

THE ECONOMIC CRISIS: POLICIES FOR
ADJUSTMENT, STABILIZATION
AND GROWTH



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SUMMARY

This paper analyses the changes in the external environment and in domestic economic policy that would be required in order to make the recovery and growth of the Latin American and Caribbean economies compatible with a decrease in inflation, the achievement and maintenance of a reasonable external balance and the improvement of the living conditions of the poorest groups of the population and of the opportunities open to them.

The first chapter contains a brief description of the main features and effects of the crisis which has been affecting most of the economies of the region since 1981, together with a discussion of the adjustment efforts they have made in order to reduce their external imbalances. On the domestic front, some of the main repercussions of the crisis have been a large and widespread drop in per capita income, a sharp decrease in capital formation, rising unemployment, the decline of real wages and higher inflation. In analysing the adjustment process, emphasis is placed on the extraordinary speed with which the countries of the region have been obliged to reduce the deficit on current account in their balance of payments the high social cost which, because of its speed, this process has entailed. As a result of the fact that the sharp decrease in net capital inflows since 1982 has been accompanied by a rise in international interest rates, the countries of Latin America and the Caribbean have had to generate huge trade surpluses in order to be able to continue meeting their external obligations. However, primarily because of unfavourable trends in world trade and in the international prices of most commodities, these surpluses have had to come almost exclusively from a reduction in imports, which has been of such great proportions that the adjustment has taken on a markedly recessionary character. The decrease in net capital inflows and the increase in interest payments have also given rise to a considerable transfer of resources out of the region which has adversely affected import capacity and national saving.

The second chapter provides an analysis of the challenges which the present crisis poses and the opportunities it offers as regards economic policy. It is asserted that, when viewed from these two angles, this crisis can be compared to the Great Depression of the 1930s. It is further maintained that, after having lost ground during the past five years, the economies must now be reactivated, but in order for an economic recovery to result in growth which will not soon be interrupted once again, both external imbalance and inflation will have to be kept under control. The difficulties involved in accomplishing this are considerable; the chances of overcoming them, as well as the extent of the costs this will involve, will depend partly on conditions in the world economy and

partly on the content and consistency of domestic economic policy. If most of the economies of the region are to resolve the immediate problems posed by the crisis, changes will have to be made in the adjustment process so that an external balance can be achieved or maintained in conjunction with an expansion of economic activity instead of economic stagnation or retrogression. To this end, the transfer of resources abroad will have to be reduced, since the region's limited import capacity currently represents the main constraint on its growth. Since the increases in both external financing and per capita consumption are likely to be slight in what remains of the 1980s, economic policy should place special priority on export and import-substitution activities and on measures designed to improve the quality of investments and to ensure the satisfaction of the basic needs of the poorest groups of the population.

The third chapter contains a more detailed analysis of the policies and changes required in order to overcome external constraints on growth and to carry out an expansionary and equitable adjustment process.

Firstly, policies designed to reduce external constraints by changing the structure of production and domestic spending are examined. In addition to a discussion of the fundamental role which exchange-rate policy should play in these two processes, the need is underscored for the adoption of selective tariff, para-tariff, credit and export-promotion policies that would make it possible to carry out a rapid and sustained increase in the production of tradeable goods. It is stressed that special incentives for import substitution and the production of exports should be of a temporary nature so that they will be in keeping with an efficient allocation of resources, and emphasis is placed on the differences in the selective criteria which should be used in the short and long terms in order to provide special incentives for those exports and import-substitution activities which a given country wishes to develop.

Secondly, an analysis is presented of ways to reduce external constraints on growth by means of changes in external financial relations. In this connection, the function performed by international public policy during the crisis is described and assessed. Although it is acknowledged that this policy has helped to avert the collapse of the international financial system, it is nevertheless maintained that the development of the debtor countries has been only a marginal component of the conventional strategy for dealing with the crisis and that this strategy has now run its course. Accordingly, broader public-sector initiatives should be mounted at the international level in order to reduce the transfer of resources from the debtor countries to the exterior. A detailed discussion is presented of the various multilateral mechanisms for achieving this objective, along with a comparative analysis of the effects which the following steps would have on the region's net external financing: a) lowering interest rates and the spreads charged by private international banks, b) increasing the net inflow of loans, c) increasing the flexibility of banking regulations in creditor countries, d) modifying the conditionality imposed by commercial banks and the International Monetary Fund in debt negotiations, and e) reducing certain obstacles which limit the adoption of broader multilateral initiatives. The various unilateral steps which debtor countries could take to diminish the transfer of resources to the exterior are then analysed and evaluated.

The chapter closes with an analysis of the relationship between the adjustment and social equity. Following a description of the deterioration in the social situation caused by the crisis, three policy packages are examined which could help to improve the situation of the poorest groups and to increase the opportunities available to them. To this end, and bearing in mind the constraints to which many countries will be subject as regards the expansion of public spending in coming years, it is recommended that such spending be systematically restructured so that it is oriented towards items which will benefit the neediest strata on a preferential basis. Furthermore, it is recommended that procedures should be applied to minimize the "leakage" of social spending to less needy groups and that greater stress should be placed on increasing employment than on raising wages.

The fourth and final chapter includes a discussion of the most suitable policies for reconciling the control of inflation with the maintenance or expansion of economic activity. Firstly, the causes and analytical implications of the failure of traditional stabilization programmes are analysed. The costs of inflation and the risks of stabilization are then examined in relation to the intensity and duration of a given inflationary process. The conclusion is reached that, whereas the costs of inflation are greater when there is a sudden and unexpected outbreak of inflation or when the economy is slipping towards hyperinflation, the risks of a stabilization programme causing a recession are greater when the country is dealing with persistent but relatively stable inflation. Using this classification, an analysis is made of the different relative roles played by the guidance of expectations, the control of aggregate demand and the correction of price lags in stabilization programmes directed towards combating occasional inflation, persistent inflation and hyperinflation. Lastly, a number of the approaches and general principles applied in stabilization programmes as regards policies on prices, income and the control of aggregate demand are described and discussed, and the preferable sequence for efforts to achieve external adjustment and domestic stabilization in the presence of inflationary processes of varying intensities is analysed.

I. THE ECONOMIC CRISIS AND THE ADJUSTMENT PROCESS

A. THE ECONOMIC CRISIS

Since 1981 most of the Latin American and Caribbean countries have been suffering from the deepest and longest economic crisis to hit them in the last 50 years. Indeed, they have lost so much ground that, from the standpoint of development, it is probable that the 1980s will turn out to be a "lost decade" for many of the region's economies, in more than a few of which per capita income may prove to be substantially lower in 1990 than it was in 1980.

The present crisis has also been widespread and multi-faceted, as well as severe and long. Although its repercussions have been more serious and longer-lasting in some countries than in others, it has affected the large as well as the medium-sized and small economies of the region, oil-exporting countries as well as those which are wholly dependent on imports for their fuel supplies, economies which had made relatively more progress towards development as well as the poorest countries with the least diversified structures of production, and countries which have applied more interventionist policies oriented towards the domestic market as well as those which have followed development strategies based on an opening-up of their economies and on the free play of market forces.

The exceptional nature of this crisis has also been manifested in the simultaneous and persistent deterioration which has been seen in the main economic indicators. Many countries have experienced not only a drop in production or in their rate of growth, but also a deterioration of the employment situation and a decrease in real wages. Moreover, inflationary processes have intensified and become more widespread, and the problems of the external sector have become more severe.

As may be seen in table 1, the growth rate of domestic product dropped sharply in 1981, while the product actually decreased in absolute terms in 1982 (for the first time in 40 years), and then declined once again, but even more markedly, in 1983. Although this downturn was interrupted in 1984, the increase in economic activity was slight in that year and it grew still weaker in 1985: the per capita product rose by less than 1% in 1984 and by scarcely 0.5% in 1985. Furthermore, this last increase was almost entirely due to the rapid growth of the Brazilian economy, which alone accounts for around one-third of the region's production of goods and services and which expanded by over 8% in

1985 (see table 2). In contrast, the per capita product in the rest of the region declined by somewhat more than 1% in 1985 after having dropped steadily between 1981-1983 and stagnated in 1984. Thus, in Latin America and the Caribbean as a whole, the per capita product was 9% lower in 1985 than in 1980 and was only equivalent to its 1977 level.

Since at the same time the terms of trade showed a sharp and persistent deterioration and net remittances abroad of interest and profits rose considerably, per capita national income (which is a better indicator of the current standard of living) dropped by even more (-14%) than the per capita product (see table 1).

The unfavourable trend of economic activity has also been quite widespread: during the past five years, there has been a notable decrease in the per capita product in 21 of the 24 countries for which information is available,¹ almost no variation in Colombia and Panama, and a considerable increase only in Cuba. Moreover, in many countries this decrease has reached colossal proportions: during this period the per capita product fell 28% in Bolivia and 24% in El Salvador, between 22% and 18% in Venezuela, Guyana, Uruguay, Argentina and Guatemala, and between 15% and 11% in Peru, Trinidad and Tobago, Costa Rica, Haiti, Honduras and Nicaragua (see table 3).

The decline in economic activity has had a particularly strong effect on capital formation, which, after having grown very rapidly between 1970 and 1980, stagnated in 1981, fell steeply during the two following years and showed only very slight growth in 1984. This brought the investment coefficient to its lowest level in the past 40 years. Furthermore the decline was very widespread. As may be seen in figure 1, between 1980-1981 and 1982-1984 gross domestic fixed capital formation increased slightly only in Colombia and Nicaragua, while it showed a very sharp decrease in the other 17 economies for which data are available. Hence, in addition to affecting present living conditions, the crisis has also lessened the possibility of securing a rapid rise in the standard of living in the future.

