3.4	3.0	3.1	4.7	5.5	6.2
				Percentages					
Contribution to growth of GDP [c]									
Consumption	4.5	-10.1	8.2	8.6	0.6	3.1	7.2	3.4	4.9
Government	0.0	0.2	0.0	0.2	-0.1	0.2	0.0	0.1	0.3
Private	4.4	-10.2	8.2	8.4	0.7	2.9	7.2	3.2	4.7
Gross domestic investment	4.5	-4.5	-2.2	5.4	5.5	2.1	-0.1	3.5	7.6
Exports	-0.6	1.7	-2.6	1.6	39.2	2.1	2.5	7.4	9.9
Imports	-3.7	8.0	-2.6	-8.9	-43.2	-3.1	-4.8	-7.3	-15.0
				Percentages of GDP [b]					
Gross domestic investment	28.4	25.1	22.8	26.4	31.3	32.0	30.4	31.7	36.6
National savings	22.9	20.8	20.1	15.3	24.7	28.7	29.0	28.6	33.8
External savings	5.5	4.3	2.6	11.1	6.6	3.3	1.4	3.1	2.8
				Percentages					
Employment and wages									
Real minimum wage (index: 1990 = 100)	102.9	100.0	97.0	118.0	112.1	119.3	119.9	120.6	119.3
				Growth rates					
Prices (December-December)									
Consumer prices	41.2	79.9	7.9	5.2	2.8	14.3	9.2	4.0	8.4
External sector									
Terms of trade (index: 1990=100) "	157.4	100.0	109.3	102.2	100.3	105.7	115.6	111.1	115.9
Nominal exchange rate (pesos per dollar)	6.34	8.53	12.69	12.77	12.70	13.20	13.60	13.78	14.27
Real effective exchange rate (index: 1990 = 100)	111.9	100.0	108.4	111.2	110.5	106.9	103.8	97.0	99.3
				Millions of dollars					
Balance of payments									
Current account	-327	-280	-157	-708	-422	-227	- 101	-239	-225
Trade balance (goods and services)	-463	-402	-351	-818	-752	-568	-434	-323	-377
Exports	1966	1 832	1857	1911	4 635	5 108	5 566	6 287	7 197
Imports	2 429	2 233	2 208	2 729	5 386	5 676	5 999	6 611	7 574
Capital and financial account	64	-195	414	644	-116	-333	161	200	458
Overall balance	-263	-474	257	-64	-461	100	128	-39	233
Variation in reserve assets (- indicates an increase)	90	49	-357	-64	-154	385	-131	15	-40
				Percentages					
External debt									
Gross debt (as a percentage of GDP)	62.5	84.7	60.6	49.2	47.8	37.9	33.6	28.8	23.5
Net interest (as a percentage of exports) [e]	6.3	8.7	3.9	6.3	4.3	3.2	3.3	3.8	3.0

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997[a]
				Percentages of GDP					
Central government									
Current revenue	13.5	10.3	13.1	15.4	16.1	15.1	15.0	14.1	15.9
Current expenditure	6.7	**5.4**	5.3	6.0	8.3	7.7	7.9	8.2	11.2
Saving	6.7	**4.9**	7.9	9.4	7.8	7.4	7.1	5.9	4.7
Capital expenditure	6.8	**4.6**	5.1	6.5	8.2	8.6	6.6	6.4	4.2
Financial balance	0.1	**0.3**	3.2	3.6	0.2	-0.8	0.6	-0.4	0.8
Domestic financing	0.1	**-0.2**	-2.5	-2.2	1.4	2.1	0.5	1.4	0.4
External financing	-0.1	**-0.1**	-0.7	-1.4	-1.6	-1.3	-1.1	-1.0	-1.1
				Growth rates					
Money and credit									
Monetary balances of banking system									
Net international reserves				53.8	45.3	-91.4	409.7	1.4	36.2
Net domestic credit			5.5	24.4	17.4	40.6	10.7	22.4	22.1
Money (Ml)			27.6	15.3	25.1	2.3	16.9	26.5	22.9
Local-currency savings and time deposits			48.9	38.9	30.3	15.8	19.4	13.5	23.9
M2			37.4	27.1	27.9	9.8	18.4	18.8	23.5
Dollar deposits				94.7	-71.4	-8.4	-16.1	294.3	5.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Includes Errors and omissions. [e] Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

Table 2

DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS

	1995				1996				1997[s]				1998"	
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)	4.5	8.2	7.0	9.3	5.Í		7.5	10.6	5.9					
Consumer prices (12-month variation, %)	14.2	11.8	11.8	9.2	6.5	6.2	3.8	3.9	6.7	7.5	9.9	8.4	5.3	4.6
Real effective exchange rate (index: 1990=100)	100.0	107.5	107.0	100.5	97.3	96.2	97.1	97.3	98.9	99.7	98.1	100.5	102.9	107.2
Money (MI) (change from same quarter of preceding year)	5.3	8.7	19.8	16.8	22.7	22.5	24.4	25.3	19.8	21.0	16.6	25.3		

Source: ECLAC, on the basis of official figures.
" Preliminary figures. Refers to the exchange rate for imports.

in January to 21% ins reduction in the cost of money and the release of excess commercial bank reserves, banks were able to meet a higher percentage of the demand for credit, mostly to the benefit of the private sector, in particular construction, commercial activities and manufacturing.

Projections for 1988 point to an 8%-9% expansion of the monetary base and of the money supply in line with the target rates for GDP growth and inflation. A more intensive use of open-market operations will be required, using short-term interest rates as a frame of reference, if these targets are to be met.

(c) Foreign-exchange and trade policies

The monetary authorities' efforts to maintain the stability of the exchange rate formed the cornerstone of the Dominican Republic's trade policy. They were aided in this undertaking by the achievement of a fiscal balance, which neutralized any upward pressure on interest rates.

The official exchange rate at the beginning of the year was 13.91 pesos to the dollar but rose to 14.02 pesos to the dollar in March, which implies a nominal variation of 0.8% and an appreciation in real terms. Following the unification of the exchange rate in December 1996, which eliminated the gap between the rates on the official and private markets, the rate began to be set every week on the basis of the peso's performance on banking markets. The nominal exchange rates on the private and non-bank markets accordingly rose from 14.12 and 14.21 pesos to the dollar, respectively, in January, to 14.35 and 14.33 in December, for a depreciation of just 2% and 1%.

Within this framework, the country's trade policy focused on consolidating its formal integration into Central America and the Caribbean and on the promotion of free trade.

In November 1997, the second special session of Central American Heads of State was held in Santo Domingo. At the close of this meeting, the Heads of State signed the Santo Domingo Declaration, in which they recognized the imperative need to incorporate the Dominican Republic into the Central American integration process and, more specifically, for it to join the Central American Integration System (SICA). In April 1998, a free trade treaty was signed with a view to promoting the formation of a wider market for reciprocal trade in goods and services. It is also expected that the Dominican Republic will take steps to phase out its non-tariff barriers, including permits and licenses for merchandise imports and exports.

Trade relations between the Dominican Republic and the Caribbean Community (CARICOM) remained at a standstill following the signature, in October 1996, of a letter of intent concerning the initiation of formal trade negotiations between the parties.

As part of the steps being taken by the country to open up its economy to the outside world, import duties on inputs, equipment and machinery for the agricultural and textile sectors were eliminated. In addition, a bill designed to bring the new customs regime more closely into line with international trade regulations was sent to Congress. Implementation of a standard Spanish version of the harmonized system will be an important step towards the country's integration into world markets. Promotion of export sectors has been reflected in the introduction of a standard export registration form, but the proposed one-stop export window has not yet been set up.

(d) Structural reforms

Structural reforms implemented in 1997 included the adoption of the State Enterprises Omnibus Reform Act, which promotes the capitalization of entities belonging to the Dominican Corporation for State Enterprises (CORDE), the Dominican Electricity Corporation (CDE), the State Sugar Council and hotels belonging to the Hotel and Tourism Industry Development Corporation (CORPOHOTEL).

3. Them variables

(a) Economic activity

Total demand grew by 12%, thanks to the boost received from private investment and, to a less extent, from private and public consumption. In turn, exports of goods and services gathered momentum. These factors all helped to stimulate economic activity, thus bringing GDP growth to over 7%; imports also expanded.

Fuelled by a 43% increase in private investment, fixed investment climbed 25%. The upswing in private investment was attributable to the higher level of liquidity in the banking system, which was reflected in declining interest rates on loans and a favourable outlook for the economy. Public investment, meanwhile, dropped sharply (-24%).

Government consumption was up by 10%, while private consumption -bolstered by wage increases and a 14% rise in remittances from family members- rose by 5%.

The 15% increase in exports (including external sales by firms in the customs-free zone) was made possible by the expansion of the manufacturing sector's production capacity. The stability of the real exchange rate also helped to generate confidence in the future of export-related activities. Against the backdrop of this stable exchange rate, imports of goods and services continued to soar, this time by 17%, with capital goods accounting for a large proportion of the total, mainly as a result of the dynamism of the economy as a whole.

Growth in the agricultural sector slowed to 3% in 1997 (down from 10% the year before) due to adverse weather conditions and pest infestations in the last quarter of the year. With the exception of cocoa, export crops did the best (with an increase of 15%, on average). Almost all crops for domestic consumption suffered setbacks.

Following a trend that was just the reverse of the agricultural sector's, gross industrial output posted an 8% expansion in 1997, up from 4% in 1996. This performance was attributable to both domestic and exogenous factors. The domestic factors included the buoyancy of the construction sector, which stimulated demand for some of the inputs produced by the manufacturing sector. One of the main exogenous factors was the strength of external demand, which boosted production of some local inputs and of others produced in the country's export processing zones (EPZs).

The EPZs recorded the highest level of value added (11%) in the last four years, partly as a result of the Government's policies on investment promotion, construction and expansion of the country's industrial parks and of the diversification of production activity by businesses operating under this system. Another contributing factor was the upsurge in sales posted by the tobacco companies in these zones, which accounted for 21% of the total.

The mining sector expanded by 3% thanks to an upturn in nickel and gypsum production and more robust demand for some of the main inputs used by the construction industry. The construction boom (18%) was spurred by higher expenditure by private businesses, a substantial increase in lending (25% in real terms) to that sector and longer repayment periods.

Notwithstanding the electrical power sector's vigorous expansion (11%), supply was not able to meet the growing demand. Dynamic sectors such as transport and telecommunications made further gains (13%) and, bolstered by a hotel occupancy rate of 76%, the growth of the tourism industry accelerated to 17% (compared with 11% in 1996).

(b) Prices, wages and employment

Inflation rebounded in 1997, with consumer prices rising by 8.4% as compared to the preceding year's level of 4%. This surge was attributable, on the supply side, to adverse weather conditions that hurt agricultural output and to the effects of the introduction of a single exchange rate in 1996, which included higher fuel prices. On the demand side, wage hikes and increased lending stimulated consumption. On the other hand, the reduction in tariffs on imports of some essential agricultural inputs and the shift in the pattern of consumption towards tradable goods, whose prices were held down by the stability of the nominal exchange rate, helped to contain inflationary pressures.

Real minimum wages improved in both State-owned enterprises (37%) and the private sector (11%). According to a survey conducted between October 1996 and April 1997, the overall unemployment rate was 15.9% (16.5% at the beginning of the period). Job creation was strongest in the business, transport and telecommunications sectors.

According to official projections, inflation should remain virtually the same in 1998 as in 1997, i.e., at around 8%.

(c) The external sector

In 1997, the balance of payments posted an overall surplus of US$ 233 million as the net result of a positive balance on the capital and financial accounts that was more than enough to offset the current account deficit. This deficit was slightly lower than in 1996, since the deterioration in the trade balance was counterbalanced by higher earnings from tourism and, to a lesser extent, by higher current transfers.

Despite the surplus recorded in the EPZs (US$ 1.332 billion), whose exports increased by 17%; to over US$ 3.8 billion, the merchandise trade balance showed a deficit of US$ 1.806 billion (0.8% of GDP). Exports of goods (not including those from the EPZs) were up by 14%, which was almost as much as the growth rate for imports (15%). The upswing in merchandise exports was in part attributable to the expansion of the manufacturing sector's production capacity, the increase in the volume of exports of sugar and sugar products (16%) and the incentives for tobacco exports provided by high international prices (110%).

Import figures reflect the economy's dynamism and the strong performance of the country's EPZs. The implementation of a nominal tariff rate of zero on machinery and equipment used in the agricultural sector, which contributed to a 43% jump in imports of capital goods, was also a factor.

The non-factor service account yielded a surplus of US$ 1.43 billion, primarily as a consequence of the tourism sector's robust growth.

Net investment flows showed a negative balance of US$ 1.193 billion which was directly attributable to the repatriation of profits by foreign companies. Unrequited private transfers swelled by 18%, totalling US$ 1.27 billion. However, the inflow of these transfers and the positive balance on the non-factor services account proved insufficient to cover the deficits on the trade balance and in net investment income. Thus, at year's end, the current account showed a deficit of US$ 225 million.

The positive balance on the capital and financial account (US$ 757 million, not including errors and omissions) was mainly the result of foreign direct investment inflows (US$ 405 million), half of which consisted of reinvested earnings.

Medium- and long-term capital inflows were in the vicinity of US$ 150 million, 15% below the previous year's figure. On the other hand, official capital flows showed a net negative balance, part of which was accounted for by the settlement of US$ 98 million of government debt with foreign companies. This helped to bring the external public debt down to US$ 3.502 million by the end of 1997, a decline of almost 8% from its the level registered 12 months before. Debt servicing amounted to US$ 431 million, or 6% of the value of exports of goods and services.

In 1998, it is expected that medium- and long-term debt service payments will amount to US$ 421 million and that a modest surplus of US$ 67 million will be posted on the balance of payments as the net result of a slightly larger current account deficit than in 1997 (US$ 330 million) and a US$ 263 million surplus on the capital and financial account (including errors and omissions).

This projection takes into account the potential repercussions of the Asian crisis on the Dominican economy. These impacts are likely to be quite limited, however, since although EPZ exports not subject to the quota system may be affected, trade between the Asian countries hit by the crisis and the Dominican Republic is negligible.

It is possible, however, that the inflow of foreign-exchange earnings from tourism could decrease, which would have a negative impact on GDP. This will only occur, however, if the crisis causes a slowdown in the growth of the economies where the bulk of demand for tourist services originates, such as those of the United States and Germany.

URUGUAY

1. General trends

The Uruguayan economy again made significant strides in 1997. Aggregate demand expanded vigorously, bringing GDP growth to more than 5%, while inflation, which continued to fall, reached 15%, its lowest level in 30 years. The unemployment rate was slow to react, however, and only in the last few months of the year did it decline to something on the order of 10%.

All the components of final demand picked up strongly. Favourable external conditions fuelled an expansion of over 12% in the physical volume of exports. This, in turn, contributed to an 8% increase in fixed investment which was also associated with the productive restructuring of the majority of the country's business enterprises. Higher personal income and the increased availability of credit to Uruguayan households buoyed domestic consumption. Stronger demand also continued to boost imports, which expanded by 14%. Trade with other members of the Southern Common Market (Mercosur) continued to play an important role in the dynamism of foreign trade.

In the first half of 1998, the economy grew at a brisk pace, and the ascent of consumer prices moderated to 10% in the 12 months ending in June. The heavy rainfall experienced in the second quarter could, however, affect some crops in the forthcoming harvest.

2. Economic policy

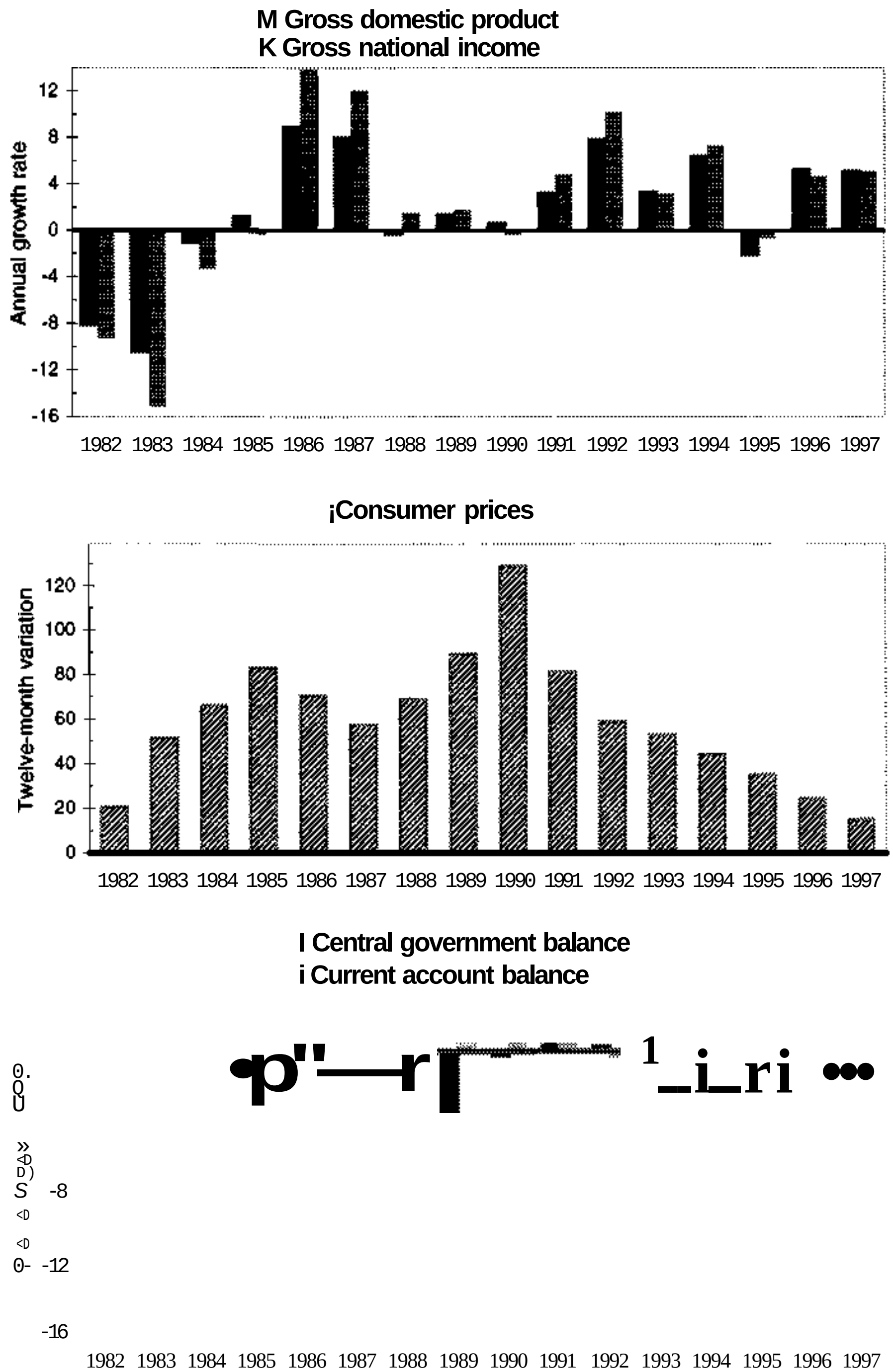
Curbing inflation continued to be the primary objective of economic policy. The policy tools used in this effort were much the same as before: the limitations of the public-sector financial deficit to an amount consistent with the available supply of external financing and the target figure for money creation; and the slowing of the pace of monthly devaluations to a rate close to that of the inflation target.

The Government proposed to cut back inflation to 14%-17% in 1997, based on projected GDP growth of 3% and on the assumption that external trends would hold firm. In order to meet these goals, the authorities sought to limit the public-sector financial deficit to 1.7% of GDP and to reduce the rate of devaluation to levels within a range similar to the targeted rate of inflation. Externally, the aim of the government programme was to maintain the balance-of-payments current account deficit at around 1.5% of GDP. On the basis of this programme, a precautionary credit arrangement was signed midway through the year with the International Monetary Fund (IMF) for the period April 1997 to December 1998. In addition, steps were taken in 1997 to reduce the degree of indexation of wages and of price controls on public-sector goods and services.

Having met the goals set for 1997, the Government intensified its stabilization policy in

Figure 1

URUGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

1998 in an effort to bring inflation down to no more than 7%-9% per year, a range not achieved at any time in the past four decades. With this in view, it will seek to reduce the public-sector deficit to 1.2% of GDP, or the equivalent of the estimated cost of administrative and social security reforms, and to bring the rate of devaluation into step with the projected rate of inflation.

(a)Fiscal policy

The prudent policy adopted for the 1997 budget, which did not allow for any increases in real spending or any changes in the tax system, was a signal of the Government's determination to consolidate the public-sector adjustment. The authorities had calculated that the freeze on real spending, coupled with an expansion of income due to increased economic activity, would eliminate the sector's financial deficit (excluding the cost of administrative and social security reforms). The outlays for these reform measures were considered to be of a transitional nature and were to be financed through special external loans.

The result was beyond expectations. The increase in income, which was chiefly attributable to brisker activity than had been forecast, was sufficient to offset the additional expenditure required by the reforms, and the non-financial public-sector deficit was therefore similar in size to that of the previous year (1% of GDP). The trend in GDP contributed to the rise in tax receipts, which are closely linked to the business cycle, and to the increase in sales by State-owned enterprises. Other factors influencing the real increase in tax revenues were the decline in inflation (thanks to the Olivera-Tanzi effect) and more efficient tax collection mechanisms. The value-added tax (VAT), which yielded 10% more in real terms, continued to be the principal source of tax receipts, accounting for close to 9% of GDP and 44% of income. The decisions taken the previous year to raise the tax on bank assets and to extend the coverage of the tax on net worth to State-owned enterprises also helped to strengthen tax revenues. Public-sector enterprises benefited from the fall in the price of petroleum.

On the expenditure side, the retirement incentive offered to civil servants represented half a percentage point of GDP. Social security transfers under the new mixed pay-as-you-go/capitalization system absorbed almost another point of GDP. If the cost of these two reforms were not included, then the non-financial public sector would show a modest surplus of about 0.3% of GDP. This is the sum of the surpluses posted by the central government (5.9% of GDP) and by State-owned enterprises (1.3% of GDP) anda social security deficit (before transfers) of approximately 7% of GDP.

The authorities sought to limit the increase in the public-sector debt to 1.8% of GDP and, at the same time, to improve its profile by replacing short-term debt with longer-term obligations. Both objectives were considered feasible in view of the ready availability of low-interest loans on the international market; this situation improved further midway through the year, when the country was upgraded to investment-grade status by four major credit rating firms. Total public-sector borrowing requirements, including the quasi-fiscal deficit of the Central Bank, amounted to 1.5% of GDP, and more than half of this amount was covered through expansion of the monetary base. Given the ready availability of international financing, the public sector contracted foreign loans equivalent to 2.3% of GDP and obtained financing from domestic sources amounting to another 0.2% of GDP. The amount in excess of the public-sector financial deficit was used to build up international reserves.

(b)Foreign exchange policy

The exchange-rate system, which is based on a 7% flotation band for the peso against the dollar and periodic devaluations of the band's floor, remained in force in 1997. In the first half of the year, the rate of exchange remained close to the bottom of the band, but early in the second half, it began to hover about one percentage point above the minimum rate. The Central Bank attributed this trend to the

Table 1
URUGUAY: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
				Growth rates					
Growth and investment									
Gross domestic product	1.4	**0.6**	**3.2**	7.8	3.3	6.4	-2.1	5.3	5.1
Per capita gross domestic product	0.8	0.1	**2.6**	7.2	2.7	5.8	-2.7	4.7	4.5
Gross national income	1.8	**-0.1**	4.8	10.2	3.1	7.3	-0.7	4.7	5.1
Gross domestic product, by sector									
Goods	1.0	**-2.3**	1.2	5.8	-4.4	5.3	-2.4	5.5	3.2
Basic services	3.4	**3.2**	**9.2**	13.0	8.2	11.3	6.5	5.2	5.0
Other services	3.0	**1.9**	1.3	4.7	5.1	3.4	-2.7	4.3	5.1
				Percentages					
Contribution to growth of GDP [c]									
Consumption	1.5	**-0.6**	**3.1**	9.0	3.4	7.8	-3.5	5.2	4.8
Government	0.2	0.3	0.2	0.2	0.1	0.6	0.0	0.6	0.3
Private	1.3	**-0.9**	3.0	8.7	3.3	7.2	-3.6	4.6	4.5
Gross domestic investment	-1.1	0.0	3.1	1.6	2.0	1.2	0.8	-0.3	1.1
Exports	1.6	**1.7**	0.3	2.7	1.3	2.6	0.0	3.5	3.4
Imports	-0.7	**-0.4**	**-3.3**	-5.4	-3.4	-5.2	0.6	-3.2	-4.3
				Percentages of GDP [b]					
Gross domestic investment	10.8	10.8	13.5	13.9	15.4	15.6	16.8	15.7	16.0
National savings	12.4	12.8	13.9	13.9	13.1	11.9	15.0	13.8	13.5
External savings	-1.5	-2.0	-0.4	0.1	2.3	3.8	1.8	1.8	2.4
				Percentages					
Employment and wages									
Labour force participation rate	57.7	57.0	57.4	57.4	56.6	58.1	59.1	58.2	57.7
Open unemployment rate [e]	8.0	8.5	8.9	9.0	8.3	9.2	10.3	11.9	11.5
Real average wage (index: 1990=100)	107.9	100.0	103.8	106.1	111.2	112.2	109.0	109.7	109.9
				Growth rates					
Prices (December-December)									
Consumer prices	89.2	129.0	81.3	59.0	52.9	44.1	35.4	24.3	15.2
Wholesale prices	80.7	120.7	68.6	46.9	31.1	41.0	27.7	23.5	
External sector									
Terms of trade (index: 1990=100)	12.1	100.0	99.6	102.8	97.6	103.8	105.5	102.5	102.5
Nominal bank exchange rate (pesos per dollar), annual average	0.61	1.17	2.02	3.03	3.95	5.05	6.35	7.97	9.45
Real effective exchange rate for imports (index: 1990 = 100)	83.0	100.0	91.4	89.5	79.9	73.2	70.2	69.6	68.2
				Millions of dollars					
Balance of payments									
Current account	134	186	42		-244	-438	-213	-234	-321
Trade balance (goods and services)	474	499	235	150	-105	-237	-62	-127	-195
Exports	2 032	2 159	2 201	2 632	2 760	3 248	3 507	3 847	4 256
Imports	1 558	1659	1966	2 482	2 865	3 485	3 568	3 974	4 450
Capital and financial account	-74	-54	37	147	437	547	422	377	652
Overall balance	60	132	80	138	193	109	209	144	330
Variation in reserve assets (- indicates an increase)	3	-40	-114	-186	-179	-99	-162	-119	-321
				Percentages					
External debt									
Gross debt (as a percentage of GDP)	87.5	88.4	71.4	65.0	57.3	56.3	57.5	60.5	63.3
Net debt (as a percentage of GDP)	40.6	35.1	24.4	20.5	17.3	19.0	16.4	15.0	16.0
Net interest (as a percentage of exports)	10.9	9.3	5.6	3.2	1.9	3.5	1.1	3.2	3.0

