

# CEPAL Review

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Review

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# The international recession and Latin America

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The international economic and financial crisis is one of the main sources of present concern, particularly as there are no generally accepted solutions for dealing with it. This article is therefore of special interest in that it seeks not only to describe the main features of the crisis but also to suggest some ways of tackling it.

The first part of the article describes the present international economic situation and its effects on the periphery in general and Latin America in particular, with special reference in the latter case to the reduction in the growth rate, the fall in the terms of trade, the increase in external indebtedness, the deterioration in the fiscal situation and the worsening of social conditions. In these circumstances, the author anticipates a further period of difficulties in view of which it would be advisable to apply a policy aimed at limiting the adverse effects of the crisis.

In view of the range of different national situations, no attempt is made to present a set of specific policy recommendations: instead, some general ideas are suggested which may be useful for guiding concrete actions. These ideas or policy options are divided into three levels: world, regional and national, with emphasis being placed among the national-level ideas on external indebtedness and tariff, exchange rate and public expenditure policies.

By way of conclusion, the author stresses that the internal adjustment cannot be left to the automatic impulses of the international market, that the fight against inflation cannot form the exclusive objective of economic policy, and that such policy must not be restricted to the use of monetary mechanisms.

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## I

### The current international economic situation: crisis, insecurity and confusion

The general characteristics of the current international economic situation are all too well known. This is a serious and profound crisis which simply cannot be dismissed as a mere downturn of a conjunctural nature.

The stagnation of economic activity has continued for a much longer period than was the case during previous recessions in almost all the industrial countries. Unemployment is the highest it has been since the Great Depression, with estimates showing around 30 million unemployed in the OECD countries.

Recently, certain favourable indicators have shown that inflation has gone down in the United States, and during the last quarter there have been signs of a slight but encouraging recovery in that country's gross product. These indicators, however, are not duplicated in other industrial centres. Thus, the May communiqué of the OECD Ministers states that while we may expect soon to see a moderate expansion of economic activity in the OECD area, possibly including an improvement in the employment situation during the coming year, this expansion will not be sufficient to bring about a rapid drop in the present high level of unemployment.

The great industrial centres have agreed to concentrate on combating inflation as their first goal and have chosen to try to achieve this goal primarily by using monetary tools. Because of this, when no significant progress was made in reducing fiscal deficits, there has been strong upward pressure on interest rates. Indeed, real interest rates have reached levels without precedent in the post-war period which are only comparable with those prevailing during the Great Depression. Thus, we are faced with a truly exceptional situation. During 1982, interest rates on the free market have remained around 16.5%. Since inflation rates have dropped at the same time, however, real interest rates, traditionally averaging about 2%, have abruptly risen to averages of 6 and 7%. This

phenomenon has brought about a drop in investment levels and heavy flows of capital between the industrial countries. These flows in turn have led to a drastic revaluation of the United States dollar *vis-à-vis* the other currencies.

The abrupt and unexpected currency fluctuations in the central countries have become a possibly inevitable but nonetheless destabilizing element in the international economy. This problem was given special attention by the Chiefs of State meeting recently at Versailles, who stressed the importance of achieving more harmonious functioning of the machinery for adjusting exchange rates.

Moreover, the increasing balance-of-payments problems of some industrialized countries, the persistence of unemployment in most of them and the stubborn unresponsiveness of the productive system have led to serious confrontations in the trade policies of the central countries that seem to be leading them into

dangerous protectionist practices. This of course would represent a serious backward step from the sustained and beneficial trend towards free trade began after World War II.

No less serious is the fact that, faced with this difficult and complicated panorama, the prevailing theoretical concepts have not been able to suggest a clear and viable course of action to those responsible for economic policy. The continuing debates between proponents of the monetarist and Keynesian approaches have not succeeded in throwing enough light on the causes of stagflation and they have been even less successful in suggesting what measures should be taken to overcome it. To this confusion at the theoretical level, with its inevitable implications at the level of action, has been added a failure to coordinate the economic policies of the industrial countries in a manner commensurate with the seriousness of the problems currently facing the international community.

## II

### The effects of the international cycle on the periphery

Obviously, this confusing situation has created difficulties for the countries of the periphery, for which the present behaviour and future evolution of the central economies are of fundamental importance. This is particularly true in the case of those Latin American countries which have in recent years, each in its own way, been pursuing policies of commercial and financial openness.