As was to be expected in view of the rapid growth rate of the labour force, the decline in economic activity has been coupled with a sharp rise in open unemployment and an increase in various forms of underemployment. In fact, despite the decrease in unemployment seen during the last few months of 1985 in most of the region's cities, Brazil was the only country in which the average unemployment rate was lower in 1985 than it was in 1980. In contrast, over the past five years open unemployment has risen moderately in Costa Rica and Mexico and very sharply in Argentina and Bolivia, Chile, Colombia, Honduras, Uruguay and Venezuela. The deterioration in the employment situation was also reflected in the substantial drop in employment in manufacturing industry (see tables 4, 5 and 6 and figures 2 and 3).

The harmful social effects of the deterioration in the employment situation were also exacerbated by a significant decrease in average real wages in most of the countries for which information is available.² As shown in figure 4, in 1985 the purchasing power of average urban wages was higher than it had been in 1980 only in Argentina, Brazil and Colombia, and even in those countries it was lower than it had been in 1974, 1982 and 1984, respectively. In the past five years average real wages have dropped by around 7% in Costa Rica and

Chile, 12% in Uruguay, 27% in Mexico and 43% in Peru. The poor have also been hurt by the even more unfavourable trend in minimum wages in a number of countries and by the cuts in social spending made by many governments with a view to reducing their fiscal deficits.³

Despite the increase in unemployment and the drop in real wages, and notwithstanding the easing of some exogenous inflationary pressures, the rate of price increases has risen in most of the economies of Latin America and the Caribbean during the crisis. In the region as a whole, the annual average variation in consumer prices climbed steadily from 27% in 1980 to 440% in 1985, while the population-weighted rate went up from 56% to 275% during the same period (see table 7). Even though the extraordinary acceleration of inflation in Bolivia (whose annual rate rose from 24% in 1980 to 8 170% in 1985) played a large part in these increases, the rise in inflation for the rest of the region was nonetheless quite substantial.

Inflation, which affected only a small number of Latin American and Caribbean countries until the beginning of the 1980s, has become more widespread as well as more intense. Indeed, Barbados, Honduras, Panama, Trinidad and Tobago and Venezuela are the only countries in which consumer prices rose less than 10% in 1985. In all the other countries except Costa Rica, the rate of inflation was significantly higher: it reached enormous proportions in Argentina (385%), Nicaragua (335%), Brazil (228%) and Peru (158%) and was also very high in Uruguay (83%) and Mexico (64%) (see table 7 and figure 5).

Nonetheless, a number of countries in the region have made significant progress in their fight against inflation since mid-1985. As may be seen in figures 6, 7 and 8, particularly notable advances in this respect have been made by Bolivia and Peru and, above all, Argentina. Inflation had speeded up sharply in these countries during the first six or nine months of the year, but the initiation of unconventional stabilization programmes brought about a sharp reversal in this trend.⁴ The progress made in the fight against inflation during the second half of 1985, although much less striking than in the above three countries, was also substantial in Chile, Colombia, Costa Rica, Ecuador and Venezuela, as shown in figure 9.

B. THE ADJUSTMENT PROCESS AND THE TRANSFER OF RESOURCES ABROAD

In general, the unsatisfactory picture with respect to production, employment and domestic prices has been closely related to the highly unfavourable changes which have occurred on the international economic scene and to the adjustment processes that many Latin American and Caribbean countries have embarked upon since 1982 in an attempt to rectify the huge external imbalance which had built up during previous years.

Indeed, although the generation and development of the crisis have been greatly influenced by a wide range of domestic economic, political and social factors —both structural and cyclical in nature—⁵ external factors have had a particularly decisive impact.

The main factors which set off the crisis, after several years of increasing deterioration in external demand, were the abrupt decrease in net capital inflows which occurred in 1982 and the huge increase registered at the same time in net external payments of profits and interest. As may be seen in table 8, this twofold process was of extraordinary proportions. The net intake of loans and investments, which had been rising sharply and steadily during almost the whole of the 1970s, reaching an unprecedented high in 1981 of over US\$ 37 billion, fell to less than US\$ 20 billion in 1982. At the same time, net remittances of interest and profits climbed from US\$ 27 billion in 1981 to nearly US\$ 39 billion in 1982. As a result of these changes, and despite a merchandise trade surplus of over US\$ 9 billion, the deficit on current account remained above US\$ 40 billion in 1982. Unlike what had occurred in preceding years, however, the very steep drop in the inflow of external loans and investments and the serious flight of capital from some countries of the region meant that over half of the deficit on current account had to be financed by means of a considerable reduction in international reserves (see table 1).

Thus, faced with a deficit on current account which was equivalent to 40% of the value of its exports of goods and services and which, under the new circumstances, could no longer be financed by the net inflow of loans and investments, the region was forced to embark upon an adjustment process. To this end, many Latin American and Caribbean governments have applied—to varying degrees of intensity and using different methods—the two groups of economic policies which are theoretically necessary in order to carry out an adjustment process and which comprise, basically, measures designed to control aggregate demand (e.g., fiscal, monetary and income policies) and those aimed at raising the relative price of internationally tradeable goods (e.g., exchange-rate, tariff or export promotion policies).⁶ In some countries these policies have been coupled with public investment programmes and other government measures whose direct purpose is to step up the substitution of certain imports which have played a major part in the foreign trade deficit.

Adjustment policies have often been carried out within the framework established by loan agreements reached with the International Monetary Fund. These agreements have contained restrictive monetary and fiscal provisions which usually place a limit on the expansion of the Central Bank's net internal assets as well as on external and domestic public-sector borrowing. Furthermore, they have stipulated that the government must reduce its deficit by raising taxes, increasing the rates charged by public-sector enterprises and cutting current expenditure. Within the framework of these agreements, it has usually been accepted that during the adjustment process it is necessary to raise the real exchange rate, reduce real wages and maintain interest rates that are positive in real terms.⁷

To be sure, the strictness and persistence with which the agreed-upon policies have actually been applied have varied from one country to another, as has the extent to which these policies have been successful in achieving their basic objectives. Nevertheless, in terms of the region as a whole, the reduction in the external imbalance has been achieved with extraordinary speed. As early as 1982 a sharp turnabout was achieved in the merchandise trade balance of Latin America: after running a deficit of US\$ 1.7 billion in 1981, the region marked up

a surplus of over US\$ 9 billion in 1982. This trend grew stronger in 1983 when the trade surplus exceeded US\$ 31 billion and continued in 1984, when a record merchandise trade surplus of nearly US\$ 39 billion was achieved. Mainly as a result of these changes in the trade balance, the deficit on current account plummeted in both 1983 and 1984: in 1984 it amounted to no more than US\$ 1 billion, which was only 2.5% of the enormous deficit of over US\$ 40 billion recorded just two years before. Even though the deficit on current account rose in 1985, at approximately US\$ 4.4 billion it was still much lower than the deficits recorded before adjustment policies began to be applied (see table 1).

However, because of the way in which it was achieved, this marked reduction in the deficit on current account had a high cost in terms of the decrease in economic activity and employment. The sudden and drastic nature of the decrease in external financing and the sharp increase in interest payments meant that the time span during which adjustment had to be carried out was extremely short and, because of this, it was not possible to carry out an adequate reallocation of resources from the production of internationally non-tradeable goods to export activities and import substitution, since this is a process which, precisely because it requires a substantive change in the structure of production, can only be accomplished over a longer period of time. In these circumstances, the region had to take extremely rapid action to reduce an external deficit which was much larger than it would have been under more normal external financial relations. In fact, in addition to making the "normal" adjustment required in order to correct the excessive deficits on current account which many Latin American countries had incurred during the years leading up to the crisis, they also had to carry out what might be called an "overadjustment" in order to deal with the repercussions of the pro-cyclical behaviour of the international commercial banks and, in some countries, the considerable outflow of national capital. Due to this situation and to the highly unfavourable external environment for the region's exports, virtually the entire burden of correcting the huge external imbalance of Latin America and the Caribbean initially had to be shouldered by imports, whose drastic reduction gave the adjustment a markedly recessionary character. Until 1983 the expansion of exports was also limited by the sharp decline in the international prices of most of the region's main export commodities and by the decrease in the volume of world trade occasioned by the long recession in the industrialized countries, the increase of protectionist practices in many of them, and the slowdown of the economies of the OPEC member countries. As a result, and despite the fact that (as shown in figure 10) the volume of exports of goods continued to rise rapidly, their value fell 9% in 1982 and showed no growth in 1983.

Thus, the spectacular change (amounting to US\$ 33 billion) seen in the merchandise trade balance between 1981 and 1983 was due in its entirety to the steep drop in imports. Their value plunged from nearly US\$ 98 billion in 1981 to US\$ 56 billion in 1983, while the volume of imports shrank during this brief period of time by an almost unbelievable 41%. The drop in import volume was even greater in Argentina and Chile (where it was halved between 1981 and 1983), Venezuela (where it went down by 47% in 1983 alone) and especially in Uruguay (which reduced its imports in real terms by over 63% in the period 1981-1983) and Mexico (which cut its imports by nearly 67% in the period 1982-1983).

Although these spectacular reductions were partly due to the unusually high pre-crisis level of imports, the decreases not only affected external purchases of non-essential consumer goods and capital equipment, but also included a considerable drop in imports of raw materials and intermediate goods necessary for the maintenance of domestic economic activity. It should thus come as no surprise that the domestic product stagnated or declined in many countries as early as 1982, or that another and even greater decrease was seen in 1983.