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997 [a]
	Percentages of GDP								
Non-financial public sector									
Current revenue	23.8	28.9	31.1	31.8	31.7	31.9	31.1	31.0	31.6
Current expenditure	23.5	24.5	25.8	26.3	27.6	28.5	28.1	28.4	28.9
Saving	0.3	4.4	5.4	5.4	3.9	3.2	3.0	2.7	2.8
Capital expenditure	3.8	4.0	4.1	3.9	4.7	5.7	4.3	3.8	4.0
Financial balance	-3.5	0.4	1.3	1.4	-0.8	-2.4	-1.3	-1.1	-1.2
	Growth rates								
Money and credit									
Monetary balance of banking system									
Net international reserves	156.5	161.1	66.9	45.8	25.5	39.2	45.0	33.5	19.8
Net domestic credit	104.5	97.0	90.8	49.4	38.9	37.4	22.7	38.9	34.6
To public sector	77.6	85.0	17.7	60.1	31.4	46.5	10.1	-5.8	-23.6
To private sector	73.5	87.6	65.8	70.2	46.8	40.1	50.2	36.2	35.0
Money (Ml)	69.1	112.3	95.5	70.1	58.4	39.6	31.7	26.4	21.4
Local-currency savings and time deposits	59.0	66.6	76.6	44.1	35.2	24.6	54.7	29.4	19.1
M2	63.6	87.3	86.4	58.3	48.8	34.0	39.8	27.5	20.5
Dollar deposits	144.4	132.3	77.7	45.7	29.5	39.2	30.4	38.6	29.6
	Annual rates								
Real interest rates (annualized)									
Deposit rate	-2.3	-13.1	-3.1	-2.9	-8.7	-4.9	2.2	3.1	3.9
Lending rate	20.3	20.5	39.8	37.0	29.4	35.5	47.9	54.0	48.9
Equivalent interest rate in foreign currency [8]	4.7	0.4	10.9	9.1	10.3	9.0	9.3	4.4	3.9

Source: ECLAC, on the basis of official figures.
* Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Percentages of the working-age population; urban areas. [e] Percentages of the economically active population (EAP); urban areas. Includes Errors and omissions. [e] Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
URUGUAY: MAES QUARTERLY INDICATORS

	1995				1996				1997[a]				1998[a]	
			III	IV			III	IV			III	IV		
Gross domestic product (change from same quarter of preceding year)	2.7	-1.0	-6.2	-2.8	1.7	0.8	10.3	1.5	3.3	8.4	4.4	4.6	6.8	
Consumer prices (nationwide) (12-month variation, %)	45.3	44.9	42.2	35.4	31.4	28.2	26.3	24.3	23.8	21.2	17.1	15.2	12.4	10.3
Real exchange rate[c] (index: 1990=100)	71.9	70.5	69.0	69.5	69.6	69.3	70.3	69.1	68.2	68.3	68.2	68.0	67.7	68.0
Exports, f.o.b. (millions of dollars)	555	537	534	481	550	580	632	636	513	726	730	691	655	
Imports, c.i.f. (millions of dollars)	665	747	670	785	698	769	928	929	872	873	946	1 055	899	
Real interest rates (annualized, %)														
Deposit rate	0.7	-2.0	12	8.7	3.1	0.3	-1.4	6.7	0.2	2.4	6.0	7.1	5.7	
Lending rate (not prime)	43.7	43.5	47.8	53.1	54.0	51.3	46.6	57.9	47.6	48.0	50.3	49.8	46.2	
Money (Ml) (change from same quarter of preceding year)	40.6	34.1	33.7	32.7	33.5	36.5	35.0	28.4	24.8	21.4	17.3	17.8		

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. On the basis of seasonally adjusted figures at constant domestic prices. [c] Refers to the exchange rate for imports.

increasing use of an export prefinancing mechanism, which included promotional interest rates and a regulation whereby foreign currency earnings had to be sold directly to the Bank. This system forced down the supply of foreign exchange on the interbank market. In mid-September the authorities therefore decided to allow exporters using the prefinancing mechanism to dispose of their foreign exchange earnings as they saw fit. With the resulting expansion in supply on the interbank market, the rate of exchange was driven down to the floor of the band. It soon rose again, however, owing to the uncertainty caused by the repercussions of the Asian crisis in Brazil, only to return to the floor of the flotation band following the adoption of corrective measures by Brazilian authorities.

Consequently, the rate of exchange rose 15% in the course of the year, in line with the Government's financial guidelines. Given the dollar's appreciation against the European currencies and the yen, the real exchange rate, calculated on the basis of a basket of the currencies of Uruguay's principal trading partners, slipped slightly.

Inflation continued to decline steadily throughout the first half of 1998. In order to reinforce this tendency and curb expectations of exchange-rate fluctuations, in April the width of the flotation band was narrowed to 3% and the rate of devaluation was lowered to 0.6% per month.

(c) **Monetary policy**

Since the exchange-rate regime is based on the use of a flotation band, there is limited scope for action by monetary policy-makers. At the floor and ceiling of the band, the Central Bank expands or tightens liquidity on the basis of the public's demand for money; the monetary policy action conducted within the margins of the flotation band remains confined to controlling short-term liquidity.

The main instrument for regulating the level of liquidity was the interest rate, including both the rate paid by the Central Bank on very short-term deposits made by private banks and the rates paid on interest-bearing cash reserves and on Monetary Regulation Notes. The nominal annual interest rates offered by the Central Bank declined from 27% at the beginning of the year to 19% by the end of 1997, for a real average annual rate of 3%.

The growth of the money supply kept pace with the expansion of nominal GDP, climbing by 5% in real terms. Broad money (M2) grew somewhat less, as fixed-term deposits contracted slightly in real terms. In contrast, savings deposits increased substantially (26% in real terms) following the introduction of technological improvements in the banking system in order to permit the use of automated teller machines (ATMs) for the payment of wages. A 10% increase was registered in 1997 in the dollar value of foreign-currency deposits, which once again accounted for the bulk (82%) of currency liabilities within the banking system (M3).

Deposits rates in the two currencies tended to converge. On the one hand, interest on deposits in Uruguayan pesos declined more slowly than inflation, so the real annual rate of return increased slightly, bordering on 4%. Interest rates on dollar accounts, meanwhile, matched the downward trend observed on the international market and by the end of the year had consequently slipped into the same range.

Greater price stability and the favourable business and income expectations among economic agents spurred credit supply and demand, and bank credit to the private sector expanded by 17% in real terms. A significant trend in private banking was the shift in credit away from industry and towards the service sectors and household loans. The availability of credit for housing, following the elimination of the monopoly formerly held by the Mortgage Bank of Uruguay over this type of operation, was part of this new trend. By year-end, real annual interest rates on loans in local currency, which fluctuated between 17% and 48%, were significantly higher than the rates on foreign-currency loans (7% to 10% in current dollars), which account for the bulk of total credit.

Expansion of the financial system's offshore activity slowed. At the end of 1997, total deposits held by non-residents in the banning system and in foreign financial institutions stood at US$ 4.1 billion (20% of GDP), around 7% above the balance at the end of the preceding year. Approximately one third of this sum was used for loans to non-residents and the balance was held as international reserves.

The country's nascent capital market received a strong boost with the entry into force of legislation approved the previous year. These statutes govern the issuance of negotiable securities by private companies and the management of investment funds. In 1997, the trading of negotiable securities more than doubled to stand at US$ 226 million, a figure equivalent to one third of the total trading volume of the country's stock market, which was equivalent to 3.5% of GDP. The pension fund management boards created under the social security reform law had handled approximately US$ 250 million by the middle of 1998.

(d)Trade policy

At the end of 1997 Mercosur member countries agreed to a temporary three-percentage-point increase in the common external tariff (Mercosur) until 31 December 2000. The application of this agreement has been monitored with special interest by Uruguayan authorities. In particular, some provisions adopted by Brazil that tended to restrict short-term external financing led to a series of negotiations which resulted in special treatment for the parties to the agreement.

3. The main variables

(a)Economic activity

Uruguay recorded 5% GDP growth for the second consecutive year in 1997; as in the case of per capita national income, the figure attained was almost one third higher than the 1990 level. When measured in dollars, the increase in the purchasing power of per capita income was even greater on account of the appreciation of the peso against the dollar.

All the components of aggregate demand expanded in 1997. The most outstanding increase was in exports (12%), followed by that of fixed investment (8%). Although growth in consumption was slower (5.5%), it accounted for half of the overall figure owing to its significant weight in total demand.

The contraction that came in the wake of the Mexican currency crisis of late 1994 was followed by a period of sustained growth in Uruguay. As of the fourth quarter 1997, economic activity had progressed by almost 18% compared with the third quarter of 1995. With the sole exception of the agricultural sector, 1997 saw an across-the-board increase, and the expansion was especially notable in commerce, restaurants and hotels; electricity, gas and water; and the manufacturing sector. Manufacturing was back up to its level of 10 years earlier; this points to a consolidation of the retooling process undertaken by companies of the sector in anticipation of the entry into force of the Mercosur treaty.

Boosted by public-sector activity, construction picked up by 3%. Meanwhile, the slowdown in construction in Punta del Este, Uruguay's main tourist resort, was offset by an expansion in the rest of the country, and private construction therefore remained stable.

Agricultural production, on the other hand, slackened by over 1%; since this followed a record high in the preceding year, however, production figures were still a third higher than in the early 1990s. This decline occurred mainly in the last few months of the year, when heavy rains ravaged wheat and barley crops. The livestock industry remained strong, with beef and milk production increasing; wool production slipped, however, following reductions in the sheep herd in response to a slump in international prices.

Services accounted for almost three quarters of total GDP growth. Basic services continued to expand steadily; electricity output increased by

6% following a reduction in the supply of water available for use in power generation in the first two quarters, while transport and communications grew by almost 5%. Commerce picked up by over 8%, buoyed by robust domestic demand and an abundant supply of domestic and imported items, while hotels and restaurants enjoyed a strong recovery, due largely to the influence of external demand.

(b)Prices, wages and employment

The greater than expected surge in domestic demand did not thwart efforts to achieve the main target of the economic programme, since inflation behaved as projected. Consumer prices rose 15% in 1997, the lowest rate in almost 30 years and one which, when compared with the rate of 129% recorded in 1990, attests to the huge strides made by the Uruguayan economy towards achieving greater stability. Nevertheless, prices have followed markedly different trends depending on the sector. While prices for clothing and footwear rose by only 7% in 1997 in the face of strong competition from abroad, the cost of housing increased by 19% and the cost of education by 27%. Among the factors contributing to this significant decline in inflation were the authorities' success in controlling the public-sector deficit and the reduction in the rate of devaluation in response to the country's favourable external accounts position.

Despite the sharp increase in activity, towards the end of the year unemployment proved to be quite intractable in the face of downward pressure. After remaining at the levels registered at the end of the previous year (11.6%), the rate in Montevideo started to rebound to over 12% in the second quarter. However, in the fourth quarter, it began to recede to around 10% due mainly to a decline in the labour supply; in 1997, the labour participation rate in Montevideo was approximately 61.2% of the working-age population, compared with 62.8% at the end of 1996. In the interior of the country, unemployment was lower.

Real wages weakened slightly in the first nine months of the year, picking up in the last quarter. Even though the average annual level increased somewhat, the purchasing power of wages remained lower than at the end of 1994.

In order to moderate the inertial effect of widespread indexation based on past price movements, a law was enacted at the end of 1997 which provides for changes in the adjustment mechanism for the salaries of central government civil servants, public rates and charges, and loan payments to the government-owned mortgage bank (Banco Hipotecario del Uruguay). Adjustments will be made once every six months if the annual variation in the consumer price index (CPI) falls between 10% and 23%, once per year if it falls below 10%, and once every four months if it exceeds 23%. In January 1998, the Government started to implement wage adjustments under the new half-yearly adjustment system at a rate of 85% of the inflation rate recorded in the preceding period.

(c)The external sector

Soaring domestic demand and a favourable international climate for the country were accompanied by a moderate balance-of-payments current account deficit, equivalent to approximately 1.6% of GDP (1.2% in 1996). Capital inflows were more than sufficient to finance the deficit and helped to bolster the international reserves of the Central Bank.

The merchandise trade deficit widened to just over US$ 720 million, although, in terms of value, exports grew faster (14%) than imports (12%). The only items that did not benefit from the export boom were textiles and dairy products. Exports of food and forestry products posted significant increases, as did paper and printing and electrical equipment and appliances.

Brisk purchases of consumer goods contributed to a sharp increase in merchandise imports. There was a surge in imports of capital goods as well (14%), while intermediate goods increased by only 7% owing to the decline in international oil prices.

On the other hand, services posted a clearly positive balance (2.6% of GDP). The better part of these earnings came from net income from tourism, mainly by Argentine nationals, although in 1997 travel expenditure by Uruguayans abroad increased more significantly than spending by incoming tourists.

Almost half of Uruguay's merchandise trade was with its Mercosur partners. Over one third of total Uruguayan exports were destined for Brazil and 13% for Argentina. As regards imports into Uruguay, these two countries have a more balanced market share, i.e., around 21% each of total foreign merchandise purchases.

With international capital readily available, the external gap was easily closed. The increase in external borrowing by the public sector was channeled through the placement of government securities and loans from multilateral agencies to finance administrative and social security reforms. Short-term debt was reduced through the prompt placement of a US$ 300 million long-term global bond. The interest rate was 7,875% (135 basis points above United States bonds) thanks to the good international credit rating assigned to the country's debt. The private sector, for its part, secured external funding amounting to US$ 440 million, including US$ 160 million of foreign direct investment (FDI).

At the end of 1997, public-sector external debt stood at US$ 5.6 billion, or the equivalent of 28% of GDP, while the international reserves held by the Central Bank of Uruguay amounted to US$2.1 billion.

VENEZUELA

1. General trends

The Venezuelan economy grew at a rate of 5.6% in 1997, climbing out of the previous year's recession. This result was once again influenced by a notable (nearly 9%) expansion in the oil sector, although the other sectors also stepped up their activity levels, availing themselves of an improved macroeconomic climate and the favourable expectations generated by the implementation of the "Agenda Venezuela" adjustment programme in 1996. Thus the upward trend of unemployment was halted, and in the second half of the year the jobless total fell below 11%.

As is normal in Venezuela, the economy's performance was heavily dependent on the situation in the oil market, which in 1997 remained favourable. This contributed to the maintenance of a large current account surplus and a year-end fiscal surplus, despite significant public expenditure growth. The increased public spending, together with the monetization of currency inflows from other sources and an expansion of bank credit, kept inflation bordering on 38%, still quite high, although much lower than the previous year. The moderation in price rises was helped by nominal exchange rate stability, based on the foreign exchange policy of the Central Bank of Venezuela and an abundance of foreign currency, which enabled US$ 2.6 billion in international reserves to be accumulated during the year, thereby financing a significant rebound in imports.

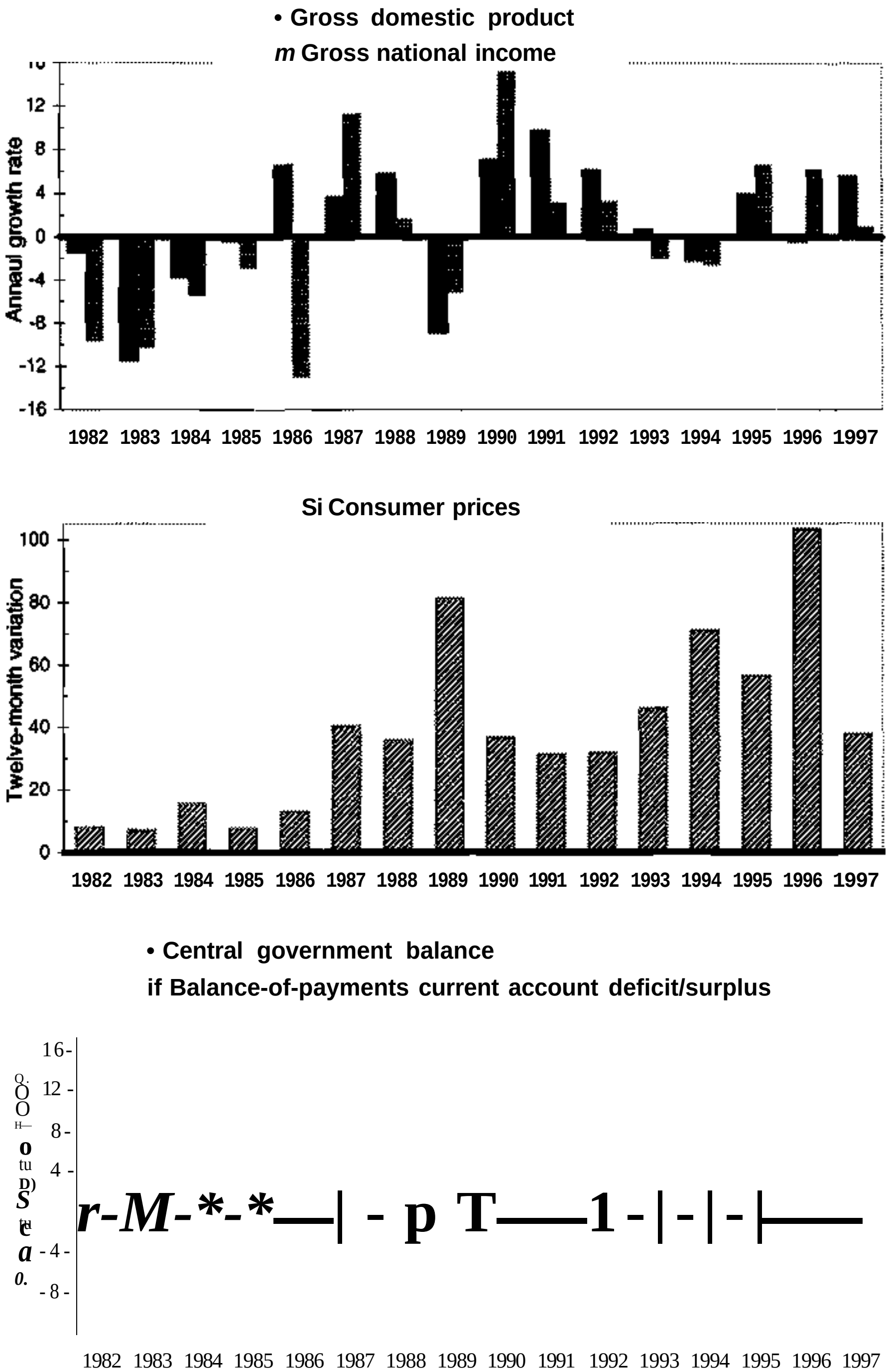
The opening up of the oil sector to private capital, in association with the State-owned firm Petróleos de Venezuela (PDVSA), continued successfully in 1997. The privatization programme also went ahead, although the main scheduled sale was postponed until 1998. Both these processes gave rise to a significant inflow of foreign direct investment. During the year the foundations were also laid for an in-depth reform of the social security system.

The performance of the economy, along with expectations, were profoundly altered towards the end of the year when the situation in the international oil market deteriorated. The drop in crude oil prices forced the Government to undertake a severe fiscal adjustment and reversed the situation in the foreign exchange market, where the demand for dollars came to exceed supply in the early months of 1998. The fiscal contraction, together with cuts in oil production decided on in an attempt to prop up prices, eroded expectations of GDP growth for 1998, which turned negative.

2. Economic policy

In 1997 the economic authorities planned to consolidate the macroeconomic stabilization process initiated in the framework of the Agenda Venezuela programme adopted the year before and to move ahead with the structural reform timetable contemplated in the programme. The

Figure 1
VENEZUELA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

degree to which these goals were fulfilled was moderate and was strongly affected by the favourable conjuncture in the oil market -the main source of revenue for the public sector. The monetary authorities found it difficult to contain the increased liquidity arising from abundant foreign currency inflows, but the influx kept the depreciation of the bolivar much smaller than anticipated, so that the exchange rate became the main counter-inflationary instrument.

The decisive effect of the immediate situation in the oil market was revealed at the end of the year, when the phase of high oil prices came to an end. As prices deteriorated, especially during 1998, the efforts of economic policy makers turned towards defending domestic and external equilibria and trying to neutralize the negative effect of this situation on public-sector accounts. While taking action the Government also sought an agreement with the International Monetary Fund (IMF) to back the measures adopted, although the solidity of the country's foreign currency position made it unnecessary for IMF to provide financing.

(a) Fiscal policy

The Government faced fiscal 1997 with a balanced budget, thanks to the fiscal measures in the economic programme of 1996 and the favourable trend in the international oil market. The latter persisted well into the year and contributed to a considerable rise in current fiscal revenues, making it possible to increase expenditure and at the same time generate a surplus on public accounts equivalent to 1.6% of GDP for central government and 2.3% for the public sector as a whole. These figures do not include extraordinary revenue received by the Government in the form of privatization proceeds equivalent to approximately half a percentage point of GDP.

Central government current revenue as a percentage of GDP, which was below 16% in 1995 but had topped 20% in 1996, rose further in 1997 to its highest level since 1991 (23.4%). Oil revenues went up from less than 12% in 1996 to 13.5% in 1997. This increase came from the proceeds of bidding on oil field rights and higher sales by Petróleos de Venezuela S.A., which made it possible to increase tax revenues and pay dividends to the State for the second year running, this time amounting to one billion bolívares.

Owing to greater consumption among the population and the upturn in the economy, domestic tax revenue also strengthened to approach 10% of GDP. The increase here was above all due to the tax on wholesale sales and luxury consumption, which, following arate hike in 1996, contributed almost half of total revenues from domestic sources. The buoyancy in imports and the rise in the national fuel price decreed a year earlier caused the corresponding tax revenues to go up.

Fiscal expenditure was greater than budgeted, as a result of wage increases granted to public-sector workers and the payment of accrued labour liabilities, as well as higher transfers to regional and local governments. These increases were partially offset by lower interest payments, which dropped in line with national interest rates. In the final analysis, the effects of the expenditure moderation policy fell on public investment, which stagnated at a level equivalent to 0.4% of GDP. The ratio of total public spending to GDP thus rose from 19.5% to 21.8% between 1996 and 1997.

Despite the fiscal surplus, a small portion of expenditure was financed via domestic and foreign borrowing in accordance with the laws on public-sector borrowing and the programmes of multilateral financial organizations. The Government also issued domestic public debt bonds to a value of around US$ 1 billion in order to pay off part of its accumulated debt with the Central Bank of Venezuela. In addition, it issued global bonds on the international market to a value of US$ 4 billion to be swapped for Brady bonds valued at US$ 4, 441 million, thereby freeing up some US$ 1.5 billion in collateral. The Government remained active in the eurobond market, where it took in US$ 315 million.

Public-sector accounts as a whole were considerably affected by a contraction in Petróleos de Venezuela S.A. operating profits, caused by a combination of high domestic inflation and a relatively stable exchange rate.

Table 1
VENEZUELA: MAIN ECONOMIC INDICATORS

	1989	1990	1991	1992	1993	1994	1995	1996	1997"
					Growth rates				
Growth and investment									
Gross domestic product	-8.8	7.0	9.7	6.1	0.7	-2.2	3.9	-0.1	5.6
Per capita gross domestic product	-11.2	4.4	7.1	3.6	-1.6	-4.3	1.7	-2.2	3.4
Gross national income	-5.1	15.2	3.1	3.3	-2.0	-2.6	6.7	6.2	0.9
Gross domestic product, by sector									
Goods	-8.4	9.9	10.2	5.4	2.9	-0.5	5.0	3.2	7.0
Basic services	-4.3	1.3	5.8	5.1	1.6	-1.9	3.1	1.2	6.0
Other services	-8.8	4.3	7.9	6.3	-2.1	-3.7	0.2	-5.4	2.1
					Percentages				
Contribution to growth of GDP [c]									
Consumption	-9.0	1.6	8.2	7.2	-0.9	-5.4	2.2	-4.2	3.1
Government	-0.2	0.4	1.3	0.0	-0.4	-0.5	0.2	-0.6	0.1
Private	-8.9	1.1	6.9	7.2	-0.5	-4.9	2.0	-3.7	3.0
Gross domestic investment	-12.0	-0.9	8.2	6.4	A.\	-5.2	4.7	-1.9	2.2
Exports	1.2	5.5	2.6	-0.6	3.8	2.9	2.6	2.6	5.9
Imports	11.0	0.8	-9.3	-7.0	1.8	5.4	-5.6	3.4	-5.7
					Percentages of GDP [b]				
Gross domestic investment	11.9	10.2	16.8	21.9	17.7	12.8	16.8	14.9	16.3
National savings	16.9	27.2	20.1	15.0	14.0	17.5	20.2	30.0	26.3
External savings	-5.0	-17.0	-3.3	6.8	3.6	-4.7	-3.4	-15.1	-10.0
					Percentages				
Employment and wages									
Labour force participation rate [d]	57.5	58.6	60.1	59.6	58.2	59.1	61.6	62.2	63.8
Open unemployment rate [e]	9.2	10.4	9.5	7.8	6.6	8.7	10.3	11.8	11.4
Real minimum wage (index: 1990=100) [f]	105.9	100.0	94.2	98.8	90.1	75.9	72.4	55.5	69.7
					Growth rates				
Prices (December-December)									
Consumer prices	81.0	36.5	31.0	31.9	45.9	70.8	56.6	103.2	37.6
Wholesale prices	106.2	20.4	23.1	26.0	47.4	89.5			
External sector									
Terms of trade (index: 1990=100)[b]	91.8	100.0	82.6	79.4	74.0	74.8	73.9	87.5	81.9
Nominal exchange rate (bolívares per dollar)	34.68	46.90	56.80	68.40	90.80	149.00	176.75	417.75	488.59
Real effective exchange rate (index: 1990=100)	95.7	100.0	93.3	89.0	86.6	90.2	71.4	85.1	66.1
					Millions of dollars				
Balance of payments									
Current account	2 161	8 279	1736	-3 749	-1993	2 541	2 014	8 824	5 999
Trade balance (goods and services)	4 712	9 355	2 698	-1 629	90	4 520	3 829	10 421	8 000
Exports	13 988	18 806	16 388	15 514	16 119	17 679	20 753	25 258	25 621
Imports	9 276	9 451	13 690	17 143	16 029	13 159	16 924	14 837	17 621
Capital and financial account [8]	-3 899	-7 238	135	2 699	2 262	-3 901	-3 396	-1 812	-2 803
Overall balance	-1 738	1041	1 871	-1050	269	-1 360	-1 382	7 012	3 196
Variation in reserve assets (- indicates an increase)	-1 077	-4 376	-2 645	845	144	1 173	1901	-6 274	-2 543
					Percentages				
External debt									
Gross debt (as a percentage of GDP)	77.6	73.1	67.3	63.6	68.0	70.5	49.8	49.9	37.7
Net interest (as a percentage of exports)	16.5	5.9	-0.2	5.4	6.2	3.9	3.6	1.9	0.7

Table 1 (conclusion)

	1989	1990	1991	1992	1993	1994	1995	1996	1997"
				Percentages of GDP					
Central government									
Current income '	19.4	22.4	22.8	17.2	16.5	17.2	15.9	20.2	23.4
Current revenue	17.2	19.1	17.8	15.7	14.3	17.4	15.9	15.8	17.8
Saving	2.2	3.4	5.0	1.6	2.2	-0.2	-0.1	4.3	5.6
Capital expenditure (net)	3.2	**2.6**	2.1	3.2	2.8	2.4	2.8	2.2	3.1
Financial balance	-1.0	**-2.1**	-0.1	-3.8	-2.5	-6.8	-4.3	0.7	1.6
				Growth rates					
Money and credit									
Monetary balance of banking system									
Net international, reserves	211.9	69.4	51.0	18.9	11.7	35.5	45.1	220.0	37.8
Domestic credit[j]	-21.1	49.4	47.2	17.5	43.2	108.4	52.1	26.9	-50.9
To public sector	87.0	0.6	-63.2	191.0	254.9	182.3	110.7	97.7	-85.8
To private sector	13.2	25.1	47.9	33.1	12.0	6.5	47.8	100.0	115.6
Money (Ml)	9.5	**41.2**	51.2	8.3	10.6	129.9	33.0	88.5	83.6
Local-currency savings and time deposits	64.2	72.5	48.7	23.3	32.1	29.9	38.3	151.0	62.5
M2	38.6	60.9	49.5	18.4	25.7	56.3	36.3	-15.6	44.8
				Annual rates					
Real interest rates (annualized)									
Deposit rate	-2.4	-2.3	3.9	7.0	16.9	-11.0	-17.7	-34.6	-16.1
Lending rate	-27.8	3.6	11.3	15.0	24.8	2.6	-5.2	-26.7	-9.6
Equivalent interest rate in foreign currency	-20.3	15.3	12.6	9.1	29.6	9.4	-1.4	-2.0	9.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1990 dollars. [c] These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP. Percentages of the working-age population. [e] Percentages of the economically active population (EAP). From June 1992 on, includes food and transport allowances. [g] Includes Errors and omissions. Refers to net interest as shown on the balance of payments, divided by exports of goods and services. ' Includes as expenditure net loans granted, extrabudgetary expenditure and Central Bank losses, which in 1995 were equivalent to 2.8% of GDP. ^ Apart from loans to the public and private sectors, includes the net amount of "other accounts". Interest rate on deposits, deflated by the variation in the exchange rate.