The effect which the unsatisfactory international situation has on our countries may be easily seen in certain very significant areas:

(a) The slackness of domestic demand in the industrial countries and particularly the decline of investments and the reduction of stocks due fundamentally to the high interest rates have substantially weakened basic commodity prices, which have dropped consistently over the past twelve months and still show no signs of firm recovery. In the case of the non-oil-exporting countries of Latin America, the

terms of trade —which had already deteriorated by nearly 30% during the three-year period 1978-1980— dropped by a further 11% in 1981, and the situation does not seem to have improved during the first half of 1982.

(b) The rise in interest rates has greatly increased the cost of servicing the external debt of the developing countries. To appreciate the effect this process has had on the Latin American economies, we should note that, given the current level of external indebtedness of the region, every time the interest rate goes up one point, the cost of servicing the debt increases by approximately one billion dollars.

(c) Restrictive fiscal policies have led to reductions in financial assistance for development, particularly as regards contributions to multilateral banking institutions and national assistance programmes. Although the percentage which such loans represent in the total external indebtedness of the region has decreased

during the last decade, they are still essential to the development of Latin America and particularly to the progress of the medium-sized and small countries that still depend heavily on public financial flows.

(d) The protectionist trends that have in various forms become stronger in certain industrialized economies threaten to create problems for Latin American trade, particularly in the case of the new exports of manufactured

goods, which have been gaining ground in recent years and, which constitute an important factor in promoting the overall economic growth of semi-industrialized countries such as many of the Latin American ones. In this regard, it is worth recalling that certain recent events, such as the multi-fibres agreement, have caused serious concern about what might happen in the future should protectionism increase in the world.

### III

## The international recession and the recent evolution of Latin America

It would be risky to blame all the problems of the Latin American economy in recent times on the behaviour of the international economy. It is well known that situations differ in the various countries of the region and that, along with the problems deriving from the external situation, there have in certain cases been problems arising from the application of unsuitable economic policies or the lack of appropriate policies.

All in all, however, we cannot ignore the fact that the external cycle plays a fundamental role in the recent behaviour of the Latin American economy. This is shown by certain basic indicators of the evolution of the region's economy in 1981:

(a) The growth rate for 1981 —barely 1.7%— was the lowest for the entire post-war period and contrasts sharply with the growth rate for the previous year, i.e., 5.9%. This meant that the per capita product dropped for the first time in the last thirty years.

(b) Because of the decline in the terms of trade and the high interest rates, the deficit on the balance-of-payments current account has remained at exceptionally high levels, with the total deficit for the region amounting to 38 billion dollars in 1981 as compared with 28 billion in 1980.

(c) As a result of the foregoing, the gross disbursed external debt is estimated to have

amounted to close on 240 billion dollars in 1981, which means that it has doubled over the last three and a half years.

(d) The fiscal situation deteriorated substantially in many countries of the region and the budget deficit grew, forcing the countries to reduce public expenditure and particularly investment.

(e) As a consequence of the above changes, there has been a clear deterioration of the social situation, with real wages going down in the great majority of the countries and a substantial rise in unemployment in many of them.

(f) Another, and no less disquieting, consequence is the critical situation faced by businesses in many countries of the region. This has been particularly influenced by the reduction in the level of domestic activity, the drop in international prices of goods and, most of all, the new phenomenon of extremely high real interest rates. The high international interest rates have been projected on to the domestic economies and the effect of this external factor has been increased by certain internal phenomena, so that the interest rates in many countries of the region have reached levels so high that they cannot be sustained beyond a limited period. Not only has this seriously hampered investment, it has also brought about serious disequilibria in the business economy, where enterprises have had to resort to increasing indebtedness at very high rates which have in

turn eroded their profitability and in some cases brought about their downfall. Naturally, these negative phenomena have affected the

profitability and even the viability of various financial entities in some countries of the region.

## IV

### The prospects for the immediate future

In these circumstances, it is rather difficult to project possible scenarios for the regional economy, inasmuch as there are no clear indicators of the probable behaviour of the world economy. It is worthwhile recalling in this connexion that in recent years the forecasts made at the international level have been more or less systematically belied by reality. We must therefore be cautious.