There was a lull in this highly adverse trend in the foreign trade of Latin America and the Caribbean during 1984 when, as a result of the recovery being made by the industrialized economies and, above all, the enormous increase in United States imports which was seen that same year, the volume of world trade expanded at a satisfactory rate for the first time since 1979. In response to this more favourable external environment and the higher level reached by the effective real exchange rate in many countries as from 1982, the volume of the region's exports climbed by around 7% (although there were substantial differences between individual countries) and their value slightly exceeded its pre-crisis level. Moreover, for the first time since 1981, the greater volume of exports was coupled with an increase in the volume of imports. However, this increase was very slight (5%), was concentrated in a few countries (Mexico, Venezuela, Costa Rica, Chile, Ecuador and Guatemala) —most of which had seen an enormous drop in the volume of their imports during the preceding years— and was followed by a slight decline in import volumes in 1985. Import volumes have thus remained far below their 1981 levels in all the countries of the region except Colombia and Paraguay, and the volume of merchandise imports of Latin America and the Caribbean as a whole during 1985 was still 38% below its 1981 level.

The spectacular turnabout seen in the region's trade balance between 1981 and 1985 was in sharp contrast to the stability displayed by net payments of interest and profits. These remittances, after having climbed steeply since 1978 to an all-time high of nearly US\$ 39 billion in 1982, fluctuated around US\$ 35 billion during the three following years: double their average during the four-year period preceding the crisis (see figure 11).

This huge increase and the even more pronounced decrease in net capital inflows which coincided with it produced a drastic change in the net result of foreign financial transactions from 1982 onwards. Until 1981 the total amount of loans and investments coming in from outside the region was well in excess of the sum total of remittances of interest and profits on foreign capital. The net result of these financial flows was therefore favourable to the region and allowed it to acquire goods and services from abroad which were worth considerably more than its exports. Due to the pro-cyclical behaviour of the private international banks and the simultaneous rise in interest rates, however, the relationship between these two financial flows underwent a reversal in 1982, so that in that year, for the first time in recent history, Latin America had to transfer abroad resources amounting to the considerable sum of nearly US\$ 19 billion (see figure 12).

The problem grew worse in 1983, when the positive effect of a slight decrease in remittances of interest and profits was more than offset by another

sharp decline in net capital inflows; the difficulties eased only very slightly in 1984, as a result of the partial recovery in net inflows of loans and investments, and in 1985 the situation grew more serious once again, with the net inflow dropping off sharply. Thus, during the past four years the region has transferred resources amounting to over US\$ 100 billion to the exterior, between factor payments and amortization of the debt.

This figure—which is equivalent to nearly a quarter of Latin America's exports of goods and services during this period— fails, however, to give an adequate idea of the magnitude of the reversal brought about by the sharply reduced capital inflows and bigger interest payments in the region's import capacity. Whereas the positive difference between the net inflow of capital and payments of interest and profits *added* an amount equivalent to nearly 16% of the region's exports of goods and services to its import capacity in the four-year period 1978-1981, the negative difference between these two financial flows *subtracted* an amount equivalent to approximately 26% of the region's external sales of goods and services from its import capacity during the four-year period 1982-1985 (see table 8). The change occurring for this reason between the two periods in question was therefore equivalent to a deterioration of 42% in the terms of trade.

The change has been even greater in Argentina, Brazil and Venezuela, and, above all, in Chile, Mexico and Uruguay, as may be seen in figure 13. It has been less intense, but nonetheless appreciable, in Ecuador and Bolivia. Although the decline in net capital inflows and the increase in interest payments have not been great enough to reverse the direction of the transfer of resources in Colombia, Costa Rica, the Dominican Republic and Paraguay, they have nonetheless played a part in sharply reducing the net contribution of financial operations to these countries' import capacity, compared with the situation before the crisis.

The only countries in which the relative contribution of financial operations to import capacity has not only remained positive but even increased during the crisis are Haiti, El Salvador and Nicaragua (see figure 13).

The financing of most of the interest payments by generating big trade surpluses has not only affected the region's growth rate as a result of the sharp cutback in imports, but has also meant that a considerable proportion of its domestic savings have been transferred abroad during the past four years.

This transfer, in addition to playing a part in reducing domestic investment, has also lowered the proportion of such investment which is financed with national saving, thus giving the impression that less effort is being made to save. Actually, just the opposite has occurred in many countries of Latin America and the Caribbean since, at the same time that national saving has declined, domestic saving proper has increased. As is well known, it is the latter (which, in statistical terms, corresponds to the difference between the domestic product and total consumption when both are valued at constant prices) which actually measures the sacrifice made by the community in terms of forgone current consumption in order to save. Therefore, the fact that the coefficient of domestic saving has increased despite the decrease or stagnation of the total product shows that the saving effort made by the region, far from having ebbed (as, at first glance, the decrease in the portion of investments financed by national saving would appear to suggest), has actually increased. The divergent

trends of these two coefficients do, however, provide an illustration of yet another way in which the unfavourable evolution of external factors has affected the development of the Latin American and Caribbean countries. Owing to the combination of the rise in interest payments and the serious deterioration in the terms of trade, a considerable portion of the region's saving has been transferred abroad, thereby leaving a smaller proportion available for financing domestic investment and thus limiting both the pace and the autonomy of the growth process.

II. THE CHALLENGES OF ECONOMIC POLICY

A. THE CRISIS: A CHALLENGE AND AN OPPORTUNITY

As we have seen, over the past four years the Latin American and Caribbean countries have paid an enormous cost for reducing the considerable external imbalance with which they were faced in 1981: in the region as a whole, per capita national income was 14% lower in 1985 than it was in 1980, and in some countries it fell to the levels it had reached a generation ago; inflation has hit record levels in more than a few economies, and most of them have seen a deterioration in the employment situation and a considerable drop in real wages. Since there has been a very sharp decrease in capital formation during the same period, the crisis has also compromised future levels of consumption and well-being. The impact of the crisis has been made even more serious by its exceptional length, since the deterioration in the living conditions of vast sectors of the population in many countries has consequently been long-lasting as well as acute.

Under these conditions, the need to reactivate the region's economies and to resume the growth process is becoming increasingly urgent, since it will otherwise be impossible to raise employment, wages and investment from their currently depressed levels.

Nonetheless, the recovery of economic activity, although essential, is not of itself enough to ensure sustained and socially satisfactory economic process. In order for a reactivation to result in growth that will not soon be interrupted once again, both external imbalance and domestic inflation will have to be kept under control. Moreover, if the expansion of the economy is to represent more than merely a return to the pre-crisis development pattern, measures will have to be adopted which will gradually but steadily lay the foundations for a more autonomous, efficient and equitable style of development.

In many ways, these tasks pose a challenge which has no equal in the history of the region save for that which the countries faced (for the most part, successfully) during the period between the beginning of the Great Depression and the end of the Second World War. If they manage to meet this new challenge, then the present crisis—even though it has been a period of economic and social regression—will also have provided an opportunity for the introduction of major reforms in the prevailing development pattern, thus playing a role similar to that which the depression of the 1930s performed in replacing the primary exporter model with industrialization based on import substitution.

This is an enormously complex task. The difficulties it entails stand out particularly clearly when it is considered within the context of the severe constraints which the crisis and its aftermath have placed on the future development of the Latin American and Caribbean countries. At least until the end of the 1980s, the expansion of many of these countries will be held back by the heavy debt burden which they incurred in the period up until 1981 and by the reluctance to increase net loans to the region which private commercial banks have shown since that time. These two phenomena will place severe limitations on import capacity, which currently represents the main constraint on economic growth in most of the Latin American and Caribbean countries. In the immediate future, economic growth will also be restricted by the extremely low level to which, as already noted, fixed capital formation has fallen in recent years and (in more than a few countries) by the limitations which stabilization programmes and the need to reduce the fiscal deficit will place on any increase in public investment.

It is also clear that the chances of successfully meeting this challenge and the extent of the costs involved will depend, in part, on the conditions prevailing in the world economy and, particularly, on future trends with respect to the volume of world trade, commodity prices, international interest rates and international capital flows.

These are variables over which national economic authorities have very little influence. Hence, notwithstanding the individual or joint efforts they may bring to bear in an attempt to make the external factors affecting the development of the region more favourable, such development will also depend to a great extent on the content and coherence of domestic economic policy. In most of the countries of the region, the authorities will have to deal in the coming years with a series of long-standing economic and social problems whose severity has been vastly increased by the crisis. Moreover, in tackling these problems, they will have a much lower level of external resources at their command than they did during the preceding decade. Thus, the fundamental challenge which they will have to overcome will be, in an almost literal sense, to "do more with less".

Certainly, the various objectives of economic policy will carry different relative priorities in the various countries of the region, just as they may also differ, in the short and medium term, within a single country. Be that as it may, one vital task for many of the countries in the next few years will be to change the adjustment process in such a way that the achievement or preservation of external balance can take place within a context of economic expansion rather than stagnation or retrogression, as has occurred up until now.

B. CHANGING THE ADJUSTMENT PROCESS

The adjustment process upon which the region embarked in 1982, although rapid and effective if evaluated from the standpoint of its specific objective (i.e., the reduction of the deficit on the balance-of-payments current account), has been enormously costly in economic and social terms. The fact is that in most cases the "over-adjustment" which the Latin American and Caribbean countries have had to make has been based almost exclusively on a reduction in the volume

of imports which, because of its extraordinary proportions, has inevitably affected domestic levels of production, employment and wages.

It is therefore clear that this approach to adjustment has run its course; in future, policies will have to be implemented that will make the achievement or maintenance of external balance compatible with reactivation and economic growth. In order to achieve these objectives, however, it will be necessary to modify the nature of the adjustment process so that its pivotal element will no longer be the indiscriminate reduction of domestic spending but rather a rapid expansion of the exports and import substitutes.

This will require that two general conditions be met: firstly, the reduction of the huge foreign transfer of resources which the region has been making in recent years, and secondly, the reorientation of domestic economic policy with the twofold purpose of promoting growth and structural changes in production and of improving the present situation and the future outlook for the poorest and most vulnerable groups of the population.