Table 2
VENEZUELA: MAIN QUARTERLY INDICATORS

	1995				1996				1997"				1998"	
	1	II	III	IV	I	II	111	IV	I	II	III	IV	1	II
Gross domestic product (change from same quarter of preceding year)	3.1	0.9	6.7	4.0	-0.9	-1.6	-1.1	1.7	0.5	7.5	7.4	4.9	6.3	
Consumer prices (12-month variation, %)	70.4	61.3	51.7	56.6	78.2	108.1	115.5	103.5	74.9	43.6	39.2	37.6	38.2	39.1
Real effective exchange rate (index: 1990=100)	79.3	72.6	66.3	67.3	80.4	94.2	87.3	78.4	72.2	68.6	64.5	59.3	56.5	55.3
International reserves (millions of dollars)	11174	10547	9207	9723	9 983	10907	12 684	15 229	15 976	16 655	18 330	17 818	15 796	15 499
Ml (change from same quarter of preceding year)	104.3	72.0	33.8	34.2	41.9	50.0	57.5	83.5	66.5	90.5	109.6	58.4	69.1	
Real interest rates (annualized, %)														
Deposit rate	-12.3	-21.4	-8.8	-28.5	-43.8	-51.0	-23.9	-19.5	-12.2	-13.9	-19.9	-18.4	-4.4	1.2
Lending rate	3.9	-10.4	4.6	-19.0	-35.6	-42.3	-15.8	-13.2	-5.8	-6.9	-13.3	-12.5	4.1	8.3

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. Refers to the exchange rate for imports.

Consequently, the ratio of public-sector revenues to GDP fell to 32%, whereas expenditure edged up by one percentage point to nearly 30%.

The fall in the price of crude oil from the end of 1997 upset central government fiscal planning for 1998, which had projected a balanced budget based on an average price of US$ 15.50 per barrel of oil exported. As the price on the international market weakened, the budget projection was adjusted downwards. In order to compensate for the anticipated reduction in revenues, equivalent to several percentage points of GDP, the Government introduced public spending cuts in the first half of 1998 and approved measures to boost revenues. These included a rise in the tax rate on wholesale sales and luxury consumption from 16.5% to 18%, a widening of the tax base and other proposals aimed at enhancing fiscal efficiency and control, which were sent to Congress for approval.

(b) Monetary policy

The financing of greater public spending with funds from abroad contributed to an expansion in the primary money supply, and this was accompanied by considerable increase in bank loans, due to greater demand for credit in the context of economic recovery. In response to the threat this posed to the inflation target, the Central Bank of Venezuela maintained its policy of keeping a tight grip on liquidity.

This policy was implemented chiefly by raising the legal reserve ratio, which was put up from 12% to 15% in July and 17% in August in response to the surge in lending to the private sector. The Central Bank also continued selling monetary stabilization bonds (TEMs), which were temporarily replaced by national public debt bonds (DPNs) at the end of 1997 and by non-negotiable certificates of deposit in 1998, but these operations had a barely contractionary result. The monetary base therefore expanded by nearly 80% in 1997. This is explained by a build-up of international reserves, only partially offset by a reduction in the public sector's debit position with the Central Bank resulting from the above-mentioned transfer of public debt bonds and the deposit of part of the extraordinary revenues coming from the oil sector and privatization.

Ml money supply growth (84%) was somewhat greater than the expansion in the monetary base, due to the increase in private-sector credit mentioned earlier. Ml growth reflected the public's greater liquidity preference, with savings and time deposits expanding less than demand deposits. The increase in broad money (M2) was limited to 45%, in a context of negative real interest rates. Nominal interest rates did not change much in 1997, after dropping from the high levels reached in the first half of the previous year. Annual average rates on deposits and loans were 16% and 24% respectively, half of those recorded in 1996. Since the rate of inflation fell more than interest rates, yields became less negative.

Negative real interest rates stimulated stock market investment, which was also fueled by foreign capital inflows. During the first three quarters of 1997, prices on the Caracas stock exchange climbed steadily, although from September onwards they began to lose ground as a result of the financial crisis affecting a number of Asian countries. Measured in dollar terms, in November 1997 stock prices fell below the level at which they had ended 1996, but began to recover again the following February.

The reduction in foreign currency earnings from oil, together with less confidence in the currency leading to a stronger demand for dollars, forced the Central Bank to defend the desired level of the exchange rate in 1998 by supplying foreign currency to the market and intensifying its policy of mopping up liquidity. Net reserves held by the Bank fell significantly in the first quarter, and the monetary base shrank by nearly 9%. Money supply growth during the quarter was restricted to less than 7%, and broad money contracted by nearly 3%, while interest rates responded by moving sharply upwards from February onward: at the beginning of May loan and deposit rates were above 40% and 31% respectively.

(c) Foreign exchange policy

The value of the bolivar was strongly affected by the inflow of foreign currency from oil revenues. Tie Central Bank of Venezuela maintained the system instituted in July 1996 involving an exchange rate band pegged to the United States dollar, but adapted it operationally to conditions in the currency market.

In early 1997, in response to the strength of the external sector, which had forced the bolivar-dollar price gradually towards the floor of the band, the Central Bank proceeded to adjust the central paiity downwards and slow its rate of crawl from l.:>0% to 1.32% per month. In July a further adjustment was made, the monthly rate of crawl being lowered to 1.16%. The nominal dollar price ir the market thus rose from 476 to 504 bolívares over the course of 1997, representing £ nominal depreciation of the local currency of ju st 6%. Consequently, in real terms, the bolivar ap] >reciated by 24% during the period.

In the face of the turnaround in dollar supply and demand conditions on the foreign exchange market, in January 1998 the Central Bank again corrected the central parity of the exchange-rate band, this time upwards, and raised the pre-set rate of crawl back up to 1.28%. As a result, bolivar depreciation accelerated over the course of 1998. At the beginning of May the dollar price passed the central parity for the first time to settle in the upper half of the band, and by the end of the first semester the dollar was being quoted at 550 bolívares

(d) Structural reforms

Once the urgent task of stabilizing the economy had got under way, in the second year of implementi tion of Agenda Venezuela special emphasis was given to the structural changes it provided for. Towards the end of the first half of 1997 amendments were passed to the labour code, which laid the foundations for an in-depth reform of social security involving a recapitalization of the Venezuelan Social Security Institute (IVSS) and the eventual creation of private pension funds. The amendments require the Government to recognize labour liabilities equivalent to US$ 8 billion, to be paid over a five-year period, and a further US$ 6 billion will be needed to recapitalize the social security system.

The 1997 privatization programme included selling the important aluminum complex of the Corporación Venezolana de Guayana (CVG), but various difficulties that arose during the bidding period caused it to be postponed to 1998. On the other hand, in addition to other smaller privatizations carried out during the year, the iron and steel firm Sidor was successfully auctioned off at the end of 1997. The sale of 70% of Sidor shares raised US$ 1.2 million for the State.

Moreover, the process continued of opening up the oil sector to private capital. In June a third round of operating agreements were signed with the company Petróleos de Venezuela, which thus raised US$ 2,172 million from rights granted to 18 national and foreign consortiums for the exploitation of marginal petroleum deposits. In November private firms were authorized to participate in supplying oil and gas to the domestic market, a change that began to take effect in February 1998. Petróleos de Venezuela, meanwhile, undertook a significant internal restructuring programme in 1998 aimed at enhancing its efficiency and increasing profitability.

3. The main variables

In 1997 Venezuela began to reap the fruits of the adjustment programme implemented the previous year, and the economy posted better results: growth with lower inflation, although the latter fell by less than expected, with external accounts remaining in surplus in the context of a still favourable situation in the oil market. When oil prices dropped in 1998, the overall performance of the economy began to deteriorate.

(a) Economic activity

Gross domestic product grew by 5.6% and per capita output by 3.4% in 1997. This result was assisted both by the external market and by the climate of greater domestic macroeconomic stability. Production for export expanded by 13%, accounting for nearly half of the increase in aggregate supply in the economy. Crude oil production played a decisive part, with output rising from 2.94 to 3.21 million barrels per day to generate growth of nearly 9% in the oil sector.

Greater macroeconomic stability, along with improved expectations, fostered a recovery in domestic investment, which grew by one third to rise above the depressed levels of the two previous years. Owing largely to the Petróleos de Venezuela investment programme, public-sector investment expanded by 11%. Its contribution to the strengthening of domestic demand was also substantial, as it continued to account for the bulk of total investment, which, despite the recent upsurge, still barely equalled one sixth of the country's GDP. Gross domestic saving as a percentage of GDP (36%) was much higher, as it needed to be to offset net capital outflows amounting to 10% of GDP, an unfavourable terms-of-trade effect (-6%), a deficit on factor services (3%) and a small net private-sector transfer abroad.

Consumption rebounded by nearly 5% and was a significant stimulus to output, accounting for nearly two thirds of its growth. Recovery here was rooted in the private sector, in response to a rise in purchasing power, a favourable employment trend and an expansion of bank credit.

Apart from public services, all activity sectors participated in the economic recovery, albeit unequally. The greatest relative growth was in construction (13%), which began to climb out of the trough into which it had fallen during 1993. Manufacturing grew by 4%, while agriculture, not very sensitive to the immediate cycle, kept up its steady expansionary trend, which, with 3% growth in 1997, meant an 11% accumulated rise since 1990.

GDP growth prospects for 1998 worsened as oil prices tumbled and the Government decided to cut oil output and exports under agreements with other producer countries. In addition, the fiscal measures taken by the public sector to face down the fall in oil revenues and the rise in interest rates arising from deteriorating exchange-market conditions have had a restraining effect on growth.

(b) Prices, wages and employment

The rise in the consumer price index during 1997 was less than the record triple-digit high recorded in 1996 and the 1995 figure, but prices nonetheless rose by 37.6%, above the official target. Thus, expectations generated since the monthly inflation rate started to fall in November 1996 were cut short: the disinflationary process only lasted until March, when the monthly rate was the lowest in several years (1.6%). The subsequent upturn coincided with a rebound in consumption and economic activity from the second quarter onward in a climate of abundant liquidity.

The resurgence of inflation was even more worrying in view of the relative stability of the exchange rate during the year. The trend was particularly driven by administrative increases in fuel prices and some utility rates, as is shown by the much more moderate course of producer price indices (19%) and wholesale price indices (15%), which exclude services. At the end of July 1998, year-on-year inflation remained around 38% and was resisting falling in line with the target rate despite the slowdown in demand.

Purchasing power among both manual and non-manual workers went up by 26%, rising for the first time in several years to almost regain its 1995 level. This rise was the outcome of lower inflation in 1997, as well as wage increases granted and the payment of accrued labour liabilities under the new labour code. Public-sector workers received larger increases than those in the private sector. In mid-1997 the minimum wage was raised and various existing supplementary allowances that had not been counted for pension purposes were added in; the minimum wage thus rose from 32,000 to 75,000 bolívares. In 1998 it was raised again, effective 1 May, to 100,000 bolívares.

The recovery of economic activity enabled more than half a million jobs to be created and reversed the rising trend of joblessness since 1994 that had culminated in the second half of

1996 with one worker in eight out of a job. The unemployment rate dropped back to 10.6% in the second half of 1997, and the size of the informal sector shrank, although continuing to account for nearly 48% of the workforce.

(c) The external sector

The persistence of favourable conditions in the world oil market almost throughout 1997 allowed Venezuela to increase slightly the already high value of its goods exports, which verged on US$ 24 billion. A slight cheapening of oil exported by Venezuela -the average price slipped from US$ 18.3 per barrel in 1996 to 16.5 in 1997- was offset by an expansion of volumes shipped from 2.75 to 3.05 million barrels per day. Other merchandise exports, which contribute 22% of the foreign currency earned from sales abroad, recovered from the setback suffered in the previous year to grow by 17%.

Goods imports surged in the context of real exchange-rate appreciation and greater economic activity, rising by 25% in value terms (27% in volume) compared to the low levels of the preceding year. In keeping with the considerable upturn in investment, purchases of capital goods were the category that grew most (nearly 50%), making up for nearly all the previous year's decline.

These trends in visible imports caused a reduction in Venezuela's large trade and current account surpluses, which shrank to US$ 8 billion and US$ 6 billion respectively. This made it possible to finance a net capital outflow and still generate an overall surplus of US$ 3.2 billion -still large, but far from the previous year's US$ 7 billion. As a result, international reserves continued to rise from their most recent low in April 1996, increasing during 1997 from US$ 15.2 billion to US$ 17.8 billion.

The capital account deficit was smaller than in 1996, owing mainly to large amounts of foreign direct investment (around US$ 5 billion) associated with the opening up of the oil sector and privatization. However, these inflows were less than the sum total of net resources transferred abroad by the non-bank private sector and amortization payments on the public sector's external debt. The latter meant that the country's total external debt was reduced once more to below US$ 33 billion by the end of 1997, despite increased borrowing by the private sector.

The first semester of 1998 saw a drastic change in trends in the external accounts. Export earnings plummeted owing to a drop in prices and volumes of oil shipments. Prices fell to an average of US$ 10.4 by the end of July; volumes were reduced because of the agreements reached between several producer countries in March and June to restrict supplies to the world market in an effort to halt the downward slide in prices. This situation, and the currency outflow it engendered among economic agents, was reflected in international reserves, which, having shed US$ 1 billion in December 1997, dropped below US$ 14.5 billion in mid-May, a level that was maintained, albeit with sharp fluctuations, until July.

ECONOMIC TRENDS IN THE CARIBBEAN

1. Introduction and synthesis

Overall, economic expansion was slightly less vigorous in 1997 than in the preceding year, although the rate of growth showed greater divergence between the countries surveyed than in 1996. The sectors recording the strongest performance were tourism, construction and the distributive trades. Agriculture had a mixed performance with declining output in Barbados, Jamaica and the Organization of Eastern Caribbean States (OECS) countries. The traditional agricultural exports suffered from lower prices, while output in the sector as a whole was adversely affected by unfavourable climatic conditions. The manufacturing sector showed heterogeneous behaviour, declining in Jamaica and the OECS countries but with moderate increases elsewhere.

In general, faster increases in the money supply and easier credit were observed in 1997. Exceptions to this were to be found in Guyana and Jamaica, where money growth slowed. In Jamaica, however, the rate of increase of the stock of liquid assets (M2) remained at the upper level of the range for Caribbean countries. Barbados represented another particular case, with banks accumulating excess liquidity over the first six months, although the demand for loans strengthened later in the year. In the Caribbean as a whole, the increased volume of credit probably contributed to generating larger trade deficits.

There was a widespread deterioration of the public accounts. Exceptions to this trend were the improved fiscal results in Barbados and Trinidad and Tobago. In OECS countries, the government current accounts showed higher surpluses. However, information on capital spending for these countries is incomplete, so that inferences regarding overall balances for them as a group are inconclusive. For all other countries, there was deterioration in the current account, with increases in recurrent spending outstripping new revenues. The overall account was further eroded by the fact that, in most instances, capital spending was augmented greatly.

Price inflation remained moderate. The notable exception was Jamaica, where the rate of price growth diminished to near 10% (down from 26% in 1996). In general, such price increases as were experienced resulted from domestic conditions, since international inflation remained subdued. In Barbados, prices rose as a consequence of the new value added tax (VAT), while in Suriname economic imbalances sparked renewed inflation after its virtual disappearance in 1996.

Unemployment fell, on average, by less than 0.5% in 1997. Jamaica and the Netherlands Antilles recorded increased unemployment, however, as a result of depressed economic conditions. In most Caribbean countries the rate of unemployment exceeded 12%, while in all of them female and youth unemployment rates were much higher than those for adult males. Construction and the building trades were among the main sources of job creation in 1997.

Asa general feature, the current account of the balance of payments showed smaller surpluses or larger deficits. This reflected the weakness of export performance and the effects of easy credit, which were not compensated for by the modest growth in tourism earnings. Most merchandise exports performed poorly. This was the case of bananas (with export revenues down by 15%), sugar (-7%) and bauxite (-1.3%); foreign sales of fuels from Trinidad fell by 3.1%. However, alumina earnings in Jamaica increased by 7%, while tourism arrivals rose by 4% for the subregion as a whole.

In several cases, such as in the Bahamas, Guyana and the OECS countries, the negative developments in the current accounts were matched by increased capital inflows, allowing for improvements in the balance of payments. Barbados and Trinidad and Tobago showed increases in international reserves, but of lesser amounts than in the previous year. The decline in the surplus of the overall balance of payments was substantial in Belize, while Jamaica reported a deficit. The external liabilities of the subregion contracted by 4%.

The economy of **Aruba** is estimated to have grown in 1997 by around 4%, with continued buoyancy being provided by the tourist sector. However, the expansion was accompanied by severely deteriorating fiscal and external accounts. The most recent data indicate a fourfold increase in the fiscal deficit over that for 1996, with government revenue, which rose by 3%, being outstripped by spending, which grew by 20%. Higher public sector wages were the main source of increased spending. Rising domestic expenditures acted on the balance of payments, foreign reserves falling by US$ 67 million. Payment arrears also accumulated. Failure to address the macroeconomic imbalances was evident in the run-up to the election, which became necessary when the ruling coalition collapsed. However, the election results were such that the impasse continued into 1998.

In the **Bahamas** the economic growth which had resumed in 1996 after two years of relative stagnation continued in 1997. However, the rate of expansion was more moderate, at 3% compared to 4.2% in 1996. Slower growth was observed in the tourism sector, in part as a result of refurbishing and upgrading of facilities. Simultaneously, this activity pushed up construction, with building starts more than doubling in value in 1997. The fiscal accounts deteriorated, with recurrent expenditure outstripping recurrent revenues, while capital spending increased by more than 60%, capital formation rising by 85%.

In the financial sector, the picture was one of buoyant liquidity. Growth in domestic credit was strong and this contributed to a widening of the deficit on the current account of the balance of payments. Capital inflows, mainly for tourism investment, redressed the balance and augmented the reserves by US$ 56 million. At the same time, the total external debt increased, by US$ 3.9 million, or just over 1%. Inflation remained moderate, falling from 1.4% in 1996 to 0.5% in the current survey year.

The economy of **Barbados,** maintaining its steady growth since 1992, expanded by 3% in 1997. Economic activity was stimulated by strong performance in the construction sector, which benefited from increased public and private investment, and by an expansion in the wholesale and retail trades. Manufacturing also recorded higher levels of output, while tourism growth was modest. Despite the increase in sugar production, the agricultural sector declined in the aggregate. The rise in job creation was reflected in a lower unemployment rate (12.2% at the end of the year), mainly because of increased labour demand in construction activities and the distributive trades. Inflation increased markedly, the average annual rate of price growth shooting up to 7.7%, as a one-time response to the value added tax. However, inflationary pressures subsided by the end of the year. The balance of payments recorded a reduced surplus, primarily because of much higher volume of imports, while the fiscal accounts strengthened, greatly augmented revenues from VAT making possible increased capital spending and a smaller deficit.

Economic activity in **Belize** picked up in 1997 with a growth rate of 4.5%. This was due to a large extent to the performance of agriculture, led by citrus production and fishing. Government activities also expanded, with increases in recurrent and capital spending. The fiscal deficit rose from 0.4% of GDP to nearly 2%. Performance on the balance of payments was not as strong as in the previous year. The reserves increased but at a much slower rate than in 1996. Inflation declined substantially, following the jump experienced in 1996 with the introduction of VAT, while unemployment fell slightly, from 13.8% to 12.7%.

The rate of economic growth in **Guyana** slowed in 1997. However, despite adverse weather and the uncertainties of an election year, expansion remained strong at 6.3%, benefiting from buoyancy in minerals, manufacturing, construction activities and transport and communications. Credit to the private sector slowed, primarily because of the malaise in agriculture, but government borrowing increased. The public finances deteriorated and there was a much larger fiscal deficit. Government revenues languished, but recurrent expenditures rose by 24%, with increases in payments to public officials and in interest payments. Capital spending also grew. Overall, the balance of payments showed a modest surplus, although the current account deficit expanded as a result of deterioration in both the goods and services accounts. However, public and private capital inflows increased. Inflation moderated slightly compared with 1996.

Output in **Jamaica** contracted for the second successive year, while unemployment increased slightly. Most productive sectors had a negative performance, with the exception of mining and quarrying and basic services. Severe drought throughout 1997 reduced the contribution of agriculture, while manufacturing activities felt the effects of the continued opening up and restructuring of the sector. Construction was hit by reduced aggregate demand and by tight credit. Monetary policies continued to be aimed at containing the growth in the supply of liquidity. The monetary aggregate M2 expanded by 13.4% as opposed to 14.5% in 1996 and 46% on average from 1993 to 1995. The inflation rate dropped substantially, from 26.4% in 1996 to 10% in 1997. However, depressed output and very high loan rates affected the profitability of enterprises. This had repercussions on banks, some of which faced insolvency.

Public accounts for the calendar year 1997 also deteriorated significantly, as a consequence of public funding to support the failing financial institutions and the cost of servicing the greatly augmented domestic debt. The balance of payments reflected the sluggish performance of the economy, export earnings remaining flat, while imports increased modestly. The net services balance also contracted, while the high level of capital inflows witnessed in recent years was also greatly reduced so that the balance of payments recorded a deficit equivalent to 2.5% of GDP.

In the **Netherlands Antilles** the annualized real GDP to the third quarter of 1997 is estimated to have declined by 2.5%. At that time, real output had contracted for seven consecutive quarters as a result of reduced purchasing power, sluggish investment and low levels of confidence among domestic economic actors. External performance was also weaker, mainly because of reduced transactions by the transportation sector, petroleum refining and international financial and business services. However, tourism performed well, mainly as a result of increased activity in Saint Marten. Despite the effort expended so far, the fiscal account continued to cause concern, the deficit being double that projected for the year, while debt arrears accumulated. Policy management has been hampered by the complex network of 12 political parties which share 22 seats in the national legislature, resulting in potentially unstable coalitions.

Overall, the OECS member countries experienced somewhat faster economic growth, with a 3% increase in GDP in 1997, compared to 2.5% in 1996. The expansion was evident in most services activities, while agriculture and manufacturing had reduced output. Performance was strong in the tourism sector, construction, communications and transportation. The decline in agricultural production was particularly substantial, the rate of contraction increasing in 1997. This was explained by a 28% reduction in the volume of bananas exported; a 47% fall in cocoa exports also contributed to this decline. The money supply rose moderately in 1997,

1 This evaluation is based on data provided by the Eastern Caribbean Central Bank (ECCB) which covers all members of the Organization of Eastern Caribbean States (OECS), namely, Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines, as well as Anguilla.

compared with the contraction in 1996; credit to private households registered the most notable increase over the previous year. The fiscal accounts strengthened, with a slightly increased recurrent surplus. The current account of the balance of payments deteriorated, but capital inflows were sufficient to redress the deficit and allow for increased reserves. The inflation rate remained low in the group of countries, falling slightly in comparison with the 1996 figures.

The rate of economic expansion quickened in **Suriname** in 1997 (5.6%, up from 3% in the previous year). The leading sector was mining, which grew by 16%, with strong performances in aluminum and gold production. Miscellaneous services including trade, restaurants and hotels also expanded rapidly. Inflation started to move upward once again, the average annual rate rising to 7%. Year end inflation increased to a level of over 16%. The fiscal accounts were put under renewed pressure because of weak tax collection and wage increases in the public sector. Total government revenues dropped by 1.3%. Receipts from indirect taxes fell by 9%, in part because import tariffs were removed from products bought within the Caribbean Community (CARICOM) and also because duties on raw materials and semi-processed goods were eliminated in March 1997. Moreover, taxes fell behind target because the sales tax scheduled for introduction in July 1997 was not introduced until February 1998 and then at half the 15% rate originally proposed.

The external current account deteriorated from a surplus in recent years to a deficit of US$ 44 million in 1997. Imports increased by 9.6%, owing to higher consumption demand and to large imports of capital goods by the bauxite/alumina industry. Export earnings declined by 5%, lower metals prices being the main cause, while sales of shrimp, oil, rice and bananas had strong performances. Foreign investment and loan inflows offset the current account deficit but the reserves excluding gold fell, in part because of continued gold purchases, so that import cover fell from 4 to 3.2 months.

In **Trinidad and Tobago** production expanded in 1997 for the fourth consecutive year, by about 4%. The increased output in the non-oil sector (at 4.1% in the aggregate), which applied to all activities with the exception of government, was sufficient to compensate for the decline of just over 1% observed in the oil sector. Unemployment fell to its lowest level in 12 years, although it remained high (15%). Despite the expansion in output, inflation stayed below 4%, slightly up on the 3.3% recorded for the previous year. Given the rapid build-up of liquidity in the financial system, the Central Bank intervened actively in the market but found it necessary to reimpose reserve requirements for commercial banks and non-bank financial institutions by the end of the year in order to contain money growth. Both the fiscal and external accounts recorded surpluses, the latter bringing about a 19% increase in international reserves. Current accounts (government and balance of payments) deteriorated, but this was offset by the receipts derived from the divestment of a methanol installation and inflows intended to finance new investments in the gas sector.