Some optimistic forecasts based on recent United States economic indicators anticipate a recovery of that economy for the last quarter of this year. Even according to the best estimates, however, this recovery will be modest and will not be accompanied by a similar phenomenon in the European countries.

Other less optimistic forecasts envisage a continuation of the current recessive conditions well into 1983; this would thus postpone any marked recovery of the industrialized economies until the second half of next year.

At all events, no one anticipates a vigorous growth cycle during 1983, and it is quite likely that, in the best of cases, recovery will be slow and uneven in the main industrial centres.

Moreover, misgivings have also been expressed with regard to the very nature of the recovery, and in particular, with regard to the ability of the system to avoid the dangers of a resurgence of inflation. Nor can we be sure of how fast and how strongly the recovery will be transmitted to the countries of the periphery.

Faced with these possibilities, what course should the countries of the region follow? I believe that, taking a conservative view, it would be wise to anticipate a further period of difficulties, which will mean that the region must make full use of the capacity for defending itself that it has shown in recent years and, in particular, that it must carry out a set of pol-

icies that will enable it, if not to avoid at least to mitigate the impact of a particular acute depressive cycle in the international economy.

I have no doubt that this is possible, although it should be stressed that when the region showed its extraordinary self-defence capacity during the energy crisis of the mid-1970s, the circumstances of its countries were very different from the present ones.

In the first place, at that time the increases in the prices of fuels were accompanied by sharp rises in basic commodities, which are vital to the external economy of the region. This greatly helped to neutralize the impact of the higher oil prices and to maintain domestic activity.

In addition, Latin America's indebtedness at the beginning of the crisis of the mid-1970s was very low. Thus, in 1973 the gross disbursed external debt was approximately 40 billion dollars, which was only 30% more than the total value of exports for that year. In such circumstances, many countries of the region were able to resort to external financing, which was moreover quite abundant because of the considerable international liquidity created by the oil surpluses and the financial permissiveness of the private international banks which were anxious to lend their surpluses profitably.

This situation has changed drastically during the 1980s. In the first place, the prices of the main export products remain at dramatically low levels. Secondly, in 1981 the external debt was estimated to total nearly 240 billion dollars, almost double the value of total exports during the same year. Thirdly, the international financial agencies themselves are not showing the same capacity for meeting the growing international financing needs of the developing countries or, at any rate, of a large number of

them. Finally, the level of domestic inflation faced by many countries of the region is substantially greater than it was before the first energy crisis.

This means that today it is much more urgent to apply more complex and integral adjustment policies: a question on which I would now like to make the following comments.

## V

### The policy options to the countries of the region

Let us begin by stressing once again that it is difficult to make generalizations about the economic policies of the countries of the region. Although there are recurring common denominators, the individual situations may be quite different. There are differences in the size of the economies, the degrees of openness to the exterior, the level of indebtedness, the trade structures and the endowment of natural resources, all of which means that we are dealing with very different situations when analysing the economic policy options open to each country.

Moreover, in view of the growing internationalization of the Latin American economy, these options will depend to a very large extent on how the large centres respond, through their adjustment policies, to the following questions:

— When and how will there be a recovery in the dynamism of domestic demand, levels of investment and stocks of raw materials?

— Also linked with the above, although with specific determining factors: when will the existing high interest rates begin to go down?

— Will it be possible to check the growing protectionist trends in the industrial countries or will they, on the contrary, become even stronger, particularly in sectors that are crucial to our exports?

— Will private and public financial flows continue to reach the region in adequate amounts and on suitable terms?

— What levels will be reached by the price of fuels on the world market?

The answers to these questions will of course determine what the policy options will be. That is why, rather than pointing to a con-

crete set of recommendations that could be carried out in each and every one of the countries of the region, our remarks are meant merely to serve as a guide for discussion of the topic, which can be dealt with in specific terms only at the national level.

Three levels of action —world-wide, regional and national— are open to the countries of the region.

#### 1. *Policy options at the world level*

It is all too well known that the economies of the periphery have very little influence on the course of the international economic situation, except in a few exceptional instances such as that of the oil-exporting countries.

It has nevertheless become obvious in recent years that the industrializing countries, by substantially increasing their foreign trade, have not only expanded their domestic production capacity but have also opened wide possibilities for imports of products from the industrialized countries. Thus, in today's world, the trading capacity of the countries of the periphery is already a significant factor for some export sectors of the industrialized countries and is thereby a dynamic factor in the international cycle.