1. Reducing the transfer of resources abroad

At present, the region's limited import capacity constitutes the main constraint on its economic recovery and growth. The truth is that in most of the countries the shortage of foreign exchange currently represents a more serious limitation than does the insufficient level of domestic saving. Thus, despite the existence of underutilized capital and labour resources (which could be employed in the production of tradeable goods, thereby reducing the external imbalance), they cannot be fully exploited because the shortage of foreign exchange makes it impossible to purchase the necessary volume of complementary imported inputs. The social productivity of foreign exchange is greater under such circumstances than it is when the economy is operating at full capacity, because a greater supply of imports makes it possible to increase not only domestic spending but also production and saving.⁸

It is therefore crucial for the Latin American and Caribbean countries to increase the amount of foreign exchange that can be used to buy imports. To this end, particularly in the short term, the transfer of financial resources abroad must be reduced so that a greater amount of foreign exchange can be used to increase imports of basic inputs and capital goods, which will then make it possible to expand domestic economic activity as well.

The best way of diminishing the transfer of resources is by reducing the very large interest payments which the Latin American and Caribbean countries have to make on their external debt.⁹ As may be seen in table 9, during the past four years these remittances have absorbed around 36% of the total value of the region's exports, which is double the percentage they represented before the crisis. Hence, if these payments could be reduced, it would then be possible to increase external purchases significantly without producing any increase in the deficit on current account. Furthermore, if the decline in interest payments were the result of a drop in international interest rates, of a decrease in the spreads charged to the Latin American and Caribbean countries or of specific agreements reached between them and their creditors, then the reduction in the transfer of resources and the ensuing reactivation of the economy could be achieved without

expanding the external debt, and would therefore have the additional advantage of not jeopardizing future import capacity.

Even so, in order for sustained economic growth to be resumed in the short term in most of the countries of the region, more external financing will also have to be made available. Naturally, the supply of such financing will have to be still greater if real interest rates remain at their present high levels or show a tendency to rise.

Although this method of reducing the transfer of resources is less desirable than that of decreasing the region's interest payments, since it would mean that greater import capacity would be achieved at the cost of an immediate increase in the external debt or in the cumulative amount of foreign investment (which would entail higher payments of principal and interest and profit remittances in the future), it is nonetheless worthwhile for four main reasons.

The first advantage of an increase in external financing is that it would make it easier to change the nature of the adjustment process which has been carried out thus far. As already noted, this process has been taking place under extremely adverse external conditions, particularly with respect to the availability of financing. Indeed, the very steep and sudden drop in net capital inflows was the factor which forced the economies of the region to reduce their deficit on current account with such extraordinary haste. Because of this, adjustment had to be carried out primarily by means of a sharp reduction in domestic spending and imports rather than through an increase in the production of internationally tradeable goods. This latter method —although socially and economically preferable, since it allows the external imbalance to be reduced while domestic economic activity is maintained or even increased— works more slowly than the former because it means that resources must be transferred from the production of non-tradeable goods to the production of exports and of import substitutes. Therefore, unlike policies designed to bring about an adjustment by reducing domestic spending, it can be geared only to a gradual —not a swift— reduction in the deficit on current account. Precisely because of this feature, it requires a significant, although decreasing, amount of external financing.

The second reason why a greater net capital inflow would be advantageous is that it would help to raise domestic investment, which, as mentioned earlier, has fallen to extremely low levels during the crisis. Because of this, and despite the fact that in the short run it would be possible to increase production significantly through a fuller and more efficient utilization of existing installed capacity, an increase in investment is an essential prerequisite if a more rapid rate of economic growth is to be achieved and maintained in coming years. Obviously, increased investment would also require increasing saving. In order to reinforce the autonomy of the development process, and ever-increasing proportion of such savings should come from domestic sources. In many countries, however, this goal will be difficult to achieve in the immediate future since, due to the very substantial decreases in real wages and government social spending which took place during the crisis, the pressure for an increase in consumption on the part of the majority groups of the population is very strong at present. For this reason, as well as basic ethical considerations, it is highly unlikely that such pressure could be ignored once the growth process has been

resumed. Under these conditions, it is probable that the increase in the domestic rate of saving which would be socially and politically attainable would initially be lower than the increase in the investment coefficient which would be required in order to speed up the rate of economic growth to a satisfactory pace. In order to step up the growth of the economy, especially during the first few years, it would therefore be essential to increase the region's net inflow of capital.

The third reason why a greater net intake of external loans and investment would be beneficial is that it would finance a larger portion of interest remittances and thus make it possible to reallocate part of the foreign exchange earnings from exports now being used for that purpose to the purchase of additional imports, which would have a favourable effect on domestic production levels.

Finally, the fourth reason is that greater external financing would make it possible to reverse the process whereby the region's *real* external debt has been steadily reduced since 1984. While it is evident that the countries of Latin America and the Caribbean should gradually reduce their debt/exports and debt/product coefficients in order to achieve a more autonomous form of economic development this does not mean that they must also reduce the absolute value of their external debt in real terms; furthermore, it would be patently absurd to oblige them to do so just when they are facing the deepest and longest crisis to hit them in over half a century. Hence, at the very least, net external financing should increase at a rate similar to that of world inflation.

2. Reorienting domestic economic policy

The reduction of the transfer of resources abroad, although essential, would not in itself be enough to ensure the achievement or maintenance of external balance in a manner compatible with the sustained growth of economic activity. This would be the case particularly if the decrease in the transfer of resources were to stem from an increase in net capital inflows, since a greater intake of loans and investment would soon give rise to additional external obligations in the form of increased payments of interest and profits. Hence, although it would help to ease external constraints in the immediate future, it would tend to heighten them in the medium term, at least until enough time passed for the investment of such resources to result in an increase in exports or in the production of import substitutes. Thus, the ultimate effect of a greater net inflow of capital depends, when all is said and done, on how such resources are utilized. If new loans are used to finance an increase in consumption, the production of non-tradeable goods or capital flight (as occurred in a number of cases during the period of financial permissiveness which preceded the crisis) this will exacerbate external constraints on development. Such constraints will be diminished, however, if the resources are used to increase investment, expand exports and augment import-substituting production.

a) *Priority for the production of tradeable goods*

Therefore in order to overcome external constraints once and for all, in addition to reducing the net transfer of resources it will also be essential to orient domestic economic policy in such a way that it stimulates a rapid and sustained

expansion of the activities involved in the production of tradeable goods and a gradual but steady rise in domestic saving. These changes are indispensable because external constraints on growth in many countries of Latin America and the Caribbean primarily stem from the very high ratio which currently exists between the level of the external debt, on the one hand, and the value of exports and the domestic product, on the other. Therefore, unless there is a considerable drop in international interest rates or a marked improvement in the terms of trade, external constraints can only be reduced if domestic production and, particularly, export and import-substitution activities expand more rapidly than the external debt.

A rapid increase in the production of tradeable goods is also essential if external balance is to be compatible with a sustained expansion of economic activity. This is because, in the expansionary type of adjustment advocated, the reduction of the deficit on current account or its maintenance within tolerable limits should be based on the more rapid growth of exports and import-substituting activities rather than on cuts in domestic spending, which have frequently been the key component of the recessionary adjustment processes carried out in many of the countries of the region thus far. Hence, although it may be necessary to keep domestic demand—and especially spending on tradeable goods under control—the core element of an expansionary adjustment programme must be formed by a package of measures designed to raise the level and modify the structure of domestic production.

To this end, given the existence of underutilized capacity in some production activities involving tradeable goods, what is required in the short run is to provide special exchange, tariff, tax and credit incentives to these subsectors in order to put their resources to use in the production of exports and import substitutes. As will be explained in greater detail in the following chapter, when the main constraint on economic activity is a shortage of foreign exchange, two of the main objectives of economic policy should be to expand import capacity and to assign the available foreign exchange in such a way as to maximize the use of existing installed capacity. In the short term, this means that the importation of intermediate inputs (especially those required for the production of tradeable goods) should be given preference above all over the acquisition of non-essential consumer goods and, to a lesser extent, over that of capital goods. With respect to the latter, preference should be given to those capital goods which will eliminate critical bottlenecks in export or import-substituting activities, as a means of paving the way for a rapid increase in the country's ability to generate or save foreign exchange.

In order to facilitate an expansionary adjustment, credit policy should be deliberately designed to promote the production of tradeable goods while at the same time helping to limit the domestic demand for such merchandise. Although reducing an external imbalance often requires that the overall growth of loans be restricted, this limitation should not be applied equally to all activities. One situation which often arises and which should particularly be avoided is when, in an effort to meet an overall quantitative credit target, large cutbacks are made in the support provided to companies which, in net terms, generate or save a substantial amount of foreign exchange. Such a policy may not only lead to a slump in economic activity, but also runs counter to the prime

objective of an expansionary adjustment process, i.e., to reduce the deficit on current account by bringing about a more rapid expansion in production than in the demand for tradeable goods.

These measures, whose purpose is to direct as much as possible of the output that can be produced with the existing installed capacity towards exports and import-substitution, should be backed up by a systematic reorientation of investment towards these activities. Indeed, this reallocation of capital expenditure is the factor which will ultimately bring about the structural changes in production that are needed in order to permanently overcome external constraints. Moreover, along with an increase in domestic saving, this reshaping of the production structure is an essential factor in reducing the region's dependence on external financing in the medium term and, as a result, increasing the autonomy of the development process.