2. Economic policies: general outlook and structural reforms[2]

Two factors loom large in the design of Caribbean macroeconomic policies. The first is the set of criteria agreed upon by the Council of Central Bank Governors of the CARICOM countries for qualification for the CARICOM single economy. The so-called "3-12-36-15 criteria", targets three months' foreign exchange cover for a period of 12 months, 36 months of

2 These issues were dealt with in greater depth in a report of the regional headquarters of ECLAC for the Caribbean, Port of Spain, entitled "Review of Caribbean economic performance, 1997: based on data for the period January to June 1997" (LC/CAR/G.512), 29 December 1997.

exchange rate stability and a debt service ratio of under 15% of export. The ultimate objective of this exercise is to create a Caribbean monetary union, modeled closely on that of the European Union and potential member countries have been influenced by the incentive to demonstrate their ability to qualify in the first tier of entrants.

The second factor is a growing conviction that in these open economies exchange rate depreciations result very quickly in higher prices. Accordingly, it is increasingly believed that flexible exchange rates have costly effects. This position has traditionally been maintained by the smaller economies in the Caribbean, the members of the Eastern Caribbean Central Bank (ECCB), Belize, the Bahamas, Barbados and the Dutch-speaking territories, Aruba and the Netherlands Antilles. The most vocal proponent of this argument, Barbados, is the only one of the so-called More Developed Countries (MDCs) of CARICOM to have used the exchange rate as a strict policy implement. Guyana, Jamaica and Suriname have experienced greater surges instability and accordingly more rapidly depreciating exchange rates. Trinidad and Tobago has adopted an intermediate course, with moderate rates of devaluation systematically managed by the central bank over time.

Recently Jamaica seems to have shifted its position, after experimenting with various foreign exchange rate regimes, ranging from a free float to a central bank managed foreign exchange auction. The current approach seems to be more closely akin to that of the majority, which is that of using other macroeconomic tools to sustain the level of reserves necessary for a stable exchange rate. While the Jamaican authorities insist that the focus is not on the exchange rate per se, but rather on inflation, the two are seen as integrally related in the Caribbean. Whether the Jamaican experiment can be sustained is being watched with a great deal of interest: the outcome is far from clear as, in the face of huge fiscal deficits, the policy is only possible with punitive interest rates.

Throughout the subregion structural reforms continued, notably in the area of fiscal policy, to make tax regimes more transparent and to substitute consumption taxes for declining trade taxes, to improve tax compliance and tax collection mechanisms and to remove loss making and other business operations from the public accounts, through privatization. Reforms were also evident in the continuing liberalization in several areas, especially in the trade and financial sectors.

In **Aruba,** the proposed anti-inflationary policy was based on restraint in public spending, which was also meant to reduce pressure on domestic credit and husband the international reserves. The attitude of fiscal restraint came after public sector wage indexation was introduced in 1996, resulting in increasing wages and salaries and related social security costs. Guidelines were therefore issued to streamline both policy and administration of the tax system, increase revenue by strengthening collection and billing procedures and liberate excess employment in the public sector by adjusting its size and composition so as to ease the manpower constraints faced by the rest of the economy. By the end of the year, much of the policy was in disarray, since uncertainty arising from the inability to maintain a stable coalition government diverted attention from fiscal consolidation.

In **Barbados,** several policy challenges were identified for attention in 1997. Chief among them was the need to concentrate efforts on the poorest segments of the population, given the fact that the economy had been stabilized and had regained its forward momentum. At the same time, implementation of the policy reform agenda was accelerated with respect to the trade and payments regimes and the development of financial markets. Other areas of focus were debt management and policies to insure against overheating of the economy, in order to contain excess liquidity.

In **Guyana,** policy statements made when the budget was presented for 1997, an election year, sought to reassure the private sector and reiterated the importance of private sector growth, especially as government continued to divest itself of productive enterprises. In fact, privatizations accelerated in 1997. In addition, an investment guide and investment code were to be prepared which would provide basic guarantees for investors and consolidate the various incentive regimes currently in operation. The institution GO-Invest was to incorporate and consolidate the functions of the Export Promotion Council in order to perform activities more efficiently and better promote investment in Guyana. A merchant bank had also been licenced which was expected to provide a range of services previously unavailable to the private sector.

Particular emphasis was to be placed on the contribution of manufacturing, especially agro-industry and wood processing, to economic growth. Accordingly, the Government undertook to seek special financing from international sources to provide venture capital and other related business and financial services to stimulate these activities. Support would also continue to be given to the tourism sector and particularly eco-tourism by rehabilitating hinterland airstrips, protecting the environment and developing collaborative links with other Governments in the Caribbean active in this field.

Tax reform was also under review. The aim was to make the tax regime send appropriate signals to the private sector, specifically to reward initiative and penalize tax evasion. The application of a value added tax was also to be considered in view of the steady erosion of trade taxes as the CARICOM common external tariff was lowered. The debt reduction efforts were also to be continued.

In **Jamaica,** the authorities gave high priority to the objectives of stabilizing prices and the exchange rate. The target set at the beginning of the year was to reduce inflation to 9%. Money supply growth was to be contained to no more than 11% per annum while the fiscal deficit was to be reduced to 2% of GDP. The Government expected that reduced inflation would contribute to decreasing interest rates, and GDP was targeted to grow at between 2% and 3%.

In 1997 the Government of Jamaica embarked on the second phase of its national industrial policy. In this phase, fiscal policy was expected to contribute by helping to reduce inflation and interest rates and by liberating resources for investment. Fiscal consolidation was to be achieved by increasing receipts and reducing recurrent spending. In the former category, the authorities planned to focus the ongoing programme of tax administration reform on improving compliance. In the latter category, recurrent spending was expected to fall as a result of better debt management and lower interest rates, which would also reduce the cost of debt servicing. Attention was also to be given to public sector wages to limit increases in line with inflation.

As the year evolved, however, it became evident that efforts to reduce interest rates were premature, domestic investors judging the policy unsustainable in the context of growing fiscal and balance of payments deficits. They responded by shifting away from domestic to foreign currency deposits. In order to support the objective of price stability, which was predicated on a stable exchange rate, the central bank increased interest rates once again and intervened in the foreign exchange market, reducing the net international reserves by US$ 153 million in the second quarter. The reserves stabilized temporarily, but came under pressure in the fourth quarter in the run-up to the general elections which were held in December. By the end of 1997, the reserves stood at US$ 542 million, sufficient for nearly three months of import cover. Capital inflows resumed thereafter, with foreign assets increasing slowly into 1998.

On the policy front, the **Netherlands Antilles** initiated a structural adjustment programme at the commencement of 1997, the main elements of which were a fiscal consolidation package, wage restraint and a tight credit policy. It was underpinned by a precautionary line of credit of Dfl 100 million from the Central Bank of the Netherlands, refinancing of outstanding debt and grants to support the social component of policies. The programme also contemplated measures of reform in the government sector, to streamline the public administration, adopt a market-oriented wage structure and improve public accounting; the authorities planned to implement divestment of several public enterprises, including the loss-making national airline. Monetary targets defined a limit of 3.5% credit growth for the private sector, while credit to the Government was not to exceed the amount outstanding at 31 October 1996. These targets would be monitored quarterly and penalties levied for non-compliance. By the end of the year the fiscal consolidation programme had not met its objectives, as the deficit seemed likely to have doubled. These negative fiscal results were in large measure due to the fact that unstable political coalitions were unable to provide the necessary policy focus either before or after the elections held in 1997.

In the OECS **countries,** policy-making was shaped by the evolution of the market for bananas. The World Trade Organization (WTO) ruling which found against the European Union banana licencing arrangements has reduced the chances of survival of the current trade regime of the good. For the banana producing countries of the Windward Islands -Dominica, Grenada, Saint Lucia and Saint Vincent and the Grenadines- the main policy problem was to find the wherewithal to cope with the loss of preferential access to the United Kingdom market. This would require diversification of output to offset the contraction of the banana industry, as well as measures to improve productivity and fruit quality, so as to preserve that portion of the sector which could be made viable under the new non-preferential regime. The issue for the OECS countries as a whole was to manage the strains which could appear within the grouping caused by the slowing economic tempo of the Windward Islands *vis-à-vis* the other members.

Further questions were posed by the proposed accession of Barbados to OECS. A task force has been established to prepare proposals for eventual Barbadian membership, which is expected to have currency unification as one of its early steps. The fixing of a common rate will have significant policy implications for all members, especially as a common CARICOM currency is mooted for early in the next decade.

In Trinidad and Tobago, policy emphasis was placed on maintaining macroeconomic stability, slowing the rate of depreciation of the exchange rate and providing incentives to increase local and foreign investment. Persistent concerns were reducing the rate of unemployment and diversifying the economy, that is inducing the expansion of the non-oil sector. Policy reforms related to lowering trade protection in line with the requirements of the CARICOM Common External Tariff (CET) and simplifying and rationalizing the tax regime by reducing the number and scope of tax credits and exemptions. At the end of the year, exchange rate pressures remained, driven by high government spending and reflected in a moderate depreciation of the currency from TT$ 6 to TT$ 6.3 to the United States dollar, while the rate of inflation inched up from 3.3% to 3.8%. The non-oil sector outperformed the oil sector, mainly because of weak performance in the latter.

(a)Public finance

Fiscal performance weakened in the Bahamas, with the deficit increasing from an estimated 1.9% of product in calendar year 1996 to 3.3% of product in 1997. Total government debt was up by 11 %, moving from the equivalent of 33% of product in 1996 to 34.6%.

Recurrent revenues increased by 6%, with a mixed performance of different taxes. Selected taxes on services provided reduced revenues, as did returns from business and professional fees; both categories were down, by 1.8% and 12.1%, respectively. On the other hand, taxes on international trade (which account for 60% of overall revenue) were up by nearly 6%. That outcome was, however, less than targeted because of lower than expected import duty collections.

Total spending, including net lending to public entities, increased by 15%. Recurrent

3 The OECS countries operate a loose integration with common monetary arrangements under the ECCB. The ECCB covers all the OECS countries and Anguilla.

expenditures, up by 7.5%, increased faster than recurrent revenues. Wages and salaries rose by 10%, while interest payments increased by just over 11%. The recurrent surplus declined from 1.1 % of estimated product to 0.8%.

Capital spending was up quite significantly, from 1.9% of product in 1996 to 3.3% in 1997. The increase, relating mainly to investments in public works and water supply projects, was greater than budgeted, in part because of the early completion of some projects.

In **Barbados,** the fiscal deficit fell from the equivalent of 3.8% of product in 1996 to 0.8% in 1997. Increased revenues and a moderate growth in spending augmented the recurrent surplus to 5.3% of product, up from 1.5%. This liberated resources for capital expenditures, which rose to 6.1% of product, up from 5.3% the year before.

Recurrent revenues increased by 19%; revenues from indirect taxes grew by 36%. This strong performance was mainly due to the imposition of VAT on all goods and services in 1997 and to the resumption of imports (after initial consumer insecurity), which strengthened revenue from taxes on foreign trade. Receipts from direct taxes grew more modestly, by just over 8%, personal income taxes and corporate profit taxes growing by 5.2% and 11.5%, respectively. Property taxes showed growth of 15.2%.

Recurrent spending rose moderately, by just under 5%. Government finances benefited from a 12% reduction in interest payments. Public service wages increased slowly, by 2.2%, in part because of a delay in negotiating new arrangements after the old contract expired at the end of the first quarter of 1997. Transfers and subsidies grew by 14%. In contrast to recurrent spending, capital outlays increased significantly, by 43%.

The reduced fiscal deficit was financed entirely from domestic sources, primarily commercial banks and the National Insurance Scheme, while central bank lending fell by a further B$ 5.7 million. Net foreign financing declined as a result of reduced project funds and increased amortization payments, since no debt was sold on the international financial markets.

The Government's indebtedness fell in 1997, to 64.6% of product as compared to 70.3% in 1996. Of this total, the foreign component continued to fall, accounting for 26% of the total in 1997 as compared to 38% in 1992. Domestic debt grew by B$ 18.4 million, all of which consisted of long-term instruments. At the end of the survey year, 69% of the debt was held on a long-term basis, as compared to 37% in 1992.

The public accounts deteriorated in **Belize,** with the deficit increasing from 0.4% of product in 1996 to an estimated 1.9% in 1997. This performance was to be explained by increased spending, a 7.5% rise in recurrent expenditure leading to a diminished recurrent surplus, down from 3.4% to 2.4% of product. Capital expenditures increased by 7.6%. Total government spending represented about 26.4% of product, up by one percentage point over the previous year.

By comparison, total revenues and grants grew more slowly, by 2.7%, actually declining as a percentage of product from 27.2% to 26%. Tax revenues increased slightly in the aggregate. The effects of the imposition of VAT (which was applied for the second year) were felt in revenues from taxes on goods and services, which rose by over 16%. At the same time, income and profit taxes fell by 9%, while taxes from international trade dropped by 6.6%, as Belize implemented the second phase of the CARICOM external tariff. Non-tax revenues increased by over 20% coming from higher property income and transfers from non-financial public enterprises.

Total government debt increased by 4.2%, falling from the equivalent of 53% of product to 51% in 1997. Domestic debt, which represented about 27% of the total, remained substantially unchanged. Over the year the external debt increased by almost 6%, with funds coming primarily from multilateral sources, up by 13%, and private banks, up by 57%, while bilateral debt and suppliers' credit fell by 5.7% and 3.6%, respectively.

The fiscal deficit rose significantly in **Guyana,** from 1.7% of product in 1996 to 6% in 1997. Most tax revenues were below target, notably taxes from companies and the self-employed. Recurrent receipts declined by about 1 %, going from 34% of product to 31 %. At the same time, recurrent expenses increased by 24%, from 23% of product to 26.4%. The main increases were in the public sector wage bill, which showed a growth of over 38%, while interest payments increased by 18.6 %. Accordingly, the recurrent surplus declined from 10.7% of product in 1996 to 6%. Capital expenditure increased by 7 %; the overall relationship between capital spending and product remained about the same, at 15%.

Financing came from external loans and balance-of-payments grants, the latter equivalent to 2.8% of product. The stock of external debt fell in 1997, benefiting from relief granted to the Highly Indebted Poor Countries (HIPC) and from schemes intended to support economic reforms. Overall, Guyana is estimated to have received debt reduction equivalent to about US$ 253 million. At the end of 1997, 63% of the debt which remained outstanding was owed to multilateral financial institutions, 30% to bilateral creditors and 7% to private creditors.

In Jamaica, the objective of fiscal policy, which was to contribute to economic stabilization, was not realized. The fiscal deficit widened from 4.8% of product in calendar year 1996 to over 15% in 1997.[4] The primary reason for the deteriorating performance was the extraordinary expenditure necessary in order to establish the Financial Sector Adjustment Company (FINCÃO) in January 1997 to administer the restructuring of financial institutions facing insolvency. The other fiscal targets also remained unmet, with tax receipts increasing by a scant 3% in nominal terms, and recurrent revenue scarcely more, by 4.8%. The failure to meet revenue projections derived from a contracting economy and declining company profits, on the one hand, and delays in legislation relating to the tax administration reform, on the other.

Simultaneously, recurrent expenditure increased by 12.7%. Initial moderation in interest rates and debt management measures reduced spending on interest payments by almost 6% but the savings were below projections since the initial reduction in interest rates could not be sustained. Interest payments still absorbed over 40% of recurrent spending. Expenditure on wages and salaries increased noticeably, by almost 20%. While the wage payments made during the year actually included back pay for as far as the fiscal year 1993/1994, increases negotiated for 1997 exceeded the rate of inflation. The stronger demands were the result of workers seeking to restore real wages to previous levels and expectations of future inflation, despite the performance in 1997. The high level of fiscal rigidity was indicated by the fact that personnel costs and interest payments accounted for 86% of recurrent spending.

The deficit on the recurrent account went up from 1.7% of product in 1996 to 3.8%. Further deterioration originated in the capital account, as proceeds from capital revenue, the bauxite levy and grants fell by 3.6%, while capital spending increased by 171%. Under the latter heading, there were increases in gross investment and debt amortization. Gross investment increased by 153%, mainly as a result of the funding necessary for FINSAC, the cost of which as of April 1998 amounted to an estimated 33% of product. Of this total, part was financed by cash transfers from the Consolidated Fund and the remainder by paper. The public sector acquired assets including shares, real estate, hotels and other property, and the loan portfolios of the institutions taken over. Debt amortization outlays increased by 59%, given the debt management strategy meant to reduce high-interest domestic liabilities and the repayment of some maturing short-term loans. The magnitude of debt servicing can be seen from the fact that in 1997 it accounted for 82% of total revenue and grants, up from 71% in 1996.

The stock of internal debt increased by almost 17% in 1997, mainly in the form of a J$ 5.6 billion advance to the central bank for liquidity support. Since fiscal year 1991/1992 the stock of domestic debt has risen by J$ 73 billion, to around 45% of product. A good portion of this increase was used

4 The fiscal year in Jamaica normally runs from April to Ma i. Computation of the deficit includes debt amortization costs. If these costs are excluded, the fiscal balance for 1996 was 4.1% product and in 1997 it was -2.4% of product.

for liquidity management; significant amounts were also utilized for budgetary purposes and to fund parastatal debts and central bank losses.

The external public and public-guaranteed debt stood at US$ 3.3 billion representing an increase compared with the end of 1996. The foreign debt had been falling in recent years; the slight growth observed in 1997 was due in part to the policy of seeking credit at the lower costs attendant on external funds. The first foray into the international bond market was initially meant to obtain US$ 100 million, but in fact raised US$ 200 million of the US$ 300 million of foreign financing required for the fiscal year 1997/1998. A second issue in the Eurobond market planned for October was deferred following developments in Asia; instead, the Government sought bridging finance of US$ 100 million from a consortium of foreign banks.

The current account surplus of Governments increased in the OECS countries. All member countries recorded such surpluses, except Montserrat and Saint Kitts and Nevis. In the former case, economic activity came almost to a halt as a result of a volcano eruption, resulting in collapsing revenues and increased welfare and other demands on the State. In Saint Kitts and Nevis the current account deficit contracted from 0.9% of product in 1996 to 0.5% in 1997, following a concentrated effort to increase revenues.

Recurrent revenues, which amounted in the subregion to 24.5% of product in 1997, increased by 4.6%. Above average performances were evident in taxes derived from the sale of domestic goods and services, which were up by 8%, and in taxes on international trade, which increased by 6.2%. Revenues rose in most OECS countries, ranging from the 13% increase recorded in Saint Kitts and Nevis to a 2.5% increase in Antigua. They remained substantially unchanged in Saint Lucia, but contracted in Montserrat.

Recurrent spending, amounting to 23.3% of product in 1997, also grew by 4.8%. More rapid increases were observed in the purchase of goods and services (9.7%), interest payments (up by 7.9%) and transfers and subsidies (8.2%). Aggregate increases varied between the various member countries, from just over 1% in Antigua to 27% in Montserrat.

Data on capital spending are incomplete, but fiscal balances weakened in Saint Vincent and the Grenadines and for Antigua and Barbuda. In the case of the first of these countries, there was a change from a small surplus in 1996 to a deficit equivalent to 4.6% of product, as a result of a sharp rise (145%) in capital expenditure. In Antigua and Barbuda, the deficit grew from 1.6% of product in 1996 to 3.1% in 1997, consequent on a 37% increase in capital spending. In other instances the deficit contracted. In Saint Kitts and Nevis, it remained the same in nominal terms, equivalent to 4.2% of product in 1997. In Saint Lucia, the deficit declined from 1.6% of product in 1996 to 0.8% of product in 1997.

The external debt for the OECS countries, which amounted to 31% of product in 1997 increased by 2.8%. The performance varied between the members. The greatest increase (69%) was in Saint Kitts and Nevis. This reflected the weight of large projects in a small economy, though the external debt to product ratio remained below 40%. Saint Lucia also increased its external debt, by 7.4%. By contrast, other countries reduced their debts, in proportions ranging from 13% in Dominica to under 1% in Saint Vincent and the Grenadines.

The fiscal accounts in **Trinidad and Tobago** showed an improvement over 1996, with a surplus equivalent to 0.9% of product being achieved as compared with a deficit of 0.5% in 1996. The recurrent surplus, equivalent to 1.7% of product, was also slightly better than in 1996 and resulted from a 7% reduction in recurrent expenditures, since revenues fell. Capital spending, however, rose by 77%, the increase being made possible by greatly augmented capital revenues in the form of divestment proceeds from the Trinidad and Tobago Methanol Company.

Recurrent revenues fell by over 4%, with oil receipts dropping by over 34% and property taxes declining by 2.4%. Nevertheless, VAT and international trade taxes each increased by 14%, reflecting high levels of consumption and imports. Among the items of recurrent spending, the wage bill fell by 5% even though it included salary arrears and payments under the unemployment relief programme. Other notable savings were effected by the 5% reduction in transfers and subsidies, which currently account for 34% of recurrent spending. These savings came about primarily as a result of subventions to State enterprises being reduced by 80%.

Domestic debt rose by 19.2%, to the equivalent of 22.4% of GDP. Part of the increase consisted of non-interest bearing emolument bonds to settle arrears of remuneration owed to public sector employees. These bonds are issued in five annual trances with a maturity of two years.

The external debt has declined steadily since 1990, moving from 34% of product in 1996 to 26.4% in 1997. The stock of debt declined by 18.6%, despite an upward adjustment of US$ 11 million as a result of United States dollar movements against other currencies.

(b)Monetary developments

Strong foreign currency inflows from private direct investment and government borrowing helped to increase the stock of money in the **Bahamas.** The growth of the overall money supply as measured by M3 accelerated, from 5.6% in 1996 to 11.1% in 1997. Narrow money (Ml) expanded by 16.4%, with demand deposits increasing by 17%. Fixed deposits grew slightly more quickly in the survey year, by 8.9% compared with 8.3% in the previous period. As a result, the aggregate (M2) grew by almost 10.7%. Residents' foreign currency deposits expanded by around 44%.

Domestic credit rose by 10%, as compared to 8% in 1996; credit to the private sector grew by almost 13% with that to government remaining stable. Personal loans accounted for 62% of private sector credit, the bulk of which was consumer lending. Residential mortgages also showed strong expansion. Sectors receiving increased credit were construction, distribution, professional and other services and tourism. Interest rates rose slightly, loan and overdraft rates by 22 basis points and deposit rates by 24 basis points.

The financial sector in **Barbados** experienced a rapid build-up in liquidity in the first semester of 1997. Strong deposit growth coupled with weak credit demand, the result of tourism earnings inflows in the first quarter and consumer caution after the imposition of VAT, caused the excess liquidity ratio to surge to almost 22% by the end of June. Nevertheless, this build-up was reversed to 14.8% by the end of the year as consumer confidence returned. By the end of the year domestic credit had expanded by 19%, with credit to the public sector, comprising one third of the total, increasing by 13%. Credit to the private sector rose by 21 %. At the end of the year the narrow money supply Ml had increased by 22.6% (against 15.2% for the corresponding period of 1996). Savings deposits grew by 7.5%, though time deposits and foreign currency deposits fell by almost 18% and 26%, respectively. Accordingly, the broad money supply M2 increased by 11% in 1997, compared with 19.4% in 1996.

Money supply (Ml) grew at a slower rate in **Belize** (4.7%) than was the case in 1996 (7.6%). Broad money, M2, however, expanded more quickly, by almost 10%, as compared with a 6% increase in 1996. The higher growth rate was caused largely by the rising volume of credit to the private sector. Credit went to the expanding citrus production in the primary sector, to building construction and manufacturing and to mortgage lending, transport and tourism. About 25% of lending went to the central government. Over the same period, currency with the public and demand and time deposits grew by almost BZ$ 62 million. The net foreign assets of the commercial banks declined by BZ$ 15 million, in response to demands for foreign exchange to pay for imports, travel and private sector loan repayments. Net foreign assets of the central bank remained nearly unchanged.

Monetary policy in **Guyana** set as its objectives price stability, a competitive exchange rate and a viable balance of payments. The growth of monetary aggregates and credit to the private sector decelerated, although credit to the Government increased and the international reserve position deteriorated. Total monetary liabilities increased by 12%, but narrow money (Ml) grew by 8.5% on account of the slow growth in demand deposits. Time and savings deposits increased by 13%, reflecting a shift from demand to interest-bearing deposits.

Credit to the private sector rose by 23.6%, a lower rate than in 1996 when it was 31%. Credit to the agricultural sector, debilitated by adverse weather conditions, fell by 8.6%. Loans to the mining sector also declined, reflecting the slump in gold prices. By contrast, there was an expansion in the volume of financing to households and to the distributive trades.

Monetary policy in **Jamaica** in 1997 was intended to continue lowering the rate of money supply growth, to maintain a stable currency and to reduce interest rates in line with inflation. The rate of increase in the monetary base slowed in 1997 to 14.5% (compared with 16.4% in the previous year) and was significantly lower than the annual average of 30.4% for the period 1990-1995. Broad money (M2) grew by 13.4%, at a slightly slower rate than in 1996. Savings deposits increased considerably (by 31%), whereas time deposits contracted by 4.4%. This decline was the first in 10 years and suggested that depositors chose to hold more liquid assets given the drop in interest rates and flagging confidence in the financial system. The 22% increase in foreign currency accounts suggested uncertainty that the currency would maintain its value. Narrow money (Ml) remained substantially unchanged with growth of 0.5% but its composition changed, with currency in the hands of the public increasing by 16% and demand deposits falling by 9%.

Open market operations and direct controls in the form of reserve requirements were the main instruments of monetary control, the former amounting to J$ 4.7 billion, barely 50% of the value of interventions undertaken in 1996. In 1997 the central bank did not act to sterilize capital inflows; rather, it released reserves to the interbank market in order to influence the exchange rate. Reserve requirements remained at 47%, with cash reserve ratios of 25% for commercial banks. Interest rates did not fall as inflation declined, given the deteriorating external and fiscal accounts and the erosion in confidence in the financial system. Accordingly, benchmark rates returned to 29% at the end of 1997, two percentage points above those prevailing at the end of 1996.

In the OECS countries, total monetary liabilities increased more rapidly in 1997, by 9.6%, compared with 1.9% in 1996. Narrow money supply (Ml), grew by 8.0%, whereas it had contracted by just over 1% in the previous year. Currency with the public and demand deposits grew by 5% and 11%, respectively, whereas they had contracted by 4% and 2.8%, in 1996. Quasi-money increased by 6.9%, while broad money (M2) rose by 8.5%.