The maintenance and especially the expansion of this import capacity of the periphery are therefore factors which have a positive influence on the policy of international reflation and cannot be ignored by the large centres.

Thus, along with considerations of international equity, which encourage and justify global negotiations aimed at achieving a new world economic order, the external dynamism of the peripheral countries is an additional element in the mutuality of interests which

should foster and inspire these negotiations. It is for these reasons that it is very much in Latin America's interest to join with the Third World countries, as indeed it is already doing, to promote a promising and constructive international dialogue.

It would thus appear to be to no one's advantage to postpone the negotiating efforts until the central economies have recovered. On the contrary, it would be beneficial for all to incorporate the growth potential of the peripheral countries into the recovery policies, especially those of Latin America.

In this context, and within the overall framework in which these negotiations will take place, two aspects will be vitally important for the region in the next few years, in view of the influence of the international economy on that of Latin America:

(a) The maintenance of smooth financial flows to support the period of transition towards a more dynamic stage within the cycle of the international economy. This is valid not only for private credit but also for that originating in public entities, since our countries' growing need for long-term investments, added to the deterioration of the external debt profile, make it necessary to resort to public capital which, even though it may not be predominant, will serve as a catalyst for the private financial sector itself and will make it possible to improve the maturity structure of the external debt. In other words, we feel that a time is coming in which the financial flows from public and private bodies must reinforce each other, and that there is room for imaginative forms of association between them which the region could use intelligently and appropriately in the present circumstances. It is for this reason that it seems important to us to include among the objectives of the programme of negotiations the strengthening of world financial institutions such as the International Bank for Reconstruction and Development and the International Monetary Fund, or regional institutions such as the Inter-American Development Bank.

(b) The opening-up of external markets to the exports of the region, particularly those of manufactures. It will not be possible to sustain the growth rate of our imports or maintain a

healthy capacity for making external payments without a concomitant step forward in our exports. In this regard, we should remember that despite the difficulties facing the expansion of world trade in 1981, the volume of exports from the region nevertheless grew by 7% that year, highlighting the fact that there is a new and more diversified productive capacity in Latin America, and that if this capacity is not used, for reasons due to external factors, both the trade and the financial capacity of the region cannot help but be affected. It is therefore important to support moves aimed at maintaining open trade policies in the industrial countries which will facilitate the efforts being made in recent years by many countries of the region to counterbalance the openness policies followed by the latter in recent years, in many cases not without high domestic cost.

Support for the global negotiations and the strengthening of the present negotiating machinery in forums such as UNCTAD, GATT, IMF and the World Bank should thus be fundamental priorities in the international action of the region. Only in this way can global interdependence be used as a clear element of support for the recovery of the world economy.

These actions will have to be complemented by determined and imaginative efforts to increase the commercial, financial and technical co-operation ties with the other regions of the Third World. This area of action, which was neglected until a few years ago, but to which the Latin American countries are now paying increasing attention, presents significant possibilities for development and diversification, especially for the more advanced economies of the region.

## *2. Policy options at the regional level*

In the present circumstances a new field is opening up for Latin American co-operation. As in earlier periods when there were difficulties in the external markets, the opportunities provided by the regional market must be vigorously developed and utilized. This market could thus become a compensating factor in the international cycle and open new and vigorous channels for regional co-operation.

The total market of Latin America is now



reaching one thousand billion dollars, while our foreign trade in goods is nearing 100 billion dollars, taking account of both exports and imports.

Perhaps the example of some specific sectors can highlight the magnitude of the opportunities for the expansion of regional trade.

The hydroelectric sector, which has high priority within regional energy policy, will require in the next 10 years about 50 turbogenerator units per year for installations of more than 100 megawatts, involving an average annual investment for this sector of nearly 9 billion dollars.

The iron and steel production capacity of the region as a whole will expand to around 55 million tons by the end of the decade. To achieve this expansion, investments of nearly 4 billion dollars per year will be required.

The expansion in cement plants already planned for the region will involve total annual investments over the decade of nearly 1 billion dollars.