Brazil's experience following the first oil crisis is enlightening in this regard. Faced with a sharp deterioration in its terms of trade as a result of the increase in international oil prices, in the mid-1970s Brazil embarked upon an ambitious investment programme aimed at reducing its dependence on fuel imports, providing substitutes for other imports which weighed heavily in its trade balance, and expanding its exports. These investments were facilitated by the ample supply and low cost of external financing at the time. This financing also covered the large deficit on current account which Brazil had built up in its balance of payments during this period. At the same time, however, these investments were paving the way for a permanent reduction in its external imbalance. The possibility of accomplishing this began to take a more concrete form in 1982 when some of the large investment projects started to mature. As a result of this and of the relatively orthodox adjustment policy applied in 1982-1984, the country saw a spectacular turnabout in its trade balance, which went from a deficit of US\$ 2.8 billion in 1982 to a surplus of US\$ 11.3 billion in 1984. Therefore, both in 1984 and in 1985 (when the country again marked up a huge merchandise trade surplus) it was possible to use this surplus to finance all of Brazil's interest payments while, at the same time, the economy was expanding forcefully. Thus, thanks to the rapid growth of the production of tradeable goods, the country was able not only to combine very rapid economic growth with the balancing of its external accounts, but also to reinforce the autonomy of its development process.¹⁰

b) *Emphasis on the quality of investments and the consumption of essential goods*

For the reasons given above, most of the Latin American and Caribbean countries may achieve only modest economic growth during what remains of the decade. This state of affairs will make it even more difficult than in the past to resolve the traditional dilemma posed by the need to decide whether more resources should be allocated to the expansion of consumption or to an increase in investment. Under these circumstances, special attention will have to be devoted to measures designed to increase the utilization of existing capacity, improve the allocation of investment and, in general, raise the productivity and efficiency of the economic system. In view of the fact that in the immediate future the supply of resources available for increasing capital formation will

grow more slowly than it did in the 1970s, and because of the sharp decrease in investment that occurred during the crisis, the expansion of economic activity will depend much more than it did before on the quality of the new projects which are undertaken and on the efficiency with which existing production facilities and human resources are utilized. Stress will have to be placed on means of raising productivity and augmenting the value added to natural resources through the increased processing of raw materials, so that the Latin American and Caribbean economies can be more competitive at the international level and so that they can expand and diversify their exports and so reduce their still-excessive dependence on commodity exports.

Given the slow rate at which economic growth is likely to proceed and the efforts that will be required in order to raise domestic saving, the increase in per capita consumption is also going to be slow in coming years. Under such circumstances, the composition and distribution of increases in consumption are of fundamental importance. Unlike what occurs when total consumption is expanding rapidly—in which case it is possible for all groups (including the poorest) to enjoy a considerable improvement in absolute living standards even if the distribution of total consumption is becoming more unequal—in a situation of austerity such as that which will probably exist in the next few years, an uneven distribution of the increase in total consumption would tend to produce a deterioration in absolute terms in the living conditions of the poorest groups of the population. Such a situation would be ethically unacceptable, especially in view of the fact that in many countries these are the groups which have borne the brunt of the crisis and of the adjustment and stabilization policies applied in recent years. Therefore, just as emphasis will have to be placed on the quality of new investments in the case of capital formation, likewise, in respect of consumption, priority will have to be given to its proper distribution and, particularly, to the satisfaction of the basic needs of the poorest and most vulnerable sectors of the population. To this end, the increase in total wages will have to come primarily from an expansion in employment rather than from wage rises,¹¹ while social spending will have to be maintained or increased and policies in the areas of health, nutrition, education, housing and social security will have to be restructured in such a way as to ensure that they truly benefit the poorest groups on a preferential basis.¹²

There will be an even greater need to stress the quality of new investments and the proper composition and distribution of increases in consumption in the case of those countries which are going to see a deterioration in their terms of trade, a decrease in net external financing and an increase in interest payments during the next few years, since the rate of expansion of the supply of goods and services that can be used for consumption or investment in these countries will need to be more rapid than the growth rate of the gross domestic product.

Carrying out a more dynamic and socially fairer adjustment is not the only reason for placing systematic emphasis on an increase in productivity and efficiency as basic means of promoting economic growth and improving the living conditions and opportunities of the poorest groups, however; such emphasis is also an essential and ongoing factor in ensuring that the prevailing development pattern of the region gradually becomes more efficient and equitable.

c) *Separation of the adjustment and of stabilization in time*

In order to make the adjustment less costly in social terms, the economic authorities should pursue the objectives of striking an external balance and stabilizing domestic price levels in succession rather than simultaneously. An attempt to achieve both these goals at the same time increases the danger of causing a recession. In addition to having a high social cost, a recession makes it more likely that, after a time, the stabilization policy will be abandoned, giving way to a resurgence of inflation.

The possibility of this occurring arises out of the fact that, basically, policies designed to control domestic demand and raise the relative prices of tradeable goods (which, as already noted, are the two main policy packages comprising orthodox adjustment programmes) have different types of effects on inflation. Whereas the former serve to reduce a country's external imbalance while also lowering inflation, the latter —although they expedite an adjustment— speed up the inflationary process, at least in the short run. For example, measures such as raising the exchange rate, tariffs, or the domestic prices of such products as foodstuffs and fuels which are designed to boost exports and reduce imports by raising the relative prices of tradeable goods, bring about an immediate rise in domestic costs and prices. Therefore, if such policies are applied at the same time as domestic spending is being reduced by means of restrictive, non-selective fiscal, monetary and credit policies (as typically occurs in orthodox adjustment and stabilization programmes), then they will tend to cause both an acceleration of inflation and a drop in economic activity.

This is why there should be a separation in time between the application of adjustment policies and stabilization policies. Generally speaking, except when inflation is very intense, it would appear best to carry out the adjustment process first and then the stabilization programme.

There are three main reasons for this sequence. The first is the urgency and, indeed, inevitability of an adjustment process when a country is faced with a deficit on the current account of its balance of payments which it cannot finance by having recourse to its net intake of external loans and investments or by drawing down its international reserves. Under such conditions, an adjustment becomes an immediate necessity because, in the final analysis, the need for it stems from a basic limitation: the economy's inability to expend more resources than the sum total of the resources at its command (both its own and those lent to it). Thus, unlike inflation, which the countries can "live with" for a relatively extended period of time, an external imbalance that cannot be financed must be dealt with promptly by means of an economic adjustment.

The second reason why it is preferable to carry out an adjustment before making a stabilization effort relates to the fact that the adjustment process must be gradual if it is to be efficient. As already noted, in order for a reduction of the external deficit to be compatible with the maintenance or expansion of economic activity, resources and investments must be reassigned from the production of non-tradeable goods to exports or import substitution, and this is a process which can only be carried out over a relatively long period of time. Thus, by its very nature, and in contrast to what occurs with a stabilization programme, an

adjustment effort is a process which does not lend itself to shock policies and, if carried out very rapidly, tends to produce a significant decrease in economic activity.

Finally, the adjustment should precede stabilization because it helps to control inflation. If the changes in relative prices required in order to eliminate an external imbalance have already been made and if the deficit on current account has already been reduced to a level that can be financed, then stabilization, although arduous, will be a less complex task because it will basically consist of slowing down the momentum of inflation by controlling aggregate demand and expectations.

However, when the rate of increase in domestic prices is speeding up at an exceptional rate and, above all, when the economy is slipping towards hyperinflation, the sequence should be the reverse. As suggested by the recent experience of various countries in the region, under these conditions the economic damage caused by inflation and the threat it poses to political and institutional stability are so great that, for a time, reducing the rate of price increases comes to be the first —and sometimes the only— priority of economic policy.

In sum, although the order in which attempts should be made to reduce a country's external imbalance or to lower inflation may differ depending on the prevailing conditions, in order to minimize the risk of a recession it is usually preferable to avoid undertaking adjustment and stabilization programmes at the same time.

III. ADJUSTMENT, REACTIVATION AND EQUITY

As already pointed out, one of the essential features of the recent evolution of many Latin American and Caribbean economies has been the fall in global output and, in particular, in levels of activity in manufacturing and construction. This decline has been accompanied in most cases by a sharp upswing in open unemployment and by the spread of various forms of underemployment. In practice, in countries where the economic contraction has been very severe, the unemployment situation has affected not only untrained workers, but also large groups of skilled operatives, technicians, professionals and management personnel.

Thus, in many countries of the region today underutilization of installed capacity is to be found side by side with unemployment and underemployment of manpower. In principle, then, it would be possible to achieve substantial production increments with no necessity for any significant prior increase in investment in fixed capital.

This does not mean, however, that the said production increments can be obtained over the short term merely by means of measures directed towards expanding domestic demand. In fact, this option is severely limited in practice by the balance-of-payments situation. As has already been explained, the exceptional reduction of the deficit on current account between 1981-1982 and 1985 was almost entirely due to the phenomenal contraction of imports, the volume of which shrank by almost 40% in the region as a whole in the course of the past four years. Furthermore, in many economies this decline was accompanied by a disproportionate reduction of imports of luxury or non-essential consumer goods and by a similarly pronounced decrease in purchases of capital goods, so that the inflexibility of imports increased.

Thus, by reason, in the first place, of the very small absolute terms of imports; secondly, because of the exceptionally high proportion currently represented by purchases of raw materials and intermediate products; and, lastly, on account of the extremely low level to which the import coefficient has sunk, the capacity to import is at once the main determinant of the level of global output and the fundamental constraint on it. Accordingly, in many of the Latin American and Caribbean countries almost any attempt at an additional external sector adjustment via a decrease in imports would precipitate new slumps in domestic economic activity. Conversely, to raise levels of production and income to a significant extent, it would be absolutely essential to increase the volume of imports, which would mean, unless at the same time there were an

improvement in import capacity, a further enlargement of the balance-of-payments deficit. In other words, in present circumstances, in order to reactivate the economy, to reduce underutilization of manpower and of installed capacity and, above all, to achieve rapid and sustained growth, it is indispensable to increase the capacity to import.

This essential task can, in turn, be carried out by expanding exports, by procuring a larger net amount of external loans and investments, or by reducing remittances of interest and profits. Thence the crucial role which will have to be played during the rest of the decade both by policies designed to vigorously and persistently step up exports and import-substituting production, and by those directed towards renegotiating the external debt so that its servicing may permit, instead of obstructing, the region's economic growth.