Domestic credit expanded slightly faster, by 13.2% (12.9% in 1996). The greatest growth was observed in credit to households, up by 20%, and earmarked mainly for home construction and improvement. Lending for durable goods and for other personal consumption also increased significantly. The rate of lending to the business sector fell, mainly in the area of agriculture. Net foreign assets of the commercial banks continued to drop, by 6.2% following a decline of 25% in 1996. Partially offsetting this contraction, the central bank net reserves increased by 7.5% with an increase in foreign assets and a sharp fall in foreign liabilities. The liquidity position of banks tightened as loans and advances, which increased by 12.2%, out paced deposits, which grew by close to 10%.

In **Trinidad and Tobago,** the Government started 1997 with the policy decision to reduce reserve requirements in the hope of increasing the efficiency of the banking system. Accordingly, those requirements fell by one percentage point at the beginning of the year for commercial banks and non-bank financial institutions and by a further point at the commencement of the second quarter. The banking system accumulated liquidity, and interest rates fell, with the prime lending rate averaging 15.3% over the year. This downward shift in interest rates was also evident for other instruments. Commercial bank credit rose by 23%. Credit to the private sector, which accounted for just over two thirds of incremental credit in 1997, increased by 19.4%, with 38% of loans and advances being allocated to consumer credit, mainly for the purchase of motor vehicles.

There was a significant expansion in the volume of demand deposits, up by 21%, while currency in circulation rose by 13.5%, so that narrow money (Ml) increased by 17.4% as compared with a scant 0.3% in 1996. While time deposits declined, savings deposits increased by 11%, leaving the broad money supply (M2) to grow by almost 10% as compared to a contraction of 0.8% in the previous year. Foreign currency deposits grew in 1997 by 10.6%, half the pace of the previous year. The high levels of liquidity prevailed despite an active policy by the central bank to withdraw funds from the system; these measures were judged insufficient and higher reserve requirements were reimposed by the end of the year.

3. Economic activity, inflation and employment

(a)Economic activity

Slowing economic expansion in the **Bahamas** was explained by the performance in the main sector, tourism. Overall, the number of visitors increased by 1%. However, while the number of visitor nights rose by 1.8%, in part owing to a higher average length of stay, the number of stopover tourists declined by almost 1%. This followed a 5.5% increase in total visitors and a 2.2% increase in the (higher spending) stopover visitor total in 1996. Tourism expenditures also grew more slowly. Stopover expenditures rose only 1.2% compared to 3.7% in 1996, while the increase in cruiseship spending fell from 6.4% in 1996 to 2.7%. Decreased arrivals were to be explained in part by reduced accommodation in New Providence as hotels were upgraded, and by the termination of cruiseship arrivals into Grand Bahama Island. The number of arrivals from the United States which accounts for more than 80% of the total, fell by 2.3%.

Construction activity continued to be brisk in 1997. The number of building starts increased, their value moving from US$ 180 million to US$ 458 million in 1997. The higher value of building starts was bolstered by activity in the business/commercial sector, which was up in value from US$ 62 million to US$ 346 million. Future building activity, as indicated by building approvals, is expected to remain buoyant in 1998, although the pace of expansion is expected to slacken from that achieved in 1997.

Output in agriculture increased marginally by 0.6%. Crop production declined by 16% in value, both prices and volumes contributing to reduced earnings. This was offset by increases in poultry and meat production, which rose by 4.4% and 6.3% respectively.

In Barbados, the expansion reached both tradable and non-tradable sectors. In the former, growth was apparent in tourism, sugar production and manufacturing; in the non-tradable sectors, construction and the distributive trades also rose. Tourism grew by a modest 2% for, although the number of stopover visitors increased by 5.6%, the average time spent by guests decreased. Cruiseship tourism continued to expand, but growth was modest at 1.6%, compared with 5.2% in 1996. The agricultural sector as a whole contracted by 7.6% as compared with a moderate expansion in 1996. Adverse weather conditions affected some crops and fish production, but sugar output increased by over 9%, the second successive year of growth after a long period of decline. Nevertheless, sugar earnings fell slightly because of adverse price movements. Manufacturing expanded, by 4.4%, driven by greater demand for processed foods, chemicals and beverages.

Among the non-tradable, construction continued its expansion, at an increased rate of 6.7% in 1997, as compared to the average growth of 4.4% achieved since 1992. Increased construction was visible in the public and private sectors. In the former, road improvement and maintenance works and a major sewerage project were the main activities, while in the private

Table 1
CARIBBEAN SUBREGION: GROSS DOMESTIC PRODUCT
(Annual growth rate)

	1991	1992	1993	1994	1995	1996	1997[a]	1981-1990	1991-1997
Caribbean subregion	1.8	0.5	0.3	2.4	2.8	2.7	1.9	0.1	1.8
Antigua and Barbuda	4.3	0.9	3.3	4.8	-4.2	5.4	4.8	6.1	2.4
Barbados	-3.5	-5.6	0.9	3.4	2.6	4.9	3.0	1.1	0.7
Belize	3.1	9.5	4.3	1.5	3.8	3.5	4.5	4.5	4.3
Dominica	2.2	2.7	1.9	2.1	1.8	3.7	1.9	4.4	2.4
Grenada	3.6	1.1	-1.3	2.3	2.3	3.1	4.6	4.9	1.8
Guyana	7.9	11.2	2.8	14.8	4.6	8.3	5.6	-2.9	7.8
Jamaica	0.7	1.7	1.6	1.1	0.7	-1.4	-2.3	2.2	0.3
Saint Kitts and Nevis	3.8	3.6	4.0	3.2	2.0	5.6		5.8	3.7[e]
Saint Vincent and the Grenadines	3.1	6.5	1.3	0.4	3.0	1.0	2.3	6.5	2.5
Saint Lucia	2.3	7.1	2.3	2.8	4.1	0.8	0.7	6.8	2.9
Suriname	3.5	4.0	-2.2	-7.0	5.0	3.0		0.5	1.0[e]
Trinidad and Tobago	3.3	-1.4	-1.3	4.1	4.2	4.4	3.9	-2.6	2.4

Source: ECLAC, on the basis of official figures converted into dollars at constant 1990 prices.
[a] Preliminary figures. Based on figures at factor cost. [c] Period 1991-1996.

sector tourism-related, commercial ventures and private residential construction were all highlighted. The wholesale and retail trades, which expanded by 4.9%, were boosted by construction activities and by the 21% increase in consumer goods imports. The sector including transport, storage and communications also increased by 2.9%, while that relating to business and other services rose by 3.5%.

In Belize, the economy expanded by 4.5% in 1997, one percentage point more than the increase recorded for 1996. The main growth came from primary activities, which expanded by 10%, led by agriculture, up 12.5%, stimulated by a 38% rise in citrus output. Fishing showed a 10% increase, because of larger catches of shrimp, lobster and conch. Secondary activities had a more modest expansion, at 1.3%. Here the driving force came from manufacturing, which expanded by 3% benefiting, from increased citrus processing. Electricity and water distribution also increased. Services recorded barely 1% growth, derived from increases in the transportation and communications sector, since tourism and public administration stagnated.

Sugar production and exports increased because of favourable growing conditions and improved production efficiency. Export volumes rose by 15%, but unit values declined owing to the appreciation of sterling, a 2% fall in the price of sugar shipped to the United States and a reduction in the quota to that market. This resulted in more sugar being sold at the lower world market price and helped to explain the 2.5% fall in earnings from sugar.

Consolidation of the banana industry commenced in Belize, with a 20% reduction in land under cultivation. This behaviour responded to the fact that local producers were unable to make a profit on fruit sold over the existing preferential quotas, but the process was also timely since the existing banana regime has been ruled illegal under WTO norms. The full impact of such developments was not seen in 1997, however, for the volume of fruit shipped and the earnings derived declined by just under 9% in each instance.

Overall, tourism arrivals rose by under 4%, with a similar growth in earnings being estimated. Increased arrivals came mainly from the cruiseship sector, which competes strongly with established hotels. Hotel occupancy rates were consequently being put under pressure, since the number of rooms has been increasing faster than stopover visitors, while live-aboard, cruise and dive-ship accommodation became more popular.

The economy of **Guyana** continued its robust expansion in 1997 and, despite adverse weather conditions and declining terms of trade, recorded growth of 6.2%. While the rate of increase in 1997 did not match that achieved in 1996, expansion was spread widely throughout the economy. The most notable slowdown was evident in the agricultural sector, which rose by 3.1%, compared with 7.6% in 1996. This deceleration was brought about by declining sugar production and stagnant rice output. While the latter increased by 1.9%, the volume of the crop was way below the 11% increase that had been projected. Moreover, the preferential access to the European Union from which Guyanese rice benefited was reduced in 1997, so that greater production efficiency would be necessary in the future if the good was to continue to have access to that market. Forestry output rose by 20%, while the fish catch increased by 8%. Non-traditional agriculture recorded modest growth.

Gold output increased strongly, by 16%, while bauxite production remained approximately unchanged. Gold mining, though still expanding rapidly, was being threatened by reduced international prices, which affected the profitabiliy of smaller producers. The manufacturing sector recorded a 4.5% increase, as compared to 2.9% in the previous year, driven by higher production of processed rice, beverages and building materials. The construction sector recorded a 13% growth, impelled by the public sector investment programme and increased activities in private housing. Service activities expanded in the aggregate by 5.2%.

In **Jamaica** output fell by 2.3% following a decline of 1.4% in 1996. Goods producing sectors contracted by 4% and services by 2.7%. Agricultural output contracted by 14.6%. The decline included both export crops (down by 11.5%) and agriculture for the domestic market (with a 20% fall). Severe drought conditions were the main cause of agricultural contraction, which affected planting activities as well as plant growth and development.

Manufacturing recorded a 2.5% decline, with a very sharp fall (26%) in the sectors producing textiles, apparel and footwear. The contraction also reached other activities, such as furniture, petroleum refining, chemicals and metal products. In general, manufacturing industries were affected by tight monetary conditions and lagging capital investment; in cases like that of textiles, in addition, local production was placed at a disadvantage because of stronger competition from Asia and the real appreciation of the domestic currency.

Mining and quarrying activities turned in a mixed performance, with an aggregate increase of 3.3%. Crude bauxite production declined by 7.1%, though alumina production rose by 6%. Construction recorded a 2.7% drop. The high cost of credit severely affected all building activities and reduced the demand for private and commercial accommodation. Public sector construction increased, however.

Basic services expanded by 5.7%, given the larger supply of electricity (up by 8%), though water and sewerage services contracted by 5%. Transport and communications also increased output 5.8%. Within the group of other services (which showed a decline of 5.3%), financial intermediation fell abruptly, by 22%, while insurance contracted by 2.7%. This behaviour reflected the conditions of severe financial instability.

The increased rate of expansion evident in the OECS countries came from higher levels of activity in services. Agriculture and manufacturing output contracted. The decrease in agriculture was most striking, from -1.2% in 1996 to -8.7% in 1997. Bananas, the main agricultural export crop, provided the explanation, with exports declining by 28% overall. Performance varied in the individual member countries, from a 12.6% contraction in Dominica, to an almost cessation of foreign sales in Grenada, because of poor fruit quality. Exports from Saint Lucia, the largest producer, fell by

32%. Cacao production in Grenada was also low, the 47% decrease being explained by the cyclical nature of the activity and by crop infestation. Other agricultural goods performed well, however, sugar output increasing by 50% in Saint Kitts and Nevis, while nutmeg and mace production in Grenada rose by 15% and 69% respectively.

Manufacturing output dropped slightly (by 0.3%), but performance in the component sectors was mixed. The sugar industry, centred in Saint Kitts and Nevis, increased production by 52%. However, other manufacturing activities were weak, with soap output in Dominica falling by 13% and flour and rice milling in Saint Vincent and the Grenadines declining by 3.6% and 15.7% respectively. Production of garments in Saint Lucia experienced some expansion, although this was insufficient to offset the 4% decline in its manufacturing sector, which was also hit by the reduced output of paper and packaging products destined for the banana industry.

Construction activities, which showed strength for the past three years, were again buoyant in 1997, with over 5% growth being recorded. Expansion was to be explained by strong private residential construction. High public sector investment was also evident in Anguilla, Grenada and in Saint Kitts and Nevis.

The bulk of increased activity was, however, observed in the services sectors. The product generated in hotels and restaurants expanded by 7%, twice as fast as the rate of growth recorded in 1996. This was associated with tourist expenditures increasing by 5%, stopover arrivals by 4.4% and cruiseship arrivals by almost 12%. Notable growth was evident in Saint Lucia, where the sector expanded by almost 11%. In Antigua, Saint Kitts and Nevis, and Saint Vincent and the Grenadines, it expanded by about 5%. However, tourism contracted in Grenada. Among the expanding services throughout the region were transport, communications and government services.

In Trinidad and Tobago, the non-oil component of the economy accounted for the aggregate growth in 1997. Expansion was broad based, being evident in all these sectors except government services. Greatest expansion was observed in non-exportable activities, notably construction and distribution, with transportation, electricity and water also showing gains. Sectors which produce exportables, such as agriculture and manufacturing, achieved more moderate expansion, while the oil sector contracted.

The decline in the oil industry was attributed to the maturing of existing oil wells, with crude oil production, refining and exports all falling. Refinery output contracted by 15%. Natural gas production, increased however, as did exports of liquid gas, fertilizers and methanol. In the non-petroleum sector, special buoyancy was evident in construction, which was up 15%, the growth coming from expansion in the natural gas facilities, and in road construction and rehabilitation. Distribution was also up by 17.6%, propelled by imports of consumer durables, food and beverages and tobacco products. Agricultural output slowed from a 3.9% growth in 1996 to 1.8% in 1997, declines being evident in sugar, cocoa and citrus production, although domestic agriculture showed a stronger performance. Manufacturing returned to growth after contracting in 1996. Buoyancy was evident in the production of beverages and tobacco, assembly type industries and food processing.

Gross domestic expenditure increased rapidly, even more than in 1996. Consumption spending, facilitated by easy liquidity and credit conditions, grew at twice the rate of 1996. The bulk of spending was for private consumption, which increased substantially more than the rate of growth of GDP; gross national savings accordingly declined for the fourth consecutive year. Government spending rose by less than 3%. Gross capital formation increased at a high rate, over twice as fast as in the previous year, with the bulk of investment going to the energy and related sectors. The high level of domestic spending was reflected in the current account of the balance of payments, which registered a deficit equivalent to 12% of product, as compared with modest surpluses for the three previous years.

(b) Prices

Consumer prices increased significantly in **Barbados** in 1997. Whereas average annual price increases had averaged 1.4% since 1992, in the current survey year they jumped to 7.7%. The imposition of VAT in January was a major cause of the growth in inflation. Increases were especially sizeable for food items, prices of which rose by 13.5% in 1997, as compared to 3.9% in the previous year. By October, however, VAT had been removed on 36 food items, which helped to reduce inflation towards the end of the year. Inflation for the period December 1996-December 1997 was 3.6% as compared to 1.8% for the preceding year.

The average annual rate of inflation in **Jamaica** moderated to 10% from 26.4% in 1996 and a peak of 77% in 1992. The figure for 1997 was the lowest in almost a decade and was attained through tight monetary policy, a stable exchange rate and increased competition as a result of market opening. Nevertheless, some inflationary impulses arose domestically, notably the severe drought which reduced the supply of domestic foodstuffs. The price of meals taken away from home increased by 13% as did starchy locally grown foods. Rents increased by 35%, reflecting the high cost of credit to the housing sector.

Price pressures increased slightly in **Trinidad and Tobago** in 1997. However, the rate of inflation remained subdued, and stabilized on average at 3.8%, as compared with 3.3% in 1996. Food prices, up by 9.9%, once again provided the major impetus for increases in 1997. Other significant items were beverages and tobacco, up by 4.7%, and education, which increased by 3.3%.

(c) Employment

Unemployment in **Barbados** stood at 12.2% at the end of December, 2.1 percentage points below that in the corresponding period of 1996. The average for the year was 14.5%, compared to 15.8% in 1996. The unemployment rate for females fell by 1.1% to 17.8%, while that for males dropped by 0.9 percentage points to 11.3%. New jobs were created in construction and in the retail and wholesale trades.

The annual average unemployment rate in **Jamaica** rose slightly in 1997 to 16.5%, as compared to 16% for 1996. Males, with a participation rate of 74.6% showed an unemployment rate of 10.6%, while females, with a participation rate of 59% experienced an unemployment rate of 23.5%. While youth unemployment remained above the average at 51 %, it was noticeably lower than the year before (56%). The increase in aggregate unemployment took place in the context of a declining labour force, with approximately 9,000 persons withdrawing from the job market, mainly to pursue further education. Accordingly, there was aloss of about 13,000 jobs in 1997. All categories of employment reported fewer workers, with the exception of white collar occupations, which showed an increase of 13%. The greatest decline was evident in the low-skilled category of craftsmen.

Higher levels of domestic activity in **Trinidad and Tobago** were reflected in a fall in the unemployment rate, to 15%. Youth unemployment declined substantially, but remained near 35%. Female unemployment was 17.2% and male unemployment 11.2%. Job creation was particularly notable in construction, followed by finance insurance and real estate services. Agriculture showed only modest increases in employment, in part because of poor weather and crop infestation problems. Real wages rose by around 1%.

(d) International trade and payments

The deficit in the external current account in the **Bahamas** widened significantly in 1997, from 6.3% of product in 1996 to 10.5% in 1997. However, capital inflows also rose sharply, so that the balance of payments showed a surplus equivalent to 1.4% of product (compared with a 0.2% deficit in 1996). There was a smaller negative balance of merchandise trade, because of an 8% increase in exports, while imports grew

Table 2

CARIBBEAN SUBREGION: CONSUMER PRICES

(Average annual variation)

	1993	1994	1995	1996	1997
Anguilla	3.7	3.4	4.0	1.4	3.6
Antigua and Barbuda	1.5	7.1	6.2	4.1	
Aruba	5.3	6.2	3.4	3.2	3.2
Bahamas	2.7	1.3	2.1	1.4	0.5
Barbados	1.1	0.1	1.9	2.4	7.1
Belize	1.5	2.6	2.9	6.4	1.0
Dominica	1.7	-0.2	1.4	2.0	2.2
Grenada	3.5	1.8	2.1	3.2	0.8
Guyana	7.7	16.1	8.1	4.5	4.1
Jamaica	23.0	35.1	19.9	26.4	10.0
Montserrat	0.7	2.8	4.4		
Saint Kitts and Nevis	1.4	1.3	2.6	3.1	11.3
Saint Lucia	0.6	2.7	5.9	0.9	0.0
Saint Vincent and the Grenadines	4.5	0.4	3.2	3.6	0.8
Suriname	243.5	368.5	235.9	-0.8	7.1
Trinidad and Tobago	8.7	9.4	5.4	3.3	3.8

Source: ECLAC, on the basis of official figures.

Table 3

CARIBBEAN SUBREGION;: UNEMPLOYMENT RATES

(Percentages)

	1993	1994	1995	1996	1997
Aruba	0.5	0.5	0.7	1.0	1.0
Barbados	24.3	21.8	19.6	15.8	14.5
Belize	9.8	9.0	12.5	13.8	12.7
Jamaica	16.3	15.4	16.2	16.0	16.5
Netherlands Antilles	13.6	12.8	13.2	13.7	14.7
Trinidad and Tobago	19.8	18.4	17.2	16.3	15.0

Source: ECLAC, on the basis of official figures.

by a modest 1.2%. Strong demand for consumer and investment goods for the construction sector boosted imports, while reduced petroleum prices just offset the increased volume of petroleum products consumed.

The surplus on the services account declined by 20%. Most noticeable was the sixfold increase in spending for construction services. Outflows for transportation services rose by 17%. The travel account surplus remained almost unchanged, as increased earnings were offset by higher travel spending by Bahamians. Offshore companies' local expenditures fell by 17%. The deficit on the income account increased by just over 9%; external remittances were up by 9%, while net labour income outflows fell by 7%.

The capital and financial account showed a substantial surplus, with inflows rising from an estimated 4.2% of product in 1996 to 9.4% in 1997. Net private foreign direct investment doubled to US$ 196 million, mainly directed to the modernization and expansion of hotel properties. Net inflows to the public sector increased by US$ 17 million. Following a decline of US$ 7.6 million in 1996, the external reserves grew by US$ 56.5 million in 1997 to the equivalent of three months of imports.

In **Barbados,** the balance of payments showed a surplus in 1997, equivalent to 1.6% of product, a significant decline from the figure observed in 1996 (7.1%). This was to be explained by the smaller current account surplus, which fell from 5.2% of product in 1996 to 1% in 1997. The deficit of merchandise trade widened by 26%; total exports declined by 3%, while imports increased by almost 18%. Earnings from services were up by 12%, with a similar rate of growth in capital inflows.

While overall exports declined, exports of domestically produced goods were up by 3.7% compared to increases of around 25% in the previous two years. Earnings from sugar, the main merchandise export, were flat despite increased volumes, while sales of food and beverages, which had grown rapidly in the previous two years, fell by 2.3%. Receipts from electronic components also fell, although sales of chemicals increased. The main markets for Barbados exports were within CARICOM, which purchased 33% of the total, followed by the United Kingdom (18%) and the United States (15%).

The ratio of imports to product rose by almost 3 percentage points, to over 43%. Consumer goods imports, after growing by less than 1% in 1996, showed a rapid increase (21%). The growth in imports of intermediate and capital goods (14% and 23%, respectively) was similar to that recorded the previous year.

Net earnings from services were up by 12.5%. The increase was due to the 11% increase in tourist earnings and higher transportation receipts. The capital account recorded a 12.6% higher surplus. There were smaller long term private capital inflows but project funds and borrowing by other public entities redressed that decline.

The surplus in the balance of payments of **Belize** decreased from the equivalent of 3.4% of product in 1996 to a scant 0.2% of product in 1997. The current account explained the decline: it moved from a deficit of 0.4% of product in 1996 to one of 6.6% of product (or US$ 42 million). The merchandise trade deficit rose from US$ 54.2 million to US$ 81 million. Exports grew by a modest 3.2%, the main increases being in citrus and fishing products while earnings from sugar and bananas declined. Imports were up by over 14%, notably of fuels.

The surplus on services, which contracted by 30%, was unable to offset the deterioration in the goods account. Spending on travel increased by 29%, while earnings only rose by 2%. Transfers, both to government and to private individuals were down slightly. Net financial flows diminished by 22%, or from the equivalent of 6.1% of product to 4.4%. The decline was notable in foreign direct investment flows, which fell by 28%. The gross official reserves increased by about 2%, to a level representing 2.5 months of import cover.

In **Guyana,** the current account of the balance of payments weakened in 1997. The deficit reached US$ 105 million, as compared to US$ 70 million in 1996. However, this performance was offset by larger capital and financial flows. They doubled, moving from the equivalent of 8.4% of product to 16.3%. Accordingly, the balance of payments shifted from a deficit equivalent to 0.2% of product in 1996 to a surplus of 0.5% in 1997.

The merchandise trade deficit widened from US$ 20 million to US$ 48 million, with spending on imports growing faster, at 7.8%, than earnings from exports, which increased by 3%. Rising imports were fueled by high public spending and by adjustments in public sector salaries. Earnings from traditional agricultural exports fell, mainly as a result of eroding terms of trade. Sugar receipts fell by 11.5% (with a 1.8% decline in export volumes), while the value of rice exports fell by 9.6%. By contrast, earnings from minerals increased, bauxite by 4% and gold by almost 32%.

The net services deficit rose by 30%. This was primarily due to higher interest payments, both from the private and the public sectors; the Government regularized its debt service, which returned to schedule. Private transfers declined.

The capital account surplus rose from US$ 59.5 million to US$ 125.7 million. Both public and private flows increased. Disbursements to the public sector amounted to US$ 67 million, with repayments amounting to US$ 29 million for a net total of US$ 38 million. Net private capital flows attained US$ 64 million, an increase of US$ 11 million over 1996 and

Table 4

CARIBBEAN SUBREGION: BALANCE ON CURRENT ACCOUNT

(Millions of dollars)

	1993	1994	1995	1996	1997 [a]
Anguilla	-12.8	-11.4	-9.5	-25.8	-26.9
Antigua and Barbuda	-0.5	-18.0	-0.5	-39.8	
Bahamas	48.7	-42.2	-145.9	-245.8	-250.2
Barbados	68.6	131.4	89.2	103.0	21.2
Belize	-48.5	-40.1	-17.2	-2.5	-42.1
Dominica	-23.4	-38.4	-49.8	-39.9	-32.8
Grenada	-43.5	-21.8	-35.2	-57.9	-74.9
Guyana	-140.2	-124.9	-134.8	-69.7	-105.1
Jamaica	-184.0	16.9	-245.2	-238.4	-330.0
Saint Kitts and Nevis	-30.1	-26.4	-46.8	-66.7	
Saint Lucia	-49.3	-48.5	-33.2	-80.3	-99.3
Saint Vincent and the Grenadines	-43.8	-58.0	-41.2	-35.2	-92.6
Suriname	44.0	58.6	72.9	79.6	
Trinidad and Tobago	113.1	217.8	293.8	44.5	-707.7

Source: ECLAC, on the basis of official data.
[a] Preliminary figures.

directed mainly to the exploitation of raw materials.

In **Jamaica,** the balance of payments deteriorated in 1997, from a surplus equivalent to 5% of product in 1996 to a deficit of 2.5% of product in 1997. The deficit resulted in a decline in the net international reserves of US$ 152 million. This performance reflected uncertainty about the sustainability of macroeconomic policy in the face of weak financial institutions and the impending election. The current account deficit rose from 2.5% of product to 5.3%, owing to a 14% increase in the deficit on visible trade and a 12% reduction in the surplus on services. Capital inflows declined by 57% (with private inflows diminishing by 72%), so that the capital and financial account surplus fell from 7.5% of product to 2.9%.

Merchandise exports remained substantially unchanged over 1996, while imports increased by 6%. Export performance was sustained mainly by sales of traditional goods, which grew in value by over 4%, while non-traditional items decreased by almost 7%. In the former category, earnings from the export of alumina, gypsum, bananas, coffee and rum increased, but those derived from bauxite, sugar, citrus and citrus products, cocoa and cocoa products and from pimento were smaller than the year before. Drought affected the performance of several agricultural crops and even where earnings from bananas increased this was to be explained by improved prices, for the volume of fruit harvested and exported diminished. In the non-traditional export category, the chief source of decline was a 10% decrease in earnings from the main item, wearing apparel. The sector continues to contract in Jamaica as it is unable to meet the competition of Mexico and Asian countries after their devaluations. The second major non-traditional export, food, showed a 5% decline in foreign sales, mainly because production fell following the drought. Beverages and tobacco products recorded strong growth, however, with a gain of 24%.