Thus, in these three sectors alone, the region will have to invest nearly 14 billion dollars per year in areas of direct interest to the Latin American metal manufactures and machinery industry. There is enough industrial experience, installed capacity and experienced management in the region to deal efficiently with a significant part of this demand for products of the metal manufactures and machinery industry, and this is only one example of the sectors open to regional co-operation.

Of course, for the efficient use of the regional market clear commitments will be required on the part of governments, as well as adequate export promotion policies and dynamic initiatives on the part of the public and private entrepreneurial sectors.

It is certainly not a question of returning to outworn policies of autarky, but rather of utilizing and improving the existing regional markets in order to achieve increasing participation in them—when necessary, in association with foreign enterprises—so as to take advantage of the opportunities offered by their expansion.

In this regard, it is worth noting that some interesting initiatives for collaboration among private Latin American entrepreneurs are now

in progress. Promotion efforts underway at CEPAL have convinced us that there is a promising field for the development and consolidation of both national and regional co-operation policies. And we should certainly not overlook the efforts to stimulate the present regional integration schemes and the flexible work that can be done through the SELA machinery.

### 3. Options at the national level

As already noted, it is impossible to specify a single ideal combination of economic policies at the national level. Most of the countries of the region, however, are taking decisions on four priority fronts, in regard to which we would like to make some comments.

#### (a) *External indebtedness*

The countries of the region have been turning to external indebtedness for various reasons. In many cases they have done this in order to cover the deficit in their external accounts, which are under pressure from imported inflation, the increase in the cost of energy or the process of external openness itself. In other cases, external indebtedness has been used to shore up domestic credit markets and finance the expansion of consumption and investment. In others, finally, external indebtedness has actually facilitated the flight of capital generated by the instability of domestic policies. Thus, the assessment of indebtedness policies in each country is obviously connected with the ultimate purpose of the external debt.

The lessons of the immediate past suggest that the current levels of this debt will oblige countries to be naturally selective in the area of external indebtedness. External credit, like the reduction of reserves, is a legitimate instrument to which countries may resort at critical points in the external cycle, such as the present time. Under the present circumstances, however, both the levels to which external indebtedness has risen and its very high cost point to the need for caution in its use.

The countries of the region have realized this, and hence, through various domestic policy approaches, they have managed to reduce

their trade deficit in recent years, even at the cost of sacrificing their level of domestic activity. However, it is obvious that the seriousness and duration of the international recession will make it necessary to resort to external debt in the years to come, with the above-mentioned reservations. On the other hand, this policy option should not be a cause for excessive concern, in view of the growth potential of the region and the vigorous export capacity shown in the past ten years.

Within this context, we believe that recourse to external financing should continue to be had, with —as mentioned before— greater participation by public credit. This is especially necessary in the current situation, since it would not only improve the debt profile but also be an additional incentive for the flow of private capital into the region.

#### (b) *Tariff policies*

In general terms, many countries of the region have applied policies in recent years aimed at increasing industrial efficiency through the restructuring and gradual reduction of their external tariffs. In essence this has involved the recognition, on the one hand, of the need for the developing countries to resort to tariff policies to support their newly created industries, at the same time as an admission, on the other hand, that this protection should have limits in time, whose specific dimensions must be defined in the economic policies by laying down the rate at which the tariff adjustments will take place.

In this area, the experiences of the region have been varied and show very different degrees of intensity.

In the present circumstances, however, these policies must be reconciled on the one hand with the international economic situation and the economic policies of the centres, and on the other, with other domestic economic policies. The international economic situation has created new factors conditioning the trade reform programmes on which some of the countries of the region have embarked. The advance of protectionist trends, the extent and intensity of the industrial centres' export promotion and subsidy policies, and even the exchange rate

fluctuations themselves make it imperative to revise the policies for restructuring and reducing tariffs being applied in our countries. In other words, the pace of this reform must be realistically reviewed in the light of the trends in international trade, so as to avoid unnecessary and intolerable costs for the domestic production apparatus.

#### (c) *Exchange policy*

Tariff reform policies should be accompanied by export promotion policies which legitimately defend the new and greater competitiveness of our countries and make it possible to consolidate the gains made in this area in international markets in recent years.