Of course, both the effectiveness and the cost of these policies will largely depend upon external circumstances. For instance, inducing the growth and diversification of exports will be easier or more difficult according to whether international trade expands quickly or slowly and whether the downward trend of the terms of trade continues or is reversed. Whether in practice the first of these possibilities prevails or the second occurs will closely depend, in turn, upon the economic policies applied in the industrialized economies as well as on their rate of growth and on the course followed by their protectionist practices. As will be explained in detail later, the possibility of raising the capacity to import by obtaining more loans or investment or by reducing interest payments is likewise conditioned by external factors which are largely beyond the control or decision-making sphere of the economic authorities of the Latin American and Caribbean countries, particularly if these do not act in co-ordination.

Even so, as is reflected in the variations discernible in regional experience, both the resumption of the growth process and its persistence and speed, although powerfully conditioned by the evolution of the external environment, mainly depend upon the quality and coherence of domestic economic policies.

A. OVERCOMING THE EXTERNAL CONSTRAINT: STRUCTURAL ADJUSTMENT POLICIES

1. Changes required in the composition of production and domestic expenditure

In order to achieve sustained economic expansion and at the same time maintain adequate external equilibrium, most of the economies of the region will have to introduce significant changes during the next few years both in the structure of production and in the composition of domestic expenditure: while in the former they will have to raise the proportion represented by internationally tradeable goods and services (exports and import-substituting products), in the latter, on the contrary, they will have to increase the fraction allocated to the purchase of non-tradeable goods and services. If this were done, concurrently with the expansion of the capacity to import there would be a tendency for the imported components of domestic production and expenditure to decrease, with the consequent two-way reduction of the external constraint on growth.

Of course, the relative priority of this twofold process of change will differ in the different countries: it will be, for example, lower in an economy like that of Brazil, which has succeeded in generating a sizeable trade surplus through a boom in exports and a structural reduction of its import coefficient; and, in contrast, it will be higher in those economies where the trade surpluses achieved are relatively smaller and have been obtained almost exclusively through an abrupt and unsustainable curtailment of imports; where the terms of trade have deteriorated to a greater extent or have less favourable prospects; and where the burden of debt servicing is relatively heavier.

Moreover, the pace at which the structural adjustment will have to be made, as well as its social cost, will depend upon the available supply of net external financing: the more abundant this is, the more gradually can the requisite changes be made in the composition of domestic supply and demand, since in that event a proportion of the increased imports required for the expansion of economic activity can be paid for with the increased external financing; on the contrary, if this latter is in very short supply, it will be more difficult and costly to attain a satisfactory rate of economic growth and at the same time to maintain a reasonable degree of external equilibrium, since this will call for a much more intensively-executed reorientation both of domestic production and of domestic demand.

2. Exchange-rate, tariff and export promotion policies

As already remarked, in order to promote production of tradeable goods, to simultaneously discourage, in relative terms, their domestic consumption, and to ensure that these changes take place in the context of a process of expansion of economic activity and employment, a multiplicity of economic policies needs to be coherently and systematically applied. Among these, special importance attaches, in the short term, to those conducive to raising the prices of tradeable goods in relation to those of non-tradeable goods and services,¹³ while over the medium term particular importance is attached to investment and development policies directed towards generating structural changes in the rate of growth and the orientation of installed capacity.

Of the policies that modify the relative prices of tradeable and non-tradeable goods, it is exchange policy that produces the most general effects. Unlike tariff policy or that of export promotion, both of which encourage production of one group of tradeable goods at the cost of another, or of production of non-tradeable goods, devaluation favours production (and discourages domestic use) of tradeable goods as a whole at the expense of that of non-tradeable goods.

Hence the importance of fixing and maintaining a high real exchange rate in any programme designed to reduce external disequilibrium or keep it under control. This is particularly necessary when the deficit on current account is due to a marked and relatively permanent deterioration of the terms of trade, to external financing, or to substantial and prolonged upward movements of international interest rates.

However, the response of export and of import-substituting activities is sensitive not only to the real level of the rate of exchange, but also to its stability. As shown by the experience of some countries of the region during the pre-crisis period, the progress made in the field of export growth and diversification and import substitution under the aegis of realistic exchange policies came to a halt or even disappeared altogether when effective exchange rates declined steeply as the result of an abundant supply of external financing, of a marked rise in the international price of some staple export product, or of the use of exchange policy as an instrument of anti-inflation programmes.

Accordingly, for the purpose of stimulating the structural changes involved in a lasting adjustment process—which by their very nature are relatively slow—it is not enough for effective real exchange parity to rise for a short spell; it must be maintained at that higher level over relatively lengthy periods. In so far as this happens, exchange policy will provide producers with a clear indication of the real value of foreign exchange over the long term and will help to ensure that not only current production but also investment is channelled into exports and import substitution. In addition to this benefit, the elimination of abrupt and frequent variations in the effective real exchange rate, by reducing uncertainty as to the future level of exchange parity, lessens the risk that speculative capital movements may be generated which are apt to produce destabilizing effects on the balance of payments, economic activity and price levels.

In situations like those of today, in which the overcoming of the external bottleneck is a basic prerequisite for economic reactivation and in which there are appreciable but different margins of idle capacity in the various sectors, it may be necessary to complement high effective real exchange rate policy with the temporary and selective application of tariff surcharges on imports and with subsidies and other measures favouring exports. On the one hand, the selective and temporary use of these instruments makes it possible to encourage those export or import-substituting activities which have greater potential for response over the short term. On the other hand, selective tariff increases and subsidies have the advantage of not exercising so general an upward pressure on costs as that normally produced by devaluation and, likewise, do less to influence the unleashing or accentuation of inflationary expectations.

Over the short term, in some Latin American economies export incentives may probably generate net foreign exchange earnings that exceed the savings of foreign exchange derived from tariff surcharges or other measures designed to reduce imports. This is partly because, as a result of the foreign trade policies traditionally applied in the region—which have placed much greater emphasis on saving foreign exchange through import substitution than on earning foreign exchange through export promotion—, activities geared to production for the domestic market are protected by a "total exchange rate"¹⁴ considerably higher than that received by the exporting sectors. But this too is due to conjunctural factors. If allowance is made for the enormous decreases in the volume of imports and the equally significant changes in their structure that have taken place in almost all the Latin American countries since 1982, together with the likewise notable decline in import coefficients, it is reasonable to assume that the

short-term possibilities of achieving a significant additional amount of import substitution are limited.

Nevertheless, selective import restriction measures may also help to make the external adjustment compatible with the recovery and growth of domestic economic activity. Generally speaking, this contribution will be greater in those countries where the tariff and para-tariff protection accorded to manufacturing industry and the agricultural sector is relatively low and equally-matched; where there is a higher degree of underutilization of installed capacity in activities competing with imports; and where the proportion of luxury or non-essential imports is relatively larger. In such cases, the imposition of temporary tariff surcharges or restrictions on imports for which domestic products can be substituted more expeditiously and at lower social cost by using existing production capacity may help to change the composition of imports in such a way that a given amount of them may make it possible to maintain a higher level of domestic production.

These temporary surcharges would have to be especially high where luxury consumer goods were concerned. Albeit in normal conditions tariff duties on non-essential imports are less effective as an instrument of economic policy than a tax applied to luxury goods irrespective of whether these are of domestic or foreign origin, they are preferable in present circumstances, in which there is an acute shortage of foreign exchange and an abundance of underutilized domestic resources. In fact, by diverting demand from imports to domestically-produced substitutes, they are conducive both to releasing foreign exchange for other more essential purposes and to stepping up employment of domestic resources. However, in so far as changes in the structure of production and expenditure gradually attenuate the external constraint and underutilized domestic resources are progressively absorbed, these surcharges should be replaced by a domestic tax on consumption of luxury goods. Otherwise, the surcharge on imports will raise the rate of return not only on current production of such goods, but also on investment earmarked for expanding the capacity to produce domestic substitutes for goods of that kind. While the former effect is desirable—inasmuch as foreign exchange can consequently be saved and employment increased by using *existing* installed capacity (which has little or no social opportunity cost)—the second is undesirable, in that it means channelling part of domestic saving and of imports (which have a high positive opportunity cost) into *expansion* of the capacity to produce goods whose social priority is low.

Generally speaking, temporary incentives to the production of tradeable goods should meet two basic criteria. The first is that they should be selective and should favour activities in which supply is highly elastic over the short term.¹⁵ The second is that their structure should conform to the basic principle of efficiency according to which the cost of earning a certain additional amount of foreign exchange through export expansion must be equal to the cost implicit in saving the same amount of foreign exchange through import substitution. Hence, ideally the incentive granted to exports should be equivalent to the tariff protection accorded to import substitution. As a first approximation, this implies that the export subsidy for a specific good must be equivalent to the tariff rate protecting that good in the domestic market.¹⁶ In so far as the tariff structure is differentiated, export stimuli should also be differentiated, so as to match up

the incentives not only to exports and to import substitution, but also to the various potential exports.

Of course, to the extent that the external constraint is mitigated and the growth process is consolidated, the level of tariff surcharges and of special incentives to exports should be gradually lowered and the criterion by which the selectivity of import substitution and export promotion policies is guided should undergo a change. In practice, the basic principle favouring those activities which show a greater short-term capacity to earn or save foreign exchange through fuller use of existing production capacity should be replaced by that of promoting sectors with greater dynamic comparative advantages over the medium and long term. These sectors —capable of competitive production of exports or import substitutes after a reasonable length of time— may not be the same as the above-mentioned activities, some of which can export or produce import substitutes only in so far as they enjoy very high protection and need to cover solely their variable production costs.