Imports increased by 6.2%, in line with the growth rates observed in recent years. Consumer goods imports rose by 24%, with those of capital goods increasing by 20%. In the former group, all categories recorded increases, the most notable being in the import of food and motor cars. Higher food imports compensated for poor domestic production, and came mainly from within the CARICOM region. Motor car purchases were up by over 30%, in part because of restocking after strict demand compression in

Table 5

CARIBBEAN SUBREGION: EXTERNAL DEBT

(Millions of dollars)

	1993	1994	1995	1996	1997 [a]
Anguilla	9	9	9	8	8
Antigua and Barbuda	232	237	244	236	222
Bahamas	453	410	395	358	362
Barbados	352	357	359	365	349
Belize	168	184	184	220	233
Dominica	94	99	103	102	89
Grenada	81	88	87	89	86
Guyana	2 062	2 004	2 058	1 537	1 514
Jamaica	3 687	3 652	3 452	3 232	3 278
Montserrat	10	10	10	10	10
Saint Kitts and Nevis	47	52	54	60	102
Saint Lucia	100	106	115	127	137
Saint Vincent and the Grenadines	77	88	88	88	87
Suriname	206	198	185	178	165
Trinidad and Tobago	2 102	2 064	1905	1876	1 527

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

1996 and because of inventory build-ups sparked by insecurities in the foreign exchange market and new regulations which would have an impact on the importation of older used vehicles. The increase in capital goods imports was most notable in industrial transport equipment and construction materials. The former related mainly to the purchase of aircraft, for industrial activity was otherwise flat. This sluggishness was also illustrated by the 6% decline in imports of raw materials and intermediate goods and the 10% fall in industrial supplies.

The services account continued to record a surplus but it was reduced by 12% in 1996. The travel account recorded a scant 1% growth with increases in receipts being eroded by growing outflows. Earnings from high-profit stopover guests especially showed deceleration. Higher payments for freight and insurance were recorded, while profit remittances increased, particularly from bauxite companies.

Net capital flows declined by 57% compared with 1996. The fall would have been greater but for significant increases in official flows, as the Government obtained US$ 200 million on the international market. Smaller private inflows reflected reduced interest rates in the first half of the year, and uncertainty about the sustainability of the exchange rate, as well as precautionary attitudes given the closeness of the general election and instability in the commercial sector.

In **Trinidad and Tobago,** the external accounts shifted from a surplus of 3.8% of product in 1996 to one of 2.7%. This resulted mainly from the performance of merchandise trade: exports fell by 3% while imports, fueled by major capital investments and easy credit, increased by over 40%.

The drop in total exports was influenced by a US$ 100 million reduction in the value of sales of mineral fuels and lubricants. The decline was to be explained by lower oil prices and by reduced volumes shipped. The export evolution of the chemicals sector was mixed, but overall earnings were up by 7%, while receipts from steel increased by 5.5%. Sales of food products, which represent about 6% of exports, were up by 30%.

The bulk of the increase in imports was to be explained by a sharp growth (111 %) in purchases of machinery and equipment for new projects in the energy sector. Imports of transport equipment also increased by 22%, while the value of manufactured goods rose by 21% following a decline in 1996. Overall, capital goods imports more than doubled, while those of consumer goods increased by 10% and raw materials imports were up by almost 8%.

The services balance showed a smaller surplus, with a 12.5% fall. Earnings from transportation and communications declined but the surplus on the travel account increased. The number of visitors to Trinidad and Tobago rose by 22% in 1997, while earnings improved by 17.3%. Earnings from insurance were also up. Income accruing to foreigners for investments in Trinidad diminished by almost 40%, and interest payments by about 28%. Given these developments, the current balance moved from a surplus equivalent to 1.2% of product to a large deficit, of 12.2% of product.

Notwithstanding the big negative shift in the current account, the overall balance was retrieved by capital inflows, which rose from US$ 43 millionin 1996 to US$597.7 in 1997 and allowed for a 31% build-up in reserves. Official capital flows moved from a slight surplus in 1996 to a deficit in 1997, caused by the repayment of various outstanding government obligations. Direct investment flows, reflecting divestment proceeds and capital injections to various energy projects, grew from US$ 356 million in 1996 to US$ 979 million in 1997, the highest value on record.

THIRD PART

FIFTY YEARS OF THE ECONOMIC SURVEY

FIFTY YEARS OF THE ECONOMIC SURVEY

1. Introduction

At its first session, the Economic Commission for Latin America of the United Nations requested the Executive Secretary, within the possibilities and facilities at his disposal, to undertake an economic survey of Latin America. The survey prepared in fulfilment of this request was the first step in what it was felt would be a long and difficult task: that of providing a complete and fully documented analysis of the economic situation in the region.

This task proved not only to be lengthy, but to be ongoing, since ECLAC has now been examining the economic situation of the countries of the region in its *Economic Survey* for an uninterrupted 50 years. The *Survey* was the new Economic Commission's first contribution to creating awareness and understanding of this situation. In so doing, ECLAC was meeting one of the two specific objectives for which it was established, that of undertaking "the collection, evaluation and dissemination of ... economic, technological and statistical information" on the region, which, since their independence, has also included the Caribbean countries.

As had been foreseen, the task also proved to be a difficult one. A letter to the Secretary-General of the United Nations, dated 13 September 1949, transmitting the first *Economic Survey* testifies to the various problems encountered in its preparation, including the scarcity of statistics in some of the countries, the difficulty of obtaining recent information and the impossibility of comparing the figures obtained because of the different data-gathering techniques used and because the periods for which figures were provided did not coincide from country to country. It was hoped that this situation would become better as Latin American government statistical services improved, with assistance from the United Nations and its specialized bodies.

This hope was fulfilled and in the 50 years since then there has been a notable advance in Governments' capacity to elaborate comprehensive and timely economic statistics, a task more necessary than ever in the current environment of globalization and integration of the world economy. During these years, ECLAC, for its part, has had to devise methodologies to compare disparate national statistics and so permit an analysis of the situation in Latin America and the Caribbean as a whole, providing a study of more overall value than the sum of its constituent countries.

The *Economic Survey* has thus been a permanent witness to the phenomenon of economic development in general and that of the rich and complex region that is Latin America in

1 Economic and Social Council, resolution 106 (VI), 25 February 1948.

2 For this reason, the title of the *Survey,* which since the first issue in 1948 had been *Economic Survey of Latin America,* was changed in 1982 to *Economic Survey of Latin America and the Caribbean,* although, even before that date, it had contained references to certain Caribbean countries. In the present chapter, it is referred to as the *Economic Survey* or simply as the *Survey*.

particular: a heterogeneous region certainly, but one that has its own undeniable characteristics. But the *Survey* has not been a mute witness. In addition to describing economic trends, it has provided an interpretation of the facts that has made it possible to evaluate them in the light of the background historical developments that give them meaning. Thus, through observation of the economic reality, a theory of economic development in the region evolved which, in its turn, was empirically substantiated.

This capacity of interpretation has been a consistent feature of the *Economic Survey*, although the interpretation has been more or less explicit depending on the period. In its early days, the *Survey* was the main ECLAC publication and contained, in addition to analysis of recent economic developments, the economic policy proposals the secretariat presented at the biennial Commission meetings. Later, those proposals came to be developed in detail in other specialized documents, although they continued to inspire the interpretation of economic events found in the *Survey*. This explains the differences between recent editions of the *Economic Survey* and those that saw the light 50 years ago, although they have important features in common.

During the 1940s and 1950s, the issue of economic development was being debated in the context of a long-term approach aimed at promoting supply, in accordance with the current underlying economic theories. The industrialized countries, for their part, were also giving priority to policies for reconstruction after the Second World War, diverting their attention for the moment from the management of economic cycles. Much greater priority was attached to such management subsequently and it spread to developing countries as a result of trends in a world economy in which internationalization had exposed them to the vicissitudes of economic fluctuations. In recent years, therefore, greater attention has been paid in the *Economic Survey* than in its earliest days to macroeconomic policies and equilibria and to short-term trends, although without neglecting analysis of the long-term economic situation, trends and structural factors that was a feature of the early editions.

The chequered development of international consensus on development policy has been reflected in the pages of the *Economic Survey*. Inward-looking industrialization developed as an unquestioned necessity in the post-war period, while the central role of the State constituted a pillar of consensus up until the 1960s. This consensus was broken in the 1970s in the face of global economic disequilibria and the feeling that the previous policy options were exhausted, just before the debt crisis abruptly imposed the need for a change of direction. From this crisis there emerged the new paradigm current in the 1990s.

In these developments, certain common features central to Latin American performance can be observed: the need to incorporate technical progress in order to raise productivity (nowadays a requirement for improving competitiveness); the need to overcome critical constraints deriving from inadequate domestic saving and external factors; and the need to assign priority to improving the living conditions of the entire population.

The purpose of the present chapter is to retrace the history of the *Economic Survey*, outlining the particular view of the economic situation presented in successive editions and avoiding interpreting the economic history of the region from a present-day perspective. It will be seen how the *Survey* combined explanation of the facts in the light of the trends with a critical evaluation of the economic policies and exogenous factors that determined the region's economic development in each of the periods into which the past half century can be divided.

3 This overall view of Latin America as the subject of study corresponded, according to the *Economic Survey of Latin America, 1975*, to a reality and a need, because political, institutional, cultural and economic conditions had evolved beyond any doubt towards a closer association, in spite of a parallel intensification of the differences between countries and groups of countries (p. 42).

2. The early post-war years

The foundations of the conceptual approach adopted by ECLAC were laid in the early editions of the *Economic Survey*. The second edition, corresponding to 1949, was in its time considered as "the Latin American manifesto". This period placed its stamp on the subsequent intellectual development of the institution. At this early date were sown the seeds of concepts relating to critical variables that are still completely applicable today, for example investment, domestic saving, technical progress and the balance of payments, as well as others which, although they have lost some support, have not ceded importance, such as that relating to the development of the manufacturing sector.

In the early 1940s, ECLAC was interested in long-term economic issues and only later, as it began to have to consider economic fluctuations occurring from year to year, did it start to pay more attention to short-term economic equilibria. Its initial concern, rooted in its interest in the development process, was with trends in investment and the structural and cyclical factors influencing it.

As a result, the first editions of the *Economic Survey* dealt with major issues relating to concrete aspects of the economy, especially product growth and linkages of the Latin American countries with the global economy; for ECLAC, the two issues were closely connected. This interpretive approach has been a constant feature of ECLAC analysis throughout its existence and has lasted into our own times, when the interdependence of economies in a global context is no longer a novelty for anyone.

(a) Industrialization and development

The observation by ECLAC of the Latin American development process originated in the need to improve the living standards of the great mass of the population, who were still living in very poor conditions compared with the population in more developed countries. From this standpoint, product and income growth constituted the central economic variable.

The sectoral distribution of product was of particular relevance. The experience of the developed economies at that time showed that economic growth was accompanied, at least in the initial phase, by a transfer of the factors of production from primary activities, especially agriculture, to industry. Hence, economic development was essentially equated with industrialization.

Industrialization, in turn, was tied to the spread of technical progress, which originated in the countries that had first experienced the industrial revolution. As modern techniques increased the productivity of agriculture, the dominant sector, a labour surplus was created that could only be productively absorbed by industry. This was why, in 1945, the *Economic Survey* noted: "agricultural improvement and industrial development are two aspects of the problem of economic development. One need only consider the large number of people engaged in agriculture in Latin America, with the exception of a few countries, to realize the magnitude of this problem and the vast effort which will be necessary to solve it". The fact that the developing countries, situated at the margin in terms of the spread of technical progress, were far from benefiting fully from it, except in restricted sectors producing low-cost foods and commodities, explained why they lagged behind.

It was therefore appropriate to examine the region's performance in the area of industrialization, and the factors that influenced this performance. In doing so, ECLAC arrived at the conclusion that Latin America had entered a new phase of incorporating technical progress. In the decade between 1937 and 1947, the period examined in the first edition of the *Economic Survey*, industrialization had accelerated. The explanation for this lay in background circumstances: serious problems of supply caused by the great economic depression of the

4 Albert Hirshman's description.

5 *Economic Survey of Latin America, 1949*, p. 4.

Table 1

LATIN AMERICA AND THE CARIBBEAN: MAIN INDICATORS, 1950-1959

(In percentages)

Country	Growth		Inflation	Foreign trade	
	Overall	Per capita		Exports	Imports
			Annual rates of variation		
Latin America	4.9	2.1	**17.8**	4.0	3.2
Argentina	2.4	0.6	31.1	2.1	1.4
Bolivia	0.0	-2.1	52.8	-3.6	1.7
Brazil	6.5	3.3	25.2	3.0	3.0
Chile	3.8	1.5	37.2	1.6	6.8
Colombia	4.7	1.7	6.7	4.5	2.9
Costa Rica	7.0	3.2	1.5	4.7	8.0
Ecuador	4.8	2.0	0.5	6.9	7.6
El Salvador	4.7	1.8	5.1	4.3	7.8
Guatemala	4.0	1.0	2.0	5.0	3.9
Haiti	1.4	-0.1	0.1	3.9	2.7
Honduras	3.1	-0.1	3.4	2.1	5.0
Mexico	5.9	2.9	7.2	4.3	2.4
Nicaragua	5.7	2.6	6.5	6.3	8.5
Panama	4.7	1.9	-0.1	1.5	3.5
Paraguay	3.2	0.4	34.6	3.4	6.6
Peru	4.9	2.2	8.8	9.7	5.5
Dominican Republic	5.8	2.5	0.0	8.1	5.9
Uruguay	2.0	0.7	14.1	-3.2	-0.4
Venezuela	8.3	4.1	1.7	7.2	3.5

Source: ECLAC, on the basis of official figures.

1930s and then by the Second World War obliged the Latin American countries to attempt to make up for the shortfall in imported articles by producing them domestically. These problems of supply persisted in the first post-war years, when the productive capacity of the main supplier countries, suffering from the after-effects of the war, was very depleted. Industrial development thus permitted partial substitution of missing imports.

This development was made possible by the use of copious foreign exchange reserves accumulated during the war. This explains the central role played by the public sector. As was pointed out in the 1953 issue of the *Economic Survey*, "during and after the Second World War the Governments of many Latin American countries embarked upon vast development programmes assisted by accumulated foreign exchange reserves and by investment projects prepared by the newly-formed development institutions". In 1945, public investment accounted for more than 40% of overall investment in the region and in the period 1945-1953 for one third on average. "Governments pursued a policy of rapid industrialization and economic development, not only through direct public investment, but also by means of other important fiscal and economic measures", including currency exchange subsidies and credit policy. "Linked with the improvement in the terms of trade, this permitted a rise in the level of real income in the wage-earning sector, which resulted in the acceleration of economic development through the additional stimulus of growing demand."

Industrial expansion also enabled part of the increased population that could no longer be absorbed in primary production and related activities to be gradually employed in urban sectors, once exports lost the momentum they had exhibited before the great depression. The

6 *Economic Survey of Latin America, 1953*, p. 5.

contraction of markets and restrictions on imports into those markets during the depression drastically slowed down the development of the export sector. The Second World War had a similar effect. During the 10 years ending in 1947, the volume of exports only increased by some 16%, compared with an increase in the population of 23%.

Industry thus became the driving force behind the development of economies, such as those of Latin American, that were still predominantly agricultural and suppliers of low value-added commodities to more developed countries. For ECLAC, already in 1948, the dilemma was not whether or not there should be industrialization, but "whether the increase in industry, resulting from the extension of technical progress, should take place in the existing industrial centres or in the new centres which are appearing", particularly in the Latin American countries.

(b) External factors affecting economic development

Thus, external circumstances played a determining role in the rapid growth of industry and output in some countries during the early post-war years. This growth was stimulated by trade difficulties and helped by favourable terms of trade and the large reserves accumulated during the Second World War. The change of direction of the regional economy that became apparent in the mid-1950s confirmed the crucial importance of external factors linked to investment, which, together with productivity (influenced by technical progress), determined the rate of growth.

From the beginning, ECLAC drew attention to the low investment rates in South America, noting that the domestic saving vital in order to accumulate necessary fixed capital was in very serious trouble in most of the countries, because of low wages and distorted consumption patterns. ECLAC was aware of the need for foreign capital in these conditions, and pointed out the wide scope for external investors in countries whose transport systems, energy sources and other sectors essential for growth were undercapitalized. However, in the first years after the war, capital flows were minimal. The foreign capital invested in Latin America between 1945 and 1952 accounted for scarcely 3% of total investment, although it had increased to around 10% by the end of the 1950s.

To the lack of saving, was added another, no less important handicap: insufficient exports to transform saving into imports of capital goods. Although the value of exports increased significantly in the immediate post-war period, because of improved prices, it soon became obvious that this was a temporary stimulus and that exports were encountering the stumbling block of limited absorption of Latin American products in the international market, a consequence of the low income-elasticity of demand for commodities.

Moreover, analysis of the trends in the terms of trade led to the formulation, in the *Economic Survey* for 1949, of the theory of deterioration in the terms of trade over the long run because the fruits of technical progress were asymmetrically distributed between producers of commodities and producers of manufactures. Given the different nature of supply and demand for the two groups of products, technical progress was causing the price of commodities to fall, the benefits being transferred to the consumer, whereas in the case of manufactures, it was leading to a decrease in costs, to the benefit of the producers.

As was repeatedly pointed out in the *Economic Survey* during the 1950s, the above-mentioned factors were restricting the long-term growth rate of regional exports, which were mainly commodities. On the other hand, it was noted, imports were tending to grow much more rapidly. The high growth rate of imports was in response to the great need for capital goods, inputs and fuels from abroad, as well as

7 *Economic Survey of Latin America, 1949,* p. 13.

8 This argument has been the subject of ongoing controversy and contradictory empirical demonstrations. The *Economic Survey* for 1969 contains a study of the evolution of the terms of trade.

the high income-elasticity of demand for manufactured consumer goods, mainly durables. Faced with this need, import capacity, crucially dependent on exports since net capital inflows were scarce, proved insufficient. This gave rise to a phenomenon that ECLAC considered to be of major importance: the trend towards a persistent balance-of-payments disequilibrium.

This phenomenon turned the external sector of Latin American countries into the main focus of analysis. It has remained so, to differing degrees and for varying reasons, throughout the 50-year history of the *Economic Survey*. In an environment such as that prevailing in the 1950s, the concept of import capacity, determined by the purchasing power of exports (which responds to the terms of trade and export volumes), assumes particular importance; on it depends not only the balance-of-payments equilibrium, but also the level of investment, a determining factor in growth and, over the long run, wage levels.

(c) Macroeconomic equilibria

The central role attributed to the external sector in output growth relegated other factors, in particular internal macroeconomic equilibrium, to a secondary level. This does not mean, however, that those factors were ignored. Starting with its first analyses, ECLAC noted the inflation in Latin America with concern. This concern was because policies to restrict public spending and domestic credit that were necessary to fight inflation were holding up economic growth and could have counterproductive social repercussions. It was also thought that inflation itself discouraged saving.

The inflation was due to monetary expansion, induced in the post-war years by the accumulation of international reserves during the Second World War and by government spending exceeding government revenue. Devaluations to cope with the external disequilibrium in turn caused prices to rise. All of this was related in the last analysis to the lack of domestic saving.

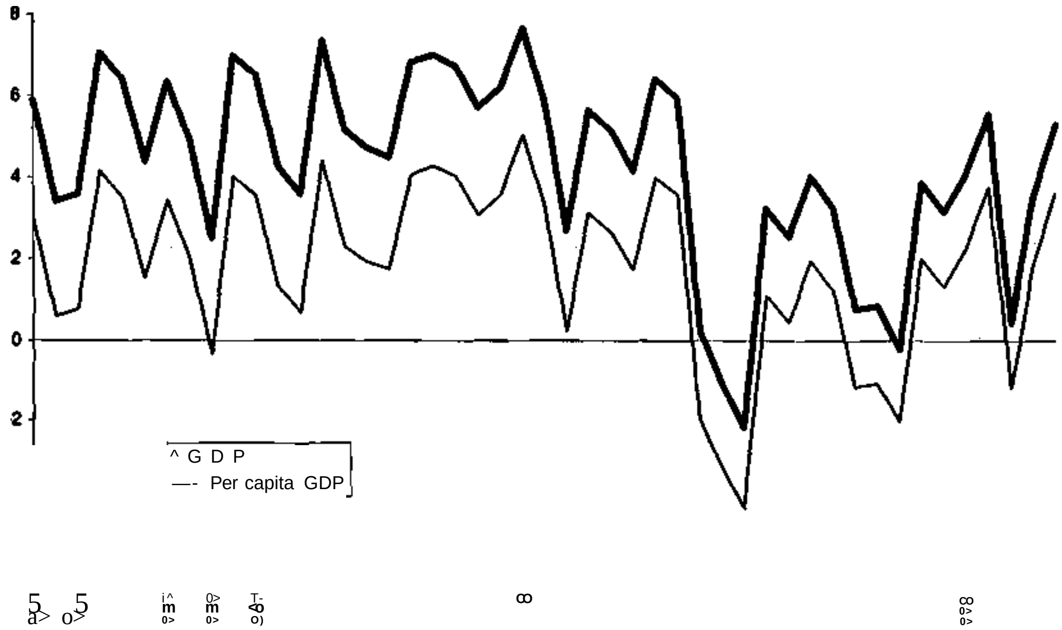
That is to say, the two problems of external and internal equilibrium were considered to be interdependent, both linked to the two deficits, the savings deficit and the external deficit, that were restricting growth. The 1958 edition of the *Economic Survey* pointed out that inflation was as much a problem of demand as of supply. On the one hand, the scarcity of imports had provoked sharp increases in domestic prices during the 1950s, either because of currency devaluations or because government measures to restrict imports (including large prior deposits, increased tariffs and exchange premiums) made them more expensive for the purchaser, while expansive economic policies fed demand. On the other hand, structural factors were perceived as worsening inflation by producing bottlenecks in the economy: "the violence and intractability of these inflations can be largely attributed to the unbalanced processes of development discussed above. Some economic sectors, especially food farming, are incapable of raising output in full response to demand pressures, which therefore induce rises in price levels".

3. The 1960s and action for development

By the end of the first decade of the post-war period, the map of the world was being reshaped, with a profound impact on perceptions and on development in Latin America. The consolidation of two ideological options in open competition with each other and the access to full sovereignty of several formerly colonized countries established a system of coordinates which divided the planet between East and West, North and South. Against this backdrop, the phenomenon of development assumed a political dimension at the international level and became a favoured objective of cooperation among the world community, as attested to by the designation of the 1960s as the United Nations Development Decade.

9 *Economic Survey of Latin America, 1958,* p. 7.

Figure 1
REGIONAL GROSS DOMESTIC PRODUCT IN THE 1950s
(Annual growth rate)



ECLAC played an active part in this process and the *Economic Survey* assumed the role of critical observer of the aspirations and accomplishments of the period.

Various institutional arrangements established at the beginning of the decade were manifestations of the international community's awareness of the importance of cooperation for development. At the level of the Americas, these included the establishment of the Inter-American Development Bank (IDB) in 1959 and the change in the economic and social policy of the United States towards Latin America, as symbolized in the Alliance for Progress enshrined in the Charter of Punta del Este in 1961. This awareness found an echo in the sense of greater responsibility on the part of the Governments of the Latin American countries for addressing the development needs of their peoples. Accordingly, the issues of the *Economic Survey* that appeared in the 1960s reflected this reality through critical assessments of these policies in the light of the progress achieved and difficulties identified.

(a) The Latin American consensus for the decade

The 1963 edition of the *Economic Survey* lists the new fundamental concepts that were taking shape in Latin America while this climate of world opinion was unfolding. These concepts, which shaped a new stage in the interpretation of development problems and in defining policy at the level of the continent, included the following:

(i) The conviction that development was an economic and social problem and that these two aspects were closely related. The heightened consciousness of the social dimension of economic issues emerged against a background of popular and political turmoil fueled by the sharp disparities in income distribution in countries of a region where world ideological confrontation had become deeply entrenched

Table 2

LATIN AMERICA AND THE CARIBBEAN: MAIN INDICATORS, 1960-1969

(In percentages)

Country	Growth		Tnfltitifwi iiiiiduun	Foreign trade	
	Overall	Per capita		Exports	Imports
			Annual rates of variation		
Latin America	5.7	**2.8**	**21.6**	4.5	4.1
Argentina	4.4	2.9	21.6	3.8	1.8
Bolivia	5.5	3.2	5.9	6.0	5.5
Brazil	6.2	3.2	43.3	6.0	4.4
Chile	4.5	2.2	24.3	3.1	4.0
Colombia	5.0	1.9	11.3	4.1	4.4
Costa Rica	6.9	3.3	2.2	9.2	9.9
Ecuador	4.7	1.6	4.4	5.0	8.2
El Salvador	5.8	2.3	0.5	7.5	3.6
Guatemala	5.2	2.3	0.5	9.3	5.1
Haiti	0.8	-0.9	2.2	-2.3	0.4
Honduras	4.8	1.5	2.3	8.1	8.9
Mexico	7.1	3.8	2.7	4.8	5.3
Nicaragua	6.9	3.6	1.2	8.7	7.3
Panama	7.9	4.8	1.0	9.8	10.3
Paraguay	4.0	1.1	3.9	5.5	4.0
Peru	5.6	2.7	9.2	3.8	6.4
Dominican Republic	4.5	1.2	1.4	0.1	10.6
Uruguay	1.4	0.3	44.9	3.3	0.7
Venezuela	5.4	1.7	1.3	2.8	0.7

Source: ECLAC, on the basis of official figures.

following the Cuban revolution of 1959. Hence, in the *Survey,* income distribution and political instability, factors that had an adverse effect on key variables such as productivity, consumption patterns, saving and the necessary climate for productive long-term investment, were identified as two of the main obstacles to development.

(ii) The need for a comprehensive well-planned policy, the main outcome of which would be the elaboration of development plans in almost all the Latin American countries, many of which were analysed by the organizations established by the Alliance for Progress and were the target of initiatives to cover their external borrowing requirements.

(iii) The acceptance that development demanded institutional reforms for social and economic organization, such as agrarian reform, restructuring of tax systems, programmes for improving income distribution, effective access to education and equality of opportunities for all, and that such reforms required steps that would go beyond the limited management of the traditional economic policy instruments. Many countries promoted national programmes consistent with these requisites.

(iv) The promotion of regional economic integration as a means of overcoming the severe constraints on expansion of exports and on the scale of import substitution, thus increasing market access for national industries. In this regard, the movement for economic cooperation among Central American countries, initiated in 1951, became a step towards a subregional common market as of 1960. On a more ambitious scale was the attempt to integrate all Latin American countries, the initial step towards which was the Treaty of Montevideo (1960) establishing the Latin American Free Trade Association (LAFTA).

(v) The efforts to influence market regulation and international trade in order to establish a trade structure and a trading relationship with the rest of the world which would obviate longstanding difficulties arising from trade dominated by exports of commodities. The most notable outcome of efforts in this area was the establishment of the United Nations Conference on Trade and Development, in which Latin America and ECLAC played a leading role.

(b)External constraints: new dimensions

In the 1960s, external constraints affecting Latin American countries took on a new dimension, arising from the gradual expansion of trade and international capital flows.

As described in the *Economic Survey* for 1970, world trade in the 1960s, and particularly in the latter half of the decade, expanded to an extraordinary degree, and this benefited regional exports. However, the products showing the greatest dynamism on international markets were manufactures, so that growth of Latin American exports was slower than the global rate. Between 1960 and 1969, world exports grew at a rate of 8.8% per year, compared with 5.5% in Latin America. Moreover, as regional exports grew more slowly than imports, huge trade imbalances accrued.