The management of exchange policies and the maintenance of realistic exchange rates are of special significance in this connexion. Naturally, these are particularly necessary in countries which have made significant reductions in their external tariffs. They are all the more indispensable in the current international economic situation, in order to maintain the competitiveness of both export industries and efficient import-substitution industries. Calling for realistic exchange rates, of course, does not mean denying that the mechanisms and forms of exchange policies are highly specific and depend on the overall economic policies and other determining factors particular to each country. However, as past experience clearly shows, the decisive role of exchange policies in export promotion and diversification must not be sacrificed by using exchange parity mainly as a policy instrument for short-term stabilization.

#### (d) *Public expenditure policies*

The inflationary pressures arising from the fiscal deficit have led many countries of the region to pursue rigorous objectives of fiscal austerity, which have meant significant cuts in public expenditures, particularly in investment.

Without disregarding the fundamental role played by fiscal austerity in any anti-inflation policy, we cannot help but point out the need to

reconcile this goal with other no less important social objectives.

The use of public expenditure for social purposes, particularly the defence of investments with a high employment content or with a heavy impact on the mobilization of idle resources, cannot be set aside in these times.

It is enough to recall on this occasion, the

policies applied in many Latin American countries during the 1930s, which —without of course overlooking the differences in time and in the nature of the economic problems— left a positive aftermath of social effects and above all helped to give vigorous support to the economic and industrial infrastructure of the region in that critical period.

## Conclusions

The greater external openness pursued in recent years has opened up new possibilities to the region in respect of its economic development policy, but it has also implied new and growing forms of vulnerability.

The recent changes in the international economic situation and the prevailing uncertainty and confusion make it difficult to forecast the future course of events. It is clear, however, that no country can avoid the cost of the adjustments being imposed by the international cycle. What must be done is to mobilize domestic resources to the maximum through appropriate policies in order to moderate or spread out over time the cost of the adjustments required.

In these circumstances, the adoption of flexible and pragmatic policies seems to be the only reasonable course of action. Only in this way will we be able to use the extraordinary defence potential available to the region and surmount the difficult current situation.

In this regard, it is worth recalling some lessons we have received as a legacy from the past.

Firstly, just as in the 1930s, it is not possible to leave domestic adjustment to the automatic forces of the international market. Although the importance of this market cannot be ignored, active economic policies are required on all fronts. Leaving adjustments to the influence of the unstable and sluggish international markets would involve extraordinarily high costs, both social and economic. It should be recalled that our economies are still weak entities whose capacity for social or economic endurance are limited. In the social area, de-

fending the levels of employment or applying policies aimed at satisfying the basic needs of the population are objectives of especially high priority in the present circumstances. In the economic field, the often inevitable impact of the international cycle on the economies of business enterprises is causing serious problems for the survival of the business sectors, which must be given the opportunity to make gradual adjustments over time in their search for economic and financial equilibrium.

Secondly, and as a corollary to the above, it is legitimate and necessary to highlight the objective of combating inflation, since the profound economic and social traumas which this phenomenon has caused and is still causing in the region are well known. But this objective cannot be totally exclusive. It must fit in with other equally important aims, such as the ability to compete internationally to defend our incipient industrial exporting sector, or the need to make sufficient social expenditure to achieve basic minimum employment and consumption objectives.

Thirdly, and while fully recognizing the importance of monetary policies, the complexity of the present times and the variety of objectives that must be pursued by economic policy indicate that such policy cannot be reduced to the use of purely monetary mechanisms. What is needed is to activate all the fronts and instruments of economic policy, particularly in the fiscal area, and make sure that income policies, which are so directly linked with the principles of fairness and justice, are not sacrificed *a priori* to the urgent demands of the current situation.

In conclusion, I should like to repeat that,

although we cannot disregard the severe difficulties of the present economic situation, we in CEPAL feel cautious optimism with regard to the near future.

We have dealt on other occasions with the more general problems of the region's economic development strategy in the medium and long term: a topic which was given particular emphasis at the CEPAL session in Montevideo in May 1981 and which was crystallized in the Development Strategy for the present decade.

The fact that we have limited ourselves on this occasion to more immediate problems does not mean, of course, that we could possibly forget the objectives whose fulfilment will provide the region with a future of vigorous growth and social progress, provided that international co-operation policies are duly mobilized, that the region recognizes the enormous development potential existing in regional co-operation, and that the domestic policies adopted succeed in overcoming the obstacles of the present in a pragmatic and flexible manner.