However, like tariff surcharges and export subsidies directed towards short-term alleviation of the external constraint, incentives to promote development of sectors with dynamic comparative advantages should be selective and temporary. Both because of the inevitable limitation of the resources available for such purposes and because of the need to make optimum use of them, protection, instead of being general and indiscriminate —as it has been in many Latin American countries— should be concentrated on a few activities which have clear prospects of attaining international competitiveness and can therefore contribute to external equilibrium through import substitution and export expansion, without needing special and permanent protection to that end. Initially, the activities in question would have to be given intensive support so that advantage could be taken of economies of scale from the outset and so that their productivity and competitiveness could be rapidly increased. But after a reasonable period the protection accorded to them should be gradually but steadily reduced in conformity with a predetermined time schedule, for the dual purpose of obliging them to improve their efficiency and to release resources by means of which other activities with dynamic comparative advantages could be launched upon a similar cycle of initial intensive support and subsequent gradual withdrawal of protection.¹⁷

In order to speed up the growth and increase the diversification of exports, policies relating to a high and stable effective real exchange rate and to promotion of activities with dynamic comparative advantages will have to be complemented with other measures designed to support production and marketing of exports. Among these, special mention may be made of the following: measures making it possible for the intermediate goods used in export production to be purchased at international prices; provision of supplies of credit to finance the working capital requirements of exporter enterprises; improvement and strict control of the quality of exports; identification of rapidly expanding markets and of the products for which international demand increases most briskly; timely and systematic dissemination of this information among domestic producers; and establishment and enlargement of trading systems which will facilitate the sale of exportable products on the international market.¹⁸

3. Investment policies

As already pointed out, a definitive overcoming of the external bottleneck necessitates, in the last analysis, changes in the structure of production making for an increase in the absolute dimension and relative participation of export activities and of those competing with imports. Although over the short term this larger volume of output must be achieved basically through more intensive use of existing installed capacity, in the medium term it will be obtainable only if production capacity is expanded in the sectors producing tradeable goods.

For this reason, and also because of the very low levels to which investment has fallen in most of the countries during the crisis, in the next few years it will be indispensable to raise the rate, increase the efficiency, and modify the structure and orientation of global capital accumulation.

Since two basic objectives of economic policy in the remainder of the present decade will be to reduce external disequilibrium or keep it under control and persistently boost levels of production and employment, priority will have to be systematically given to investment channelled towards expanding production capacity in respect of exportable and import substituting goods as well as labour-intensive goods requiring relatively few imported inputs.

This latter principle implies, particularly in the more immediate future, increasing investment in machinery and equipment relatively less than expenditure on construction. In most Latin American countries, construction has a very low import content and, on the contrary, generates, directly or indirectly, a great deal of employment. Accordingly, abrupt curtailment of public works and housing programmes — a decision which is often one of the first to be taken in programmes designed to reduce a fiscal deficit, and which has in fact been adopted in recent years in many countries of the region — yields very few benefits from the standpoint of adjustment, since it reduces imports hardly at all, and, on the other hand, has a high economic and social cost, since it leaves jobless many workers for whom it is difficult to find employment quickly in export or import-substituting activities.

Nonetheless, if expenditure on construction is to contribute to employment, it will be necessary to modify its allocation. Thus, in the selection of public works preference will have to be systematically given to those which increase or promote production of exports and of import substitutes (such as, for example, irrigation and drainage works, opening-up and improvement of roads in agricultural and mining areas, expansion of port facilities, etc.), over those (such as underground railways, motorways and other highway and modernization projects, etc.) which only improve the living conditions of certain groups resident in the larger and normally wealthier cities.

Besides according priority to works which directly or indirectly facilitate the production of tradeable goods, construction policy will have to be guided by a redistributive criterion, seeking to satisfy some of the basic needs of the poorest groups. In this sense, the building of low-cost housing, construction of piped water and sewage networks, and environmental sanitation of the poorer neighbourhoods have the threefold advantage that their execution signifies the use of a minimum of imported inputs and capital goods, employment of a great

deal of labour and immediate and lasting improvement in the living conditions of the most deprived groups.

Generally speaking, as regards both investment in construction and investment in machinery and equipment, priority will have to be given to investment projects which have a shorter maturity or which supplement existing installed capacity. As long as the net capital inflow fails to recover and it is necessary to apply a restrictive monetary policy in order to facilitate stabilization and adjustment, the rate of interest will tend to be very high and, consequently, it will be advisable to postpone investment projects involving longer gestation periods; these can be undertaken once the crisis in the external sector has been overcome, when greater financial elbow-room and a more plentiful supply of foreign exchange will be favourable to projects with long maturities and with a higher imported content.

Similarly, with a view to upgrading the efficiency of investment and complying with the basic principles implicit in giving priority to investment which increases production of exports and import substitutes, which has a relatively low imported content, and/or which creates more jobs, it will be necessary to subject all public-sector investment projects to a rigorous and uniform evaluation, based on the application of social prices, and to take care that as far as possible the market values of the rate of exchange, the interest rate and wages reflect relative social scarcities.

B. OVERCOMING THE EXTERNAL CONSTRAINT: EXTERNAL FINANCE

As mentioned earlier, in the present context of a severe economic recession the return on a dollar of foreign exchange is quite high. However, the productivity of foreign exchange is one thing; access to it is another. In the long run the preferable way of securing foreign exchange is through "expenditure switching", and especially the production of exports and import substitutes. But we have already seen that there is also something of a vicious circle here, since to produce foreign exchange the region will need foreign exchange. Moreover, that circle is tightened by the sluggish performance of the world economy. This is because a relatively slow growth of the world product weighs especially heavily on the prices of primary commodities, which still account for 80% of Latin American exports. Also slow world growth generates less space for new and marginal exporters and makes greater demands on investment (hence savings) in order to increase international competitiveness.

The persistence of sluggish economic activity at the world level naturally causes attention to shift increasingly to creditor-debtor relations. The reason for this is that an enormous amount of foreign exchange potentially available for economic recovery is being transferred from debtor to creditor countries. In fact, over the last four years, this transfer has absorbed the equivalent of one-quarter of the region's annual export earnings. Viewed from the standpoint of generation of domestic resources, it has represented an average annual drain of 3.5% of the gross domestic product.

To what is so large a transfer attributable? It stems on the one hand from the extraordinarily high level of world interest rates (see figure 14) —coupled with the relatively onerous conditions negotiated for rescheduling debts (see table 10)— and on the other from the collapse of capital inflows, which until 1981 had been more than covering factor payments. This latter phenomenon, in turn, reflects the massive withdrawal of new lending by creditors (mostly banks), beginning in mid-1982, a sharp slowdown in direct foreign investment flows, and a considerable flight of capital belonging to private economic agents (see table 11).¹⁹

The question that must be addressed is how this transfer may be reduced so as to generate additional foreign exchange for economic recovery and dynamic adjustment. In terms of the amount of financing that is required, an idea is provided in some recent simulations undertaken by ECLAC.²⁰ In its base case scenario, which postulates only a modest recovery that will permit the region to recoup 1980s per capita income in 1990, there is a need for net current account financing of US\$ 20 billion per annum, in contrast to the less than US\$ 2 billion recorded in 1984.²¹

1. The catalytic role of international public policy

An obvious way for the outward transfer of financial resources from Latin America to be reduced is for commercial banks —holding somewhat less than three-quarters of Latin America's US\$ 368 billion external debt— to curtail their intake of the region's resources. This can be done either by lowering interest charges, or by increasing new lending, or by some combination of both. Of course, from the standpoint of development, the more the transfer can be reduced through lower interest payments the better, since this type of relief does not involve any further accumulation of debt.

The outward transfer to the banks has been extremely large. Since the outbreak of the crisis, new net lending from banks has fallen drastically; in 1985 it was expanding by less than 1%, in face of an average interest rate of about 10% (including spreads). Thus the net reverse flow of resources to these creditors (by interest payments) has been equivalent to around 9% of outstanding commitments.²²

The banks have been able to effect this net transfer from the debtors to themselves because of the aforementioned large trade surpluses generated by Latin American countries during the adjustment process, and secondarily because of net disbursements to them from other creditors, principally official public lenders.²³ The outward transfers have had a very salutary effect on the banking system. In effect, the banks have been able to avoid 1930-style defaults and receive interest income, all without significantly expanding their own portfolio in the region. This has permitted the banks to report healthy profits even in the face of the most severe financial crisis in the post-war era, and also allowed the creditors to substantially reduce their vulnerability by lowering asset/capital ratios in Latin America.²⁴ The main sacrifice imposed upon the creditors has been a more rigid loan portfolio due to the rescheduling of amortization (also necessary to avoid losses) and the deterioration of the value of bank shares, as stockholders are apparently anticipating some losses in the future.²⁵

This relatively benign set of circumstances for the banks was achieved with the aid of multilateral public policy. First, IMF adjustment programmes helped to introduce financial discipline among the borrowers and have contributed to the rapid generation of trade surpluses. Secondly, OECD governments and the IMF assisted the big commercial banks to exert enough control over small and medium-sized banks to ensure that they would participate in new loans packages designed to partially refinance interest payments and thereby avoid default on the part of the debtor countries.²⁶ Thirdly, the United States Treasury and the Bank of International Settlements extended bridge loans to debtor countries to help them pay interest to the banks while they negotiated with these creditors and the IMF.

Multilateral public policy has, however, been cautiously deployed and limited in scope. This has reflected the underlying preference of the creditor governments for relying on "natural" or market-related forces to resolve the crisis. In effect, public intervention has been reluctant and pragmatically designed to stem a classic panic among bank creditors, which would have induced defaults and large balance-sheet losses for the international financial system, while "buying time" until i) an expected strong recovery of the world economy took hold and ii) the debtors net transfers to the banks and export growth pushed down debt/export coefficients to below 2:1, —conventionally considered a threshold for renewed creditworthiness and autonomous access to the Eurocurrency market.

The creditor governments' strategy has successfully avoided a collapse of the international financial system. However, the debtor countries' economic growth and development have consistently been a residual part of the overall management of the crisis.²⁷ The failure of many key variables to move in expected directions has contributed to an extremely asymmetric adjustment process, in which debtors have borne a disproportionate amount of the costs of the crisis. Moreover, continued economic stagnation in the debtor countries is no longer functional even to the narrowly-defined goal of servicing the foreign debt.

The conventional strategy for handling the current debt crisis has clearly exhausted itself. The strategy's serious shortcomings, long highlighted by the Latin American governments,²⁸ have been implicitly recognized in the recently-announced "Baker Initiative". It proposes an abandoning of the focus on austerity for a new focus on growth, through expanded public initiatives at the international level designed to reduce the outward transfer of the debtors.²⁹ But, as observed in the Declaration of Montevideo, issued by the Cartagena Consensus in December 1985, the Baker Initiative, while a positive step forward, falls short of the comprehensive action needed to break the vicious circle of economic stagnation in Latin America.³⁰

This vicious circle, arising from the negative externalities that frequently eddy around a debt crisis, was anticipated in a study which ECLAC first published in early 1984.³¹ The study suggested that a socially efficient "first best" solution to the crisis was a comprehensive set of multilateral public policy measures which would be directed at these negative externalities and would quickly restore growth and repayment capacity in Latin America. An argument which some in the North then saw as persuasive, has now become compelling.

The limited success of the management of the debt crisis in the last few years is indeed not entirely surprising. As already mentioned, the conventional strategy has been heavily influenced by a faith in natural or market responses. There appears, however, to have been a systematic underestimation of the paralysis that can set in throughout private financial markets during a crisis. Both history and theory show that private financial institutions tend to exaggerate their expectations of profit (underestimate risk) in the upswing of a credit cycle and then to sharply reverse this tendency and exaggerate their expectations of losses (overestimate risk) in a crisis.³² Indeed, during a crisis revulsion often occurs in credit markets, as reflected in Latin America by the retreat from the region of all but the big bank creditors (which are "locked in")³³ and a dramatic slowdown of international lending more generally (see tables 12 and 13). Furthermore, it is well known from historical experience that once revulsion sets in it takes a long time to be overcome.³⁴

Under these circumstances, reliance on mechanical formulas to establish conditions for reintegration into autonomous credit markets —such as debt/export ratios of 2:1— are of limited usefulness, as even some financial experts now admit. Indeed, certain analysts have found that considerably higher ratios are fully compatible with profitable investment, growth and macroeconomic equilibrium.³⁵

Correction of private expectations is a time-consuming process, in part because of the aforementioned negative externalities attendant upon a crisis. For example, a financial institution with more buoyant expectations about Latin America may nevertheless refrain from lending if it perceives that its loans will merely finance the withdrawal of other more pessimistic lenders, or domestic holders of capital. Alternatively, persistent problems in a large debtor country can have negative repercussions, or a contagion effect, on the creditworthiness image of better-off neighbouring countries, as risk perception is systematically regionalized.³⁶ Witness to the burden of negative externalities is borne in Latin America today by the failure of credit markets to respond with new autonomous (or voluntary) lending in cases where external adjustment has been manifestly quite successful, e.g., Brazil.³⁷

Underlying much of the phenomenon is the fact that banks are run on the criterion of private profit, which is generated in an environment of heightened uncertainty. Such circumstances are known to contribute to procyclical behaviour.³⁸ This in turn introduces the need for an anticyclical agent, which traditionally is a public entity. In a crisis, the role of the anticyclical agent is to provide a critical mass of assistance to the market in order to turn around private expectations; in this way the market's procyclical tendencies are exploited to generate a virtuous circle of growth which pulls economies out of stagnation.

Moreover, the multiplier effect of public policy on foreign finance can be quite considerable, because banks are not the only procyclical agents. The shortage of foreign exchange and economic stagnation in Latin America have also severely curtailed opportunities for direct foreign investment and have circumscribed the efforts of debtor governments to repatriate the large amounts of private capital held abroad by their residents. (As shown in table 14 total deposits placed by Latin American residents in commercial banks greatly exceed official international reserves.) The greater the extent to which multilateral

initiatives can rekindle growth and help to restore normal rates of return in the region, the bigger will be the role that both foreign private investment and expatriated national capital will assume in the financing of current account deficits.

Apart from the catalytic role of public policy in extricating economies from crisis, another strong reason for comprehensive multilateral public action is that resolution of the crisis is fundamentally handicapped by macroeconomic disequilibria in the OECD economies. These include the extraordinarily high levels of real interest rates and the persistence of a relatively sluggish economic performance in the OECD area.

2. Reducing the outward transfer of financial resources: multilateral initiatives

As outlined earlier, underlying the adjustment process is the medium-term objective of a structural change in the Latin American economies which will make them more internationally competitive and creditworthy. However, in the short term the process needs to be "lubricated" with additional foreign finance that will permit the economies to employ existing idle domestic resources in the production of traded goods, and to initiate the investment so much needed for international competitiveness. Given the procyclical nature of private capital, the required amounts of finance can be efficiently mobilized and channelled into adjustment only through more comprehensive multilateral initiatives on the part of creditor and debtor governments. Such new initiatives must substantially reduce Latin America's debt burden and promote more equitable sharing of the costs of the crisis. Apart from its technical merits, the new strategy is also justified by what Latin American governments have termed co-responsibility in the crisis, i.e., current problems have arisen not just because of policies pursued by the debtor countries, but also because of those adopted by the banks and their governments.³⁹

a) *Lowering interest rates*

Of all the potential international public actions to resolve the crisis, the bringing down of interest rates to historical levels stands out as perhaps the most important. Abnormally high rates are a primary impulse behind the vicious circle of economic stagnation that is plaguing the region; they increase debt burdens, scare off private creditors, and at the same time prejudice export growth through their depressive effects on the volume of world output and trade as well as on the level of primary commodity prices. Moreover, as long as real interest rates persistently remain higher than the growth rate of output, and nominal interest rates remain higher than the growth rate of export earnings, there is a progressive risk that debtor countries will drift into insolvency. The urgency of the need for more normal interest rates is given prominence in the Declaration of Montevideo, which states that a reduction of the current high rate of interest constitutes a fundamental element in the resolution of the debt problem.⁴⁰ Obviously, too, it is one of the least conflictive ways of tackling the crisis, since it benefits both debtors and creditors: substantial relief can be afforded to borrowers while new lending by creditors can be minimized.

Since mid-1985 LIBOR has hovered around 8%. If that rate fell to 6% — which at the prevailing level of world inflation would approximate to a historically normal real interest rate— Latin America would have US\$ 5 billion more as foreign exchange at its disposal. In effect, a 2-point drop in the interest rate would generate resources equivalent to an increase of almost 5% in the region's exports of goods and services; moreover, since exports exceed imports by 40%, the effective rise in the capacity to import would be even greater: 6.5%.

An additional US\$ 2.5 billion could be raised if government authorities in the North pursued policies which "encouraged" their banks to at least temporarily lower their spreads by 1%. Such a move —which would still leave the banks' interest rate above LIBOR (whereby the cost of funds is measured for many lending institutions)⁴¹— could be promoted by multilateral guarantees on part of the bank debt, direct "moral suasion" by OECD Central Banks, and flexible interpretation of regulatory bank accounting.⁴² Moreover, such transitory interest rate relief would be in the same spirit as action taken by the banks when their domestic clients have encountered debt servicing problems. For example, the United States banks, with the assistance of their government, have made important concessions for problem borrowers such as the City of New York, large corporations (like Chrysler and International Harvester) and domestic farmers (see table 15).⁴³

Finally, for those few debtor countries that exhibit clear signs of insolvency, rates of interest below LIBOR are clearly appropriate. In the first place, it is technically impossible for these countries to pay a commercial rate, and to force them to do so will merely be conducive to arrears and astronomical debt/GDP and debt/export ratios. Secondly, the banks share co-responsibility for the problem through their own erroneous evaluation of risk and therefore must bear part of the costs of resolving it.

b) *Increasing capital flows*

The less successful public policy is in terms of lowering interest rates, the greater will be the ones on increased capital flows for reducing the outward transfer on the part of the debtors. There have been numerous proposals in this area.⁴⁴

First, public policy in the OECD governments could strongly "encourage" private banks to temporarily capitalize a greater share of Latin America's interest payments. *At a minimum*, the goal should be to follow the suggestion made in the Declaration of Montevideo and require the banks to maintain their credit balances in real terms. This is because to the extent that the banks' exposure increases by less than the rate of inflation, the countries are forced to endure effective amortization of their foreign debt even though the lenders may be completely rescheduling their maturities falling due.⁴⁵ By conventional standards amortization of debt during a crisis is certainly unwarranted and should be postponed. If banks maintained their real credit balances and expanded lending by 4% per annum (an approximate rate of world inflation), the region would receive nearly an additional US\$ 10 billion in foreign exchange.

Secondly, official lenders could raise the rate of disbursement on committed loans. While multilateral lenders are in theory anticyclical creditors,

their behaviour in practice has been relatively procyclical due to difficulty in increasing disbursements. This in turn stems in part from the fact that stabilization programmes and economic recession have made it difficult for borrowers to raise counterpart funds and to pursue new projects, which become less attractive as an economy's utilization of capacity declines.⁴⁶ Disbursements could be increased if these institutions stepped up their participation in existing projects and channelled more financing to general balance-of-payments support (programme lending) which is usually designed to reduce the foreign exchange constraint. Gauging the position from some estimates of committed but undisbursed funds from official lenders, there is a considerable amount of potential relief in this area.⁴⁷

Thirdly, in 1983 the Government of Mexico proposed the establishment of a window at the IMF which would finance that part of the debtors' interest rate which exceeded 2% real (the historical interest rate).⁴⁸ Such