In addition, interest payments and remittances abroad of returns on capital inflows in the form of loans and foreign direct investment increased sharply. These payments increased at such a rate that during this decade they amounted to double the totals recorded in the 1950s and accounted for as much as 35% of overall regional exports of goods and services; in most countries, they represented over half of the current account deficit. Consequently, it was increasingly necessary to resort to external financing in order to facilitate the necessary expansion in import capacity, especially at the end of the decade, propelling the region into a vicious circle of indebtedness and current account deficit.

(c) Performance and the role of economic policy

The results achieved by the region in the decade were analysed and evaluated in the 1969 and 1970 editions of the *Economic Survey*. The overall assessment was positive but qualified: "The rate of expansion of the Latin American economy during the 1960s slightly exceeded the figure for the preceding decade and was about the same as that of the world economy, although not so high as those of more dynamic regions and countries". This growth, which like that of the 1950s was above 5%, was concentrated in the industrial sector, the most vibrant and stable, and was based on domestic demand, in particular government spending. Moreover, it took place in a climate of relative stability. In 1970, as few as four out of 23 countries in Latin America and the Caribbean experienced double digit inflation; the highest level, in Chile, was less than 33%, and in approximately half the countries, inflation was below 4%.

Towards the end of the decade, most countries had managed to increase the rate of investment, which was of the order of 20% of GDP. Given the increasing rate of public investment, the availability of public services in the areas of health and education had improved.

These results, which, according to current criteria would be considered favourable, were the subject then of extensive discussion regarding the true picture concealed by these macroeconomic figures. Basically, ECLAC was concerned about low productivity, in particular in agriculture, services and traditional sectors, which was accentuating "structural heterogeneity", as it was termed. The internal contrasts also affected social issues, starting with unemployment, which remained high with a slight tendency to rise and was one of the factors that contributed to sharp inequalities in income distribution.

Thus, a great deal of ground remained to be covered along the path to development. And, in keeping with the new consensus, it was the State's responsibility to take the necessary action to accelerate the pace. The State was, indeed, the legitimate entity which could ensure that social justice and the general interest prevailed with respect to ownership, it was the architect of planning and coordination of all economic agents, the protagonist of integrationist efforts, the rightful interlocutor in relations with international organizations -including ECLAC-

10 *Economic Survey of Latin America, 1970,* p. 29.

and in providing support for development projects. It was natural that ECLAC should deepen its analysis and evaluation of the policies adopted to achieve these ends, all the more so in view of the preparations for a second development decade envisaged for the 1970s.

Whereas ECLAC recognized the achievements of economic policies, as well as the internal and external structural limitations which they were coming up against, it was no less certain that the deficiencies of those policies contributed to the lack of economic dynamism and the existing social imbalance. As indicated in the assessments carried out in successive editions of the *Economic Survey*, progress in development policy was tediously slow and the results not far-reaching enough.

National planning failed to achieve the desired degree of effectiveness, owing to the need for reform of the political and social decision-making structure. Agrarian reform programmes limped along, suffering from indecision and meeting with resistance; as a result agricultural production stagnated, slowing growth, encouraging inflation and leading to a deterioration in the external deficit. The necessary banking and financial reforms were not adopted, nor were tax systems modified substantially. The measures taken to cut back excessively high public administration costs, put finances on a sound footing and improve the output of State-owned enterprises were not thoroughgoing enough. There were no national policies on foreign investment to ensure that such investment benefited the recipient countries. Economic integration did not proceed as expected.

In view of the structural causes of inflation in Latin America, as outlined by ECLAC, such deficiencies limited the effectiveness of anti-inflationary policies referred to as "stabilization policies". In turn, these policies placed limits on growth. To achieve long-term stability, countries which had done their utmost to enforce anti-inflationary policies, aimed primarily at curbing demand, needed to combine them with appropriate measures to prevent a decline in economic growth; in this regard, a great deal of importance was attached to the development of a sound domestic investment policy. In light of its direct link with growth, efforts to curb inflation were continued.

During the decade, ECLAC paid increasing attention to cyclical factors and economic fluctuations, and to short-term policies adopted in response to these phenomena. These were added to the Commission's traditional concern with development, which had led it to give priority to long-term analysis. However, ECLAC did not lose sight of what should be the essential policy goal, namely the improvement of the living conditions of the population, nor did it abandon its characteristic structuralist approach.

(d) Criticism of import substitution

The import substitution strategy applied by Latin American countries was critically appraised in the *Economic Survey*. This appraisal coincided with changes in the external context and deserves special attention since it remains closely associated in the popular perception with ECLAC thinking "par excellence".

This appraisal was based on the recognition that, formerly, the policy of import substitution had been the main stimulus for growth and had provided experience and industrial training, so that, by the end of the 1960s, the countries of Latin America had more solid foundations on which to sustain a more efficient economic and social development policy. As pointed out in the 1969 edition of the *Economic Survey*, this recognition was no less necessary when this process became the target of criticism from various quarters, many of which ECLAC deemed justified in view of the obvious failings of industrialization in Latin America.

Since the late 1950s, it had been recognized that import substitution did little to alleviate pressures on the balance of payments; on the

11 An analysis of Latin American experience in planning is presented in the *Economic Survey of Latin America, 1972*.

12 An initial analysis of short-run fluctuations between 1948 and 1959 is to be found in the *Economic Survey for Latin America, 1960*.

contrary, it exacerbated them. The hope subsisted, nevertheless, that in the long term, as industrialization proceeded, it would bring foreign currency savings. However, already in 1961, it was admitted that protectionist measures used to stimulate local industry "sometimes tend to over-extend themselves and to outlast the need",[13] thereby weakening incentives and, hence, the competitiveness of certain industries, despite the tendency to view regional integration as a palliative to this serious shortcoming.

The validity of this assessment was borne out by experience; indeed, the 1966 edition of the *Survey* echoed the concern that Latin American Governments should "seek a new policy which will enable them to ... free their economies from the stranglehold of a policy focused on indiscriminate import substitution designed solely to supply domestic markets".[14] And in 1969, the *Survey* added that "indiscriminate import substitution under the shelter of much too high tariff walls has led to an extensive industrialization which, at its present stage, is characterized by a distorted structure of production that is both costly and inefficient in some vital aspects ... The establishment of a large number of plants of unsuitable sizes has meant a squandering of capital and low productivity. Where economies of scale could be meaningful, they have not been achieved, and much of the capacity is under-utilized. Lack of specialization in industrial plants helps to keep costs up".

Moreover, the external barriers which initially were an incentive for the local manufacture of items previously imported had, for the most part, disappeared. Goods were readily available on world markets, so that, as already indicated, imports tended to grow at a very fast rate. The problem then was the lack of dynamism of exports, which grew at a slower rate not only than imports but also than world trade. The *Economic Survey* for 1969 stated: "the only sound and lasting remedy for the external bottleneck is essentially to develop exports". Policy based exclusively on import substitution kept those countries dependent on primary products and subject to constraints imposed by the economic policy of the major centres overseas, by technological advances that brought in new substitutes and by the low elasticity of demand.

In short, ECLAC attributed the deficiencies in the existing industrial structure to "the lack of an industrial policy with clear-cut development goals and ... production purely for national markets". This diagnosis led to the conclusion that: "in a development strategy, two things are clearly essential: to strengthen national markets and to make industry export-oriented. The absorption of surplus labour in productive activities, a policy of income redistribution and a programme of land reform will immediately help to do the former. Integration and the sale of industrial goods outside the region will bring with them the advantages of a broader market and the incentives for continuing the process of industrialization in a more efficient way".

4. Furthering international integration in the 1970s

The shift in emphasis in the Commission's approach from import substitution to exports went hand in hand with the developing countries' new demands in the area of international trade. With reference to the cardinal divides that split the world in the 1960s and 1970s, whereas the hallmark of the 1960s for the region seemed to be the ideological rivalry between East and West,

13 *Economic Survey for Latin America, 1961,* p. 351.

14 *Economic Survey for Latin America, 1966,* p. 4.

15 *Economic Survey for Latin America, 1969,* p. 10.

16 Ibid. p. 11.

in the 1970s, Latín America found itself caught up in the uncertainties of the North-South confrontation.[17]

The international consensus on development that reigned in the 1960s was succeeded by confrontation in the 1970s, the result of a sense of frustration at the lack of progress achieved by the Third World, and also of a crisis in the world order established by the developed countries following the Second World War. The first manifestation of this crisis came in August 1971, when the United States devalued its currency ending the convertibility of dollars into gold and bringing about the definitive collapse of the monetary and financial system which had been instituted at Bretton Woods. This marked the end of the gold standard in a world beset by inflation and a dollar glut.

The time had apparently come to replace the old order by a new international economic order which, among other things, would take into account the new developing countries and the major issues confronting them. In this context, the event of greatest import was the agreement among petroleum-exporting countries, which culminated in sharp rises in energy prices and thrust the world into a dizzying spiral of stagnation and inflation.

Whereas, up to this point, it had been difficult to speak of Latin America as a whole, these events led to the emergence of a new economic geography within the region. On the one hand, the energy crisis set a minority of oil-exporting countries (in the first instance, Bolivia, Ecuador, Trinidad and Tobago and Venezuela, subsequently joined by Colombia, Mexico and Peru) apart from the other countries. On the other hand, during this decade, the way was paved for a new economic policy option, which took the form of an opening-up to the outside world, epitomized most dramatically in the case of Chile. ECLAC analysis had to take heed of this situation and also of the indirect, but by no means irrelevant consequences, which the energy crisis had for all the countries of the region, owing to the massive financial transfers it engendered worldwide.

(a)The "internationalization" of the Latin American economy

As highlighted in the analyses contained in various editions of the *Economic Survey* published in the course of the decade, exports accelerated in the late 1960s, contributing to a strong revival in economic activity, a situation which lasted throughout the first half of the 1970s. Between 1968 and 1974, Latin America achieved spectacular GDP growth rates, of the order of 7%, and an investment ratio which soared to close to 24% of GDP.

Strictly speaking, as ECLAC noted, these results were chiefly attributable to the strength of domestic demand, since the value of exports as a percentage of GDP did not vary significantly. However, as was also pointed out, exogenous factors assumed a leading role in Latin America owing to the combination of robust demand for primary products and a clear improvement in the terms of trade between 1971 and 1973, the increasing involvement of transnational corporations, staggering financial flows and even an increasingly large share of manufactures in exports from the larger countries of the region. This prompted ECLAC to state in 1975 that "if account is taken only of the external factors, it could well be argued that the stage which ended was merely equivalent to a new and more complex version of 'outward-oriented' growth",[18] reminiscent of the growth experience in the region prior to the crisis of the 1930s. This accounts for the description of the period as one

17 It should be recalled that ECLAC did not subscribe to the most extreme arguments of the centre/periphery theory. While it did recognize the "transparent truth of the subordination and unequal relationships between centre and periphery", it did not, as pointed out in the *Economic Survey* for 1975, consider "that all the great problems of the periphery stem from this circumstance; still less does it mean, as has been maintained on occasion, that the underdevelopment of the majority has been at once the determinant cause and effect of the progress of the fortunate nucleus" (p. 39).

18 *Economic Survey for Latin America, 1975,* p. 44. It will be recalled that "internationalization" of the world economy was a common theme in the 1960s, in much the same way and with the same connotations as the term "globalization" today. For a comprehensive report and discussion on the issue, see *Economic Survey of Latin America, 1978,* Part three: "Latin America and the internationalization of the world economy: significance and options", pp. 519-589.

Table 3

LATIN AMERICA AND THE CARIBBEAN: MAIN INDICATORS, 1970-1979

(In percentages)

Country	Growth: Overall	Growth: Per capita	Inflation	Foreign trade: Exports	Foreign trade: Imports	Current account balance	Capital account balance	Transfer of resources
	Annual rates of variation					As a percentage of GDP		
Latin America and the Caribbean	5.6	**3.1**	37.9	2.6	7.8	-2.3	**2.7**	1.7
Argentina	3.0	1.4	112.0	2.0	7.8	0.1	0.6	-0.1
Bolivia	4.6	2.1	17.6	-1.1	6.4	-2.1	2.7	0.7
Brazil	8.6	6.0	32.3	8.4	7.8	-3.9	4.9	3.2
Chile	2.0	0.3	131.9	8.9	5.9	-3.6	4.4	1.8
Colombia	5.7	3.4	19.8	5.0	5.6	-1.1	3.0	1.0
Costa Rica	6.2	3.3	10.0	4.2	5.5	-10.0	10.3	7.6
Ecuador	9.0	5.9	12.0	15.1	10.9	-4.6	6.1	2.7
El Salvador	4.0	1.4	9.6	5.0	5.2	-2.2	2.7	1.5
Guatemala	5.9	3.0	9.2	6.2	8.0	-2.0	4.0	2.6
Haiti	4.5	2.8	9.6	7.3	11.0	-1.6	1.9	0.7
Honduras	6.0	2.7	7.3	4.4	3.8	-7.8	9.1	5.1
Mexico	6.5	3.3	15.3	8.3	10.5	-2.8	3.0	1.2
Nicaragua	0.1	-3.0	12.6	-1.7	3.3	-4.3	5.0	1.0
Panama	4.5	1.8	6.0	7.0	4.7	-8.2	8.4	6.0
Paraguay	8.1	5.1	12.4	7.3	9.4	-3.4	6.3	5.0
Peru	4.0	1.2	27.1	2.9	2.9	-2.6	3.5	1.0
Dominican Republic	7.4	4.6	10.4	6.1	5.9	-5.0	5.3	2.7
Uruguay	2.9	2.5	60.7	5.9	4.7	-2.3	3.3	2.0
Venezuela	3.2	-0.3	7.6	-5.5	9.5	1.0	3.2	1.7
Barbados	2.4	2.0	13.3					
Guyana	1.4	0.7	10.0					
Jamaica	-1.1	-2.4	17.3					
Trinidad and Tobago	4.8	3.7	12.2					

Source: ECLAC, on the basis of official figures.

of "internationalization" of the Latin American economy.

From the mid-1970s, however, this process took a different turn. As described in the *Economic Survey,* trade, which had previously played a predominant role in the Latin American economies, was eclipsed by external financing. The relative decline in trade was due to a weakening of economic activity in the developed countries and was exacerbated by the resulting resurgence of protectionist practices. Moreover, inflation was a chronic problem in these countries so that, in addition to price rises for petroleum products, Latin America also had to contend with higher prices for other imports. While the decline in trade reduced the revenues of the countries of the region, costly imports resulted in increased payments and their combined effect was to push up borrowing requirements.

These borrowing requirements were covered by rechannelling the financial surpluses of the petroleum-exporting countries. In the course of the decade, the net inflow of capital into the region increased more than five-fold, from US$ 4.9 billion in 1970 to close to US$ 26.5 billion in 1979. This was a basic factor in Latin America's relatively quick recovery from the effects of stagnation in the industrialized world in the second half of the 1970s, and in the maintenance of high import growth rates, which, in conjunction with the huge increase in outflows in the form of interest payments and profits, contributed to an astronomical increase in the current account deficits.

Furthermore, debt servicing was made more difficult by the commercial terms on which loans were obtained, since the main instruments for rechannelling funds were private international banks. The Latin American countries were excluded, by virtue of their position as middle-income developing countries, from benefiting from official loans at concessionary rates, which were intended basically to respond to the more pressing financial needs of the poorest countries of Africa and Asia. At an early stage, in 1975, ECLAC warned that "given the already heavy burden of external debt for many developing countries, the taking out of loans on commercial terms -at least on the scale of recent years- may not be a viable means of financing future current account deficits". The problem did not abate; on the contrary, debt servicing as a percentage of exports of goods and services, increased steadily from less than 10% in the middle of the decade, to 20% at the end of the 1970s, before rocketing to almost 40% in 1982.

(b) Imported inflation

The *Economic Survey* also analysed the links between the international context described above and another crucial factor: the emergence of galloping inflation, which was to plague the region in the following decade. In fact, the spark that hit the inflationary bonfire came from outside the region: world inflation following the dollar issues in the 1960s, the monetary and financial upheavals of the early 1970s and the backward linkage effect of the oil price rise which unleashed an upward spiral of costs and prices. This external influence, passed on through prices for tradable goods, found fertile ground in Latin America, given the lack of resolve of anti-inflationary policy, which, up to then, had, in practice, been assigned low priority.

The growing interest of ECLAC in the phenomenon of inflation was reflected in the *Economic Survey* for 1974, which contained exhaustive information on inflation in Latin America and the world. When the role of external factors in the acceleration of inflation was brought home more forcefully, in 1973-1974, most of the countries were in the throes of inflation in which exogenous causes played a predominant role, although price rises were relatively moderate, fluctuating between 10% and 20%. Roughly similar influences from internal factors and "imported inflation" affected another group of countries, where price rises varied between 30% and 40% in 1974. In these countries, conditions were ripe for foreign-bred inflation to spread. Only in two countries (Chile and Uruguay) did inflation from abroad exacerbate an already volatile domestic situation, leading to chronic and acute triple-digit inflation.

In 1974, inflation in Latin America averaged 40%, compared with 12% in 1970. It rose above 60% in 1976. However, these levels were still low compared with those that would be recorded in the following decade.

(c) Towards a new model of external linkages

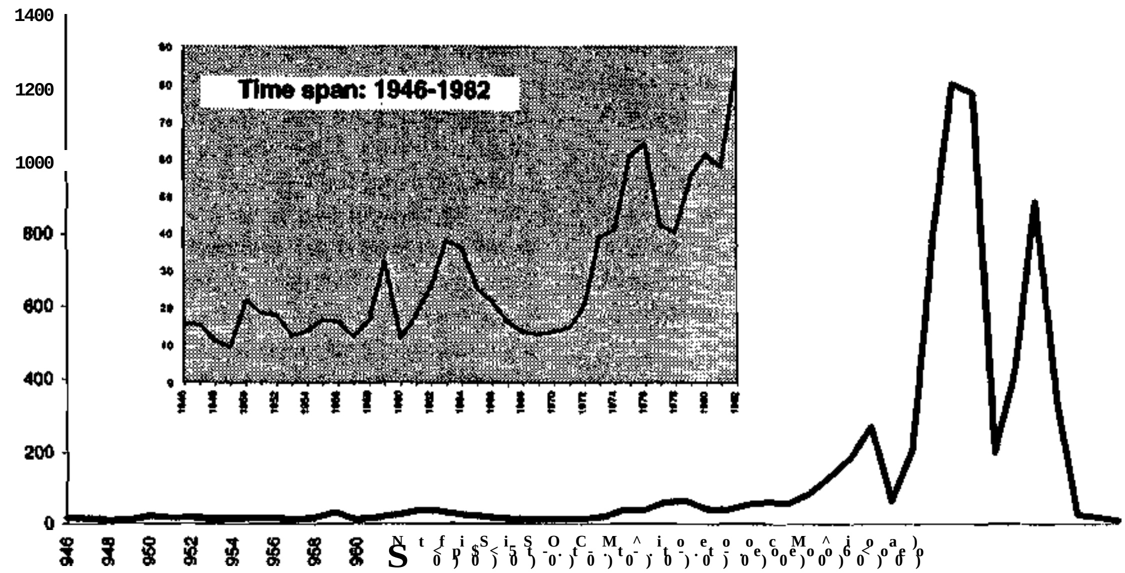
Given the grave and well-nigh unsustainable risks to which the external sector was being exposed, ECLAC suggested in its *Economic Survey* for 1975, that internationalization of the economy of Latin America had gone "beyond the limit permitted by its place in the system of international division of labour as an exporter of primary products". The Commission could see springing up once more the latent contradiction which had hung heavily over the previous decades, i.e., the asymmetry between the demand for imports generated by a certain type of growth pattern and the capacity of such growth to generate sufficient foreign exchange to finance

19 *Economic Survey of Latin America, 1975, p.* 6.

20 *Economic Survey of Latin America, 1974,pp.* 180 and 181 and table 152.

21 *Economic Survey of Latin America, 1975, p.* 47.

Figure 2
RISE AND FALL OF INFLATION IN LATIN AMERICA
(Annual percentage rise in consumer prices)



those imports. The new circumstances abroad heightened that contradiction.

This problem compounded the difficulties and shortcomings of import substitution, to which ECLAC had drawn attention, mainly because of the limitations of domestic markets. This combination of factors highlighted the need to adopt appropriate policies for strengthening linkages with external markets in order to take more advantage of the opportunities provided by the international division of labour, treating export promotion as the top priority so as to sustain the high level of imports and act as "the engine of growth".

This approach, which was termed "opening-up" to the outside world, was applied in varying degrees in different countries. However, as applied in the countries of the Southern Cone, especially Chile, it involved a drastic change, a sudden break with policies applied up to that point. This extreme liberalization, analysed in detail in the *Economic Survey*, was part of a readjustment which covered practically every dimension of economic and social life and which was governed by the logic of comparative advantage, market mechanisms and external competition. In other countries, a combination of selective protectionism and export promotion measures gave rise to policies reminiscent of those successfully applied in Asia by the Republic of Korea, Hong Kong, Singapore and Taiwan, Province of China.

In response to this situation, ECLAC pointed to the risks implicit in radical liberalization. It would have adverse effects on the existing industrial structure, which was geared to the domestic market. The logic of external competitiveness was consistent with the maintenance of low wages in productive activities, whereas a strategy centred on the domestic market demanded, as a priority, simultaneous measures to boost demand for local goods and services, and this was contingent on appropriate wage levels. Radical liberalization seemed to be incompatible with the principles that had inspired regional integration.

Within these countries, the changes heralded in by that strategy in the pricing system and in the form of greater availability of products targeted at higher income groups (which, by regional consensus, had previously been subject to tighter import restrictions) were fraught with consequences and prompted ECLAC to issue the following emphatic warning: "an unfettered opening-up of the economy runs the risk of reestablishing, creating or deepening economic and social features which have long been criticized in Latin America".[22]

For ECLAC, export promotion was fundamental, in particular exports of manufactures, since these combined two essential functions: allowing industrialization to proceed and permitting another form of linkage to the world economy which provided better prospects than that based on the export of commodities. But ECLAC saw no contradiction between inward-looking and outward-looking industrialization strategies.

Import substitution had played an important role in the initial phase of industrialization, which was geared to the domestic market. This phase had the potential to serve as a springboard for access to external markets. In this regard, the regional experience was compared with that of late industrializing countries, headed by Japan, a country that had started by importing manufactured products from more developed countries, which it subsequently replaced by Japanese products, and, ultimately, became an exporter of these same items. This ECLAC approach was based on the adoption of a more dynamic and more long-term view of comparative advantages, embodied in the concept of "acquired" comparative advantages.

The central issue of the debate, for ECLAC, was "confined to weighing up the respective roles of planning (or the deliberateness of economic policy) and of the market, to the relationship between these two determinants of the allocation of resources and, above all, to the nature of the economic and social objectives pursued". The necessary policies had to be directed, at *inter alia,* developing regional links, negotiating with transnational corporations the best contribution that they could make as key agents of internationalization and ensuring that the State played a role as "guide and guardian".

Some of the key elements of external opening-up would be the basis for the proposal subsequently put forward by ECLAC for "changing production patterns with social equity". But the preparation of these policy guidelines was peremptorily cut short by economic circumstances. At the end of the decade, Latin American countries were on the verge of economic and financial collapse; a mere puff, in the form of a rise in international interest rates, was to be sufficient to push them over the brink. Thus a debt crisis was building up which would abruptly awaken countries to the urgent demands of the economic situation, would mark the 1980s as the lost decade for Latin American development and would eventually shift the balance decisively in favour of economic liberalization.

5. The decade

Between 1980 and 1990, the average annual growth rate in Latin America and the Caribbean was barely more than 1 %. In the words of ECLAC, this period was marked by the "crisis which had begun in 1981 and which by 1982 had attained dimensions unrecorded since the Great Depression of the 1930s".[24] At the end of the decade, per capita product was 9% lower than in 1980. The situation with respect to national income was even more disheartening, given the deterioration in the terms of trade. This period represented a big step backwards in the economic development of the region: a lost decade as it has been aptly termed.

22 *Economic Survey of Latin America, 1978,* p. 568.

23 Ibid. p. 571.

24 *Economic Survey of Latin America and the Caribbean,* ',p.3.

The root cause of this disastrous performance was the situation of the external sector during the second half of the 1970s, referred to above. ECLAC analysis with respect to this situation centred on a new concept that summed up and characterized the set of disequilibria with which the economies of the region were confronted in the following decade. If the purchasing power of exports was the key variable for external restriction of Latin American development in the three decades after the Second World War, the net transfer of resources abroad played this pivotal role during the 1980s.

Starting in 1982, the countries of Latin America became net exporters of vast amounts of financial resources to the developed countries, which, as ECLAC pointed out, "thwarts the aspirations of its peoples and confutes the principles of development and international cooperation".

Linked to this phenomenon, which reflected the drying up of voluntary external financing during this decade, the countries' high level of indebtedness and their debt-service payment difficulties, was serious internal disequilibrium which gave rise to hyperinflation and plunged States into extremely grave crisis, causing them to abandon their previous proactive stance. In these conditions, structural development issues took second place to Governments' need to adopt stringent adjustment programmes that would enable them to negotiate the rescheduling of their debt obligations with their external creditors. These adjustment programmes, implemented by Governments with the financial support of the International Monetary Fund, initiated the process of structural market reform that was becoming generalized by the mid-1980s.

During this period the *Economic Survey* provided an account of these changes and they were reflected in its own approach and the new tone of its analysis, mainly focusing on the harsh conditions in the region, now extended by the official inclusion of the English-speaking countries of the Caribbean.

(a) Net transfer of resources abroad

Between 1982 and 1990 there was a new phenomenon in Latin America and the Caribbean: the massive transfer of financial resources abroad, in contrast to the copious inflows of a decade earlier. This phenomenon had two interrelated causes. They were flagged by ECLAC in an account of the start of the crisis: "The sharp drop in the net inflow of loans and investments and the sharp rise in payments for profits and interest also meant that in 1982, instead of receiving a net transfer of real resources/rom abroad, Latin America was forced to transfer *to* the exterior real resources amounting to over US$ 14.3 billion".[26]

As the editions of the *Economic Survey* for this period make clear, the unsustainable increase in net payments of profits and interest, which more than quadrupled between 1977 and 1982, from US$ 8.2 billion to US$ 36.9 billion, was the direct consequence of two successive phenomena. The first of these was the massive accumulated indebtedness of the Latin American countries, referred to above, especially in the latter half of the 1970s. In 1981, net short- and long-term capital inflows were at a record high, equivalent to 40% of the value of exports, compared to around 14% in 1960. The second phenomenon was the sharp rise in international interest rates, which had an affect on interest payments on loans that had been agreed at floating rates. This rise followed the liberalization at the end of the 1970s of the interest rate used in the United States as an instrument of monetary policy and the adoption by that country of a restrictive monetary policy in a context of major fiscal disequilibria and high inflation.

The contraction in net income from loans and investments occurred when Mexico's suspension of its debt servicing payments in 1982, combined with high interest rates in the United States, abruptly diverted international flows of private capital away from Latin America. Having lost this source of financing, the region was obliged

25 *Economic Survey of Latin America and the Caribbean,* »,p. 129.

26 *Economic Survey of Latin America and the Caribbean,* t,p. 18.

Table 4
LATIN AMERICA AND THE CARIBBEAN: MAIN INDICATORS, 1980-1989
(In percentages)

Country	Growth		Inflation	Foreign trade		Current account balance	Capital account balance	Transfer of resources
	Overall	Per capita		Exports	Imports			
	Annual rates of variation					Relative to GDP		
Latin America and the Caribbean	1.7	**-0.4**	**203.4**	5.4	**0.0**	**-1.9**	-0.7	-2.6
Argentina	-0.6	-2.1	349.4	5.5	-7.4	-2.3	-1.4	-5.9
Bolivia	-0.5	-2.5	224.4	2.7	3.0	-5.1	-1.3	-7.3
Brazil	2.9	0.8	260.4	6.7	-0.2	-1.9	-1.0	-5.1
Chile	3.2	1.6	20.5	6.4	1.4	-7.2	-1.0	-9.4
Colombia	3.7	1.7	23.2	6.0	1.7	-2.9	3.1	-0.6
Costa Rica	2.0	-0.9	25.2	6.2	4.2	-9.2	-1.9	-10.2
Ecuador	2.1	-0.5	34.3	5.0	-3.1	-5.4	-4.6	-13.1
E) Salvador	-2.1	-3.4	19.0	-3.5	1.2	-3.3	-0.2	-2.4
Guatemala	0.9	-1.9	12.2	-1.5	-2.3	-3.8	0.2	-1.5
Haiti	0.3	-1.6	6.7	-0.2	-1.5	-5.0	4.0	3.0
Honduras	2.5	-0.7	6.9	0.8	-0.8	-7.9	3.3	-2.4
Mexico	2.1	0.0	65.2	8.6	3.2	-1.0	0.2	-4.4
Nicaragua	-1.0	-3.7	504.8	-2.4	-5.7	-27.2	2.9	-7.5
Panama	1.5	-0.6	2.7	0.6	0.9	0.1	-5.6	-10.7
Paraguay	4.0	0.7	19.8	9.4	8.1	-5.1	4.0	3.5
Peru	-0.2	-2.4	218.7	-2.8	-2.8	-3.5	-2.3	-6.7
Dominican Republic	3.7	1.4	20.0	3.8	-1.6	-4.6	3.2	-0.9
Uruguay	1.0	0.3	56.5	3.4	-0.8	-2.0	2.0	-2.2
Venezuela	-0.8	-3.4	22.3	2.7	-5.6	1.4	-3.1	-5.6
Barbados	1.7	1.3	6.2					
Guyana	-2.1	-2.6	17.9					
Jamaica	1.6	0.4	15.3					
Trinidad and Tobago	-1.8	-3.1	11.3					

Source: ECLAC, on the basis of official figures.

to generate trade surpluses in order to service its accumulated debt. This was achieved by means of a sharp contraction in domestic demand, which reduced imports, especially from 1983 on, generated exportable surpluses and slowed down economic activity.

The net transfer of resources, corresponding to net capital inflows minus net factor payments, had been positive since 1968, after being slightly negative for two decades following the war. As a proportion of GDP, this positive transfer had reached its maximum level in 1978, when it was equivalent to 3.2% of product. As ECLAC noted, "up to 1981 the region had received capital of which the gross amount substantially exceeded the sum total of amortization payments, investment abroad and remittances of interest and profits ... In these circumstances, Latin America was able to pay amortization and interest payments on its external debt and the profits accruing on foreign capital by means of the new loans and investment received year by year. As from 1979, however, the size of this net transfer of resources began to diminish, since the increases in the net inflow of capital were more than offset by the still greater increases in payments of interest and profits."

The mobilization of greater resources to cope with increasing payments started an unsustainable spiral. From 1982, when this spiral finally collapsed, the transfer became negative and very large: "Between 1982 and 1986, this transfer was equivalent to 4% of the region's GDP, which was even higher than the transfers that Germany had to make in the form of reparations to the allies following the First World War".[28] Moreover, it rose to the equivalent of almost a quarter of export revenue, from 16% between 1973 and 1981.

This financial outflow had serious repercussions for the domestic saving and external sector deficits, and hobbled Latin American development. As the statistics elaborated by ECLAC at the end of the decade show, the resources transferred abroad absorbed a large share of domestic saving, which remained at a high level, 24% of GDP, in spite of the contraction in the per capita level of activity. Another substantial share of this saving served to offset the decline in the real terms of trade, which was equivalent to 3% of GDP between 1982 and 1989. As a result, investment in this period represented only 17% of regional product, a much lower percentage than in the previous decades: it had held at between 21% and 22% in the 1950s and 1960s and at 24% in the period 1974-1981.

The transfer of resources abroad also severely restricted import capacity, which declined sharply after having stagnated until the mid-1960s and increasing thereafter until 1980. After 1982, import capacity fell by 25% compared with before the crisis and remained around the level recorded in the region 10 years earlier.

(b)The trauma of hyperinflation

The phenomenon of accelerating inflation which began in the previous decade reached its peak in the 1980s. As ECLAC explained on many occasions during this decade, the stepping up of inflationary pressures was in large measure a response to the inability of the fiscal structure to carry out its basic functions and at the same time undertake the transfer of resources abroad required for debt payments, 80% of which came to be underwritten or guaranteed by the State after successive rounds of renegotiation. Faced with obligatory limits on public expenditure which inhibited its management capacity, the State was unable to collect sufficient revenue through taxation and external financing or through domestic debt issues, so that a significant part of resources were derived from inflationary financing.

This explains why the average regional year-end inflation rate of 56% in 1980 rose steeply to an extraordinary 1,200% in 1989. However, this average had little meaning in view of the runaway price rises recorded in several countries in the second half of the decade. One of the most extreme cases, and the first in which inflation reached four or more digits, was Bolivia in 1984, with an inter-annual rate that peaked at 23,500% the following year. In Nicaragua inflation soared to 43,000% in 1989, and in 1990, Argentina recorded 20,300%, Brazil 6,500% and Peru 12,400%.

The type of measures initially adopted by several countries to stem the vertiginous rise in prices, prominent among them being price and wage controls, had only short-lived results. As ECLAC noted, for example, in 1986, "in Argentina, Brazil and Peru the sharp reductions in the annual variation of consumer prices brought about by the application of unorthodox stabilization programmes were not accompanied by a comparable slackening of basic inflationary pressures. As a result, the second half of the year saw a reversal in the downward trend followed by the annual rate of inflation since the third quarter of 1985 in Argentina and Peru, and much the same thine occurred in Brazil towards the end of the year." The countries therefore went on to apply a combination of both orthodox measures, in the

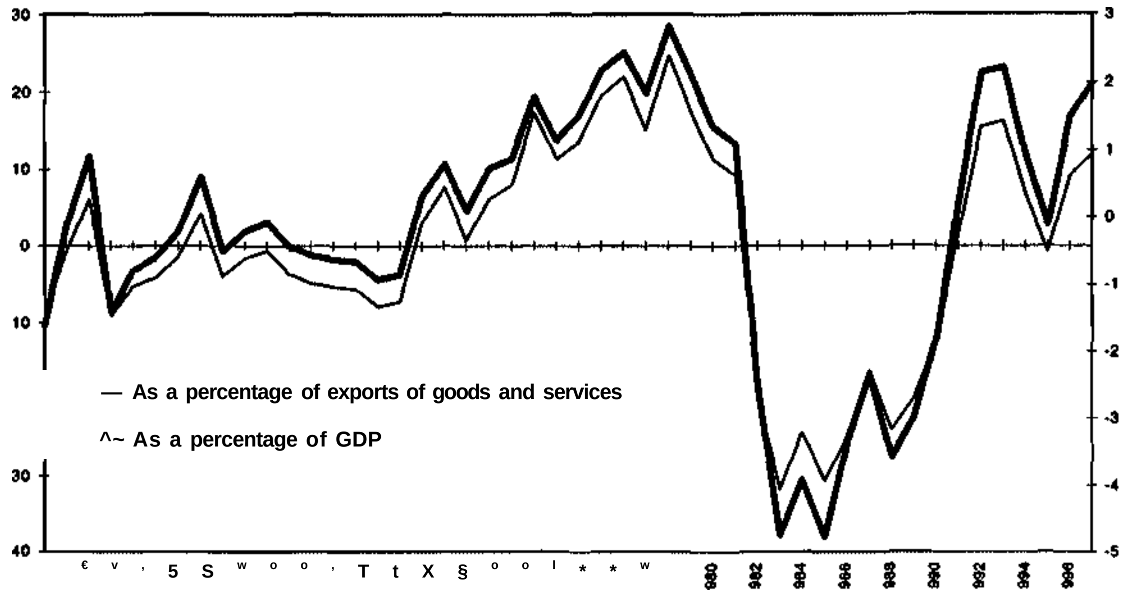
27 *Economic Survey of Latin America and the Caribbean, 1983,* pp. 5 and 7.

28 *Economic Survey of Latin America and the Caribbean, 1992,* vol. 1, Part Two: "External capital movements in Latin America and the Caribbean", p. 258. This section provides a detailed analysis of capital movements from a historical perspective.

29 See, for example, the analysis of the relationship between the transfer of resources and inflation in *Economic Survey of Latin America and the Caribbean, 1988,* pp. 99-106.

30 *Economic Survey of Latin America and the Caribbean, 1986,* p. 11.

Figure 3
NET TRANSFER OF RESOURCES
(As a percentage of GDP and of exports of goods and services)



framework of orthodox macroeconomic adjustment programmes, and heterodox measures such as certain deindexation processes or tripartite social compacts between Government, trade unions and employers. In some cases also, exchange rates were used as an anchor.

(c) From macroeconomic adjustment to market reforms

ECLAC was aware that the urgent problems engendered by the crisis of the 1980s drastically limited the scope for manoeuvre of economic policy and made it much more difficult than in the past. As economic problems grew more pressing, it became increasingly difficult, in the words of ECLAC at the end of the decade, "to tackle long-standing structural obstacles to development such as outmoded systems of education, inefficient agrarian structures, very limited application of new technology in production, and outdated financial and taxation systems".[32] This was reflected in public policies, as well as in the *Economic Survey*. In view of the above, it was also pointed out that "in order to overcome the deep and prolonged recession suffered by the vast majority of the countries during this decade, three things are required: greater import capacity, improved internal economic management, and structural transformations to overcome long-standing obstacles to both greater growth and greater equity."[33]

Because of the scarcity of foreign currency, adjustment policies had been adopted in the external sector that granted a major role to exchange rate measures. The depreciation of national currencies served to promote exports and reduce imports. But these measures were not sufficient to generate surpluses for debt servicing, so that a general debt moratorium followed (with the notable exception of

31 For a retrospective analysis of inflation in Latin America, see *Economic Survey of Latin America and the Caribbean, 1996-1997,* chapter V, "Inflation", pp. 71-81.

32 *Economic Survey of Latin America and the Caribbean, 1988,* p. 12.

33 Ibid.

Colombia) and debt amortization and later even interest payments were suspended. This situation led to difficult negotiations with creditors, conducted in various phases or rounds. ECLAC became one of the main sources of statistical data and analysis on these processes.

Although initially it was considered that the financial difficulties were confined to liquidity, it was later admitted that excessive indebtedness also led to structural problems. In parallel, after the initial phases in which the official sector stayed in the background, at the end of the decade, with the adoption of the Brady Plan, the international debt management strategy involved the public sector in implementing debt reduction measures.

To sum up, the negotiations with the international financial institutions, in addition to achieving significant debt reduction, made Governments responsible for adopting deep-seated structural reforms and macroeconomic adjustment programmes, made unavoidable by the serious internal and external disequilibria. These policies, which countries began to implement in the mid-1980s, were based on the need to maintain the basic macroeconomic equilibria by means of rigorous monetary and fiscal policies, to redefine the role of a State overwhelmed by the debt crisis and, consequently, to assign to the market the function of allocating resources, which was achieved through trade and financial liberalization and the privation of public enterprises.

The introduction of these reforms, which were backed and inspired by the financial institutions, in particular the International Monetary Fund, led ECLAC to observe in 1990: "In the midst of great difficulties, Latin America and the Caribbean are still trying to overcome, once and for all, the crisis that has burdened them for almost a decade now. They base their hopes on the results of the sweeping and irreversible structural changes taking place in the countries of the region."

Although there were similarities between the reforms introduced in the various countries, they did not conform to a single pattern. There were great differences in the context and sequence in which measures were implemented, in the political orientation of the Governments and sectors responsible for implementing them, in the extent to which they were applied, in the reaction they encountered among the population and in the progress achieved, and the setbacks and interruptions encountered.

6. Macroeconomics and the withdrawal of the State in the 1990s

Thus it was that by the start of the 1990s, the majority of the economies in the region were functioning on a new basis, with new policy orientations, centred on acceptance of the principle of a free market and on according priority to maintaining macroeconomic equilibria. These two issues are among the main issues to have marked the decade, in contrast to the environment in the postwar period addressed in the earliest editions of the *Economic Survey*.

The *Survey* now reflects this macroeconomic trend, which is very different from the more structural view it took in the 1950s. But the events of the current decade also show that the initial ECLAC analyses regarding the external conditionalities of Latin American development remain valid. The risks of external desequilibrium are as present now as they ever were. During the post-war period they were seen as limiting economic development over the long term; today, their possible destabilizing effects on macroeconomic variables over the short term are also giving rise to concern.

All this is taking place in a global economic context that is very different from 50 years ago. The internationalization of the economy has taken on enormous proportions since it began to pick up speed at the end of the 1960s. Trade exchanges have increased more and more relative to world output and, especially during the

34 *Economic Survey of Latin America and the Caribbean, 1990,* p. 9.

present decade, the ratio between their respective rates of growth has increased. The international financial markets have expanded to an extraordinary degree, as has the volume of capital crossing frontiers every day. Global production has acquired a hitherto unprecedented transnational character. Technological progress, above all in the field of communications, is the underlying factor in this process. In reference to these changes, the term "globalization" has invaded everyday vocabulary.

(a)The new bases on which economies function

As has been amply described in the *Economic Survey,* the policies and reforms introduced in many countries in the second half of the 1980s laid new foundations for their economies, generally more export-oriented and also incorporating trade liberalization, fiscal austerity, more prudential management of monetary policy and a greater reluctance to resort to public regulation of economic activity. All this has inspired greater confidence in the permanence of the rules guiding public policy.[35]

This confidence, strengthened by Governments' commitment to achieving macroeconomic stability and progress towards solving the debt problem, made a decisive contribution to the return of external capital to the region. In this climate, there was a positive transfer of resources to the region in 1991, which resulted in an easing of currency restrictions, the need for which had been indicated by the *Economic Survey* in 1988. Around the same time, there began to be signs of a lifting of the grim panorama of stagnation, recession and inflation that had engulfed most of the countries of Latin America and the Caribbean.

The *Economic Survey* provided testimony to the progress in structural reform and macroeconomic adjustment made during the first half of the 1990s. Reforms continued apace, although with great variations from country to country. Significant privatization activity and the adoption of measures to improve regulatory systems in the sectors concerned, among others public utilities, were of special note among these reforms. Mechanisms were established to regulate the functioning of the financial system. Several countries made progress in reforming their social security systems, developing capitalization schemes for employees' contributions.

The cornerstone of progress towards macroeconomic stability was drastic fiscal adjustment, backed by restrictive monetary policies and the use of the exchange rate as an anchor, and based on structural and institutional changes, such as tax reforms to increase and guarantee fiscal revenues, administrative and public spending policy reforms to reduce costs and make State administration more efficient and reforms of the monetary institutions to provide them with more autonomy in their task of controlling inflation. This resulted in a spectacular curb in price rises : the rate of increase was progressively reduced from 888% in 1993 to 26% in 1993 and to less than 11% in 1997, the lowest rate in almost half a century.

The change of direction taken by economic policy led to new developments in another area to which ECLAC had paid particular attention since the 1960s, that of regional integration. The opportunities offered by the regional and subregional markets as a result of economic integration ceased to be seen as a means of overcoming the shortcomings of inward-looking industrialization and instead began to be used to support the new export-oriented approach, calling to mind the suggestions formulated by ECLAC at the end of the 1970s. The concept of open regionalism refers to this new principle which has inspired integration efforts.

Concrete progress towards integration has been achieved through, among other things: the establishment of Mercosur in 1991; the revitalization of the Andean Pact; the signing of the North American Free Trade Agreement,

35 *Economic Survey of Latin America and the Caribbean, 1 1,* vol. 1, p. 9.

36 Chapter V of the *Economic Survey* for 1996-1997 (pp. 71 -! provides a detailed account of the historical evolution of inflation and of stabilization policies.

Table 5

LATIN AMERICA AND THE CARIBBEAN: MAIN INDICATORS, 1990-1997

(In percentages)

Country	Growth		Inflation	External trade		Current account balance	Capital account balance	Transfer of resources
	Overall	Per capita		Exports	Imports			
	Annual rates of variation					**Relative to GDP**		
Latin America and the Caribbean	3.2	**1.4**	**160.7**	9.1	**14.2**	**-2.2**	**2.6**	0.9
Argentina	4.8	3.4	42.9	6.3	25.2	-1.4	1.7	0.1
Bolivia	4.2	1.7	8.7	6.1	7.0	-5.5	4.7	1.1
Brazil	2.1	0.6	268.2	6.1	17.8	-1.2	1.8	-0.3
Chile	7.4	5.7	9.8	9.6	13.7	-3.2	7.3	2.8
Colombia	4.1	2.2	18.5	6.7	17.2	-2.1	3.6	-0.4
Costa Rica	3.5	1.1	14.2	8.6	8.9	-4.3	3.3	0.7
Ecuador	3.5	1.3	28.0	6.6	5.1	-3.3	-1.9	-10.9
El Salvador	5.2	2.9	8.9	12.3	11.5	-2.4	2.9	1.4
Guatemala	4.0	1.3	12.1	6.9	9.2	-4.0	4.9	3.6
Haiti	-2.1	•4.1	17.3	-2.0	11.0	-2.1	2.2	1.4
Honduras	3.1	0.2	16.5	2.2	3.7	-6.7	4.0	-3.0
Mexico	3.1	1.3	16.2	12.9	11.9	-3.8	3.6	0.4
Nicaragua	2.3	-0.5	35.2	10.8	9.1	-35.8	-7.1	-26.6
Panama	5.2	3.3	0.8	4.1	6.2	-1.8	0.1	-3.9
Paraguay	2.8	0.0	13.1	6.1	11.6	-6.4	7.8	7.9
Peru	4.1	2.3	90.0	10.1	13.5	-5.2	4.9	1.5
Dominican Republic	3.4	1.5	11.4	19.1	20.8	-3.2	2.3	-3.2
Uruguay	3.7	3.1	39.6	7.7	14.0	-0.7	1.9	0.1
Venezuela	3.7	1.4	38.4	6.9	9.6	4.6	-2.9	-5.3
Barbados	0.3	-0.1	2.3					
Guyana	6.1	5.2	3.0					
Jamaica	0.9	0.2	24.0					
Trinidad and Tobago	2.3	1.2	5.0					

Source: ECLAC, on the basis of official figures.

which provided for trade integration of Mexico with its northern neighbours as of 1994; the movement to create a continental free trade zone (the "Free Trade Area of the Americas"); and a proliferation of bilateral agreements. All of these developments were only possible in the new climate of greater macroeconomic stability and, as ECLAC noted in 1993, pointed up the need to coordinate the relevant countries' macroeconomic policies in order to continue strengthening their trade links.[37]

(b)Financial vulnerability and external shocks

In providing an account of the establishment of the economies' new bases for operation, ECLAC warned of difficulties being encountered which revealed the countries' financial vulnerability, domestically and externally, and which for some commentators called to mind the serious situation at the beginning of the 1980s. At the domestic level, for example, the banking crises that plagued the region in the mid-1990s, analysed in the *Economic Survey* for 1995-1996,

37 *Economic Survey of Latin America and the Caribbean, 1992*, p. 21.

revealed discrepancies between policies and reforms, as well as microeconomic and institutional deficiencies. ECLAC noted the risks of all-out liberalization or financial deregulation in conditions where there was insufficient saving and before macroeconomic disequilibria had been controlled and the corresponding institutional improvements consolidated, including more effective supervision. In such conditions, financial instability in the largest economies in the region (Argentina, Brazil and Mexico) had been aggravated by drastic macroeconomic adjustments.

External restrictions now, in the view of ECLAC, presented a contrast compared with a decade earlier. The opening up of the capital account and the return of massive capital flows to Latin America in the 1990s had brought with them the risk of external shocks provoked by sudden withdrawal of this capital by foreign investors at any sign of trouble, especially a large current account deficit.

Such deficits are mainly brought about by the gap between exports and imports, which tend to increase at different rates. So far in the present decade, exports have been expanding at high rates (11% annually on average), but imports have been increasing at an even greater rate (16%). A problem noted many times in the past is arising once again in relation to the tendency of imports to grow more rapidly than exports. It is a problem that the new economic model has not so far been able to solve. In the current situation, capital of external origin, in addition to amply covering the trade deficit, has contributed to widening it because of the increase in expenditure that it allows and because of the real currency appreciation that it induces in the recipient countries. These factors, combined with others, such as fiscal and monetary management and the composition of external financing, cause uncertainty, to which the financial markets are very sensitive.

The problem is particularly significant in view of the volatility of these markets, which are closely integrated at the global level thanks to widespread communications technology, and in view of the private nature of the funds invested. This is why the evaluation by specialized international institutions of the degree of risk that different economies present for foreign investors has acquired great importance. So, too, has the provision of reliable, timely, widely available information on the key economic variables; ECLAC assists the Governments in this task through its work of compiling and analysing data.

Experience so far in this decade serves as an example in this respect. Since 1991, the year in which net financial flows to the region resumed, successive editions of the *Economic Survey* have contained warnings of these risks. In the 1994 edition, it was pointed out that this state of affairs "increases the vulnerability of many of the region's economies to any new external impacts that may arise". A few months later, investors' abrupt withdrawal from the Mexican market led to a severe crisis which spread to the rest of Latin America. The region had barely recovered from this crisis when in 1997 it suffered the consequences of another shock, this time originating outside the region in the financial events that affected various Asian economies.

The effects of this latest crisis, the one that began in Asia, are still making themselves felt, but the Latin American region has faced it in better conditions than in 1994, when the gravity of the situation caused ECLAC to reiterate its warning regarding "the dangers of a growing trade deficit, excessive dependence on inflows of short-term foreign capital and a low national saving rate and ... the need for greater coordination in economic policy". It was the

38 See *Economic Survey of Latin America and the Caribbean, 1995-1996,* chapter IV: "The fragility of Latin America's financial system", pp. 55-65.

39 *Economic Survey of Latin America and the Caribbean, 1993,* p. 13. The warning continued: "A large share of this capital is of a short-term nature or has been brought into the region for purposes of speculation in the form of long-term instruments. A portion of this type of investment may be particularly sensitive to any increase in international interest rates or to the normalization of initial returns even in the absence of any abrupt changes in economic policy. Furthermore, foreign investors also monitor the size of each country's trade deficit, since it serves as an indicator of the sustainability of the basic process by which investment, growth and imports are linked with capital inflows."

40 *Economic Survey of Latin America and the Caribbean, 1995-1996,* p. 13.

view of ECLAC that overcoming this state of affairs in the medium term essentially depended on an accelerated and sustained expansion of exports, which required consistent efforts to change the region's production patterns and to invest more in tradables-producing sectors.

Furthermore, throughout the many years in which the export structure was being diversified, ECLAC considered it essential that the necessary external conditions should be created for a harmonious expansion of global trade, both in the area of macroeconomic management of the main developed economies and that of the institutional structure governing trade in goods and services. At the same time, it was necessary to promote interregional trade in the framework of economic integration. It was no less important to adopt measures to help modify the composition of capital flows to make them more stable.

Some of these conditions have been met and the region's financial vulnerability has been diminishing as internal financial systems have been strengthened after surviving the banking crises, privatizations have attracted huge amounts of direct foreign investment and short-term capital flows have been reduced somewhat relative to long-term loans and funds captured through bond issues and other more stable sources of financing. But there is still a need to review the arsenal of economic policies countries have at their disposal to deal successfully with external disruptions, as well as to strengthen national saving -another issue to which ECLAC has attached primary importance throughout its history- in order to dampen the demand for external capital to buttress investment and cover the trade deficit.

(c) **Equity: the unmet challenge**

One of the shadows cast by the new economic schemes is the continuing serious deterioration in the living conditions of large sectors of the population; it is a source of great concern. As ECLAC pointed out at the beginning of the present decade, there is no doubt that the new methods of operation are built on even greater income inequalities than in the past, more insecurity with respect to employment, a contraction of fiscal resources and a more limited field of action for economic policy. All of this implies diminished capacity to effect transfers between economic sectors or social strata. Thus, despite the progress of the macroeconomic variables, the majority of the countries have not yet managed to remedy to any great extent the social backwardness inherited from the past.

Employment is one of the most relevant variables in this respect. Throughout the decade, ECLAC has stressed that insufficient productive employment was being created to absorb the increase in the workforce. In some countries, economic restructuring and efforts to improve competitiveness have had unfavourable short-term effects on demand for labour; as a result, by the mid-1990s it was apparent that growth rates in the order of 4% were not enough to allow for major progress in the fight against poverty or to prevent unemployment and underemployment from reaching unacceptable levels.

As was recalled in the *Economic Survey* for 1996-1997, ECLAC has pointed out on numerous occasions that in order to reduce unemployment and eradicate extreme poverty it was essential for the countries of Latin America and the Caribbean to speed up growth. However, the experience of some countries suggests that growth is a prerequisite for achieving these ends, but is not enough in itself. In some cases, the cause of unemployment was the slow growth of output. In others, restructuring in the initial phases of the reform process had become the main cause of the extremely high unemployment rates observed. Thus, it was deduced that, given the nature of the reforms under way in the region, dealing with the employment problem w as likely to require labour

41 See *Economic Survey of Latin America and the Caribbean, 1992*, p. 11 and ibid. 1993, p. 13.

42 *Economic Survey of Latin America and the Caribbean, 1996-1997,* p. 24.

43 *Economic Survey of Latin America and the Caribbean, 1994-1995,* p. 15.

policies specifically designed to help workers adapt to changing conditions.

In any event, the increased attention that is once again being given to the issue of equity and the related issues of productivity, investment and domestic saving signals a return to the basic concerns of the *Economic Survey* in its early days. This was possible once the most urgent requirements of the economies of the region had been addressed and once their level of stability and the changes introduced permitted attention to be focused on the more defining aspects of economic development.

44 *Economic Survey of Latin America and the Caribbean, 1996-1997,* p. 23.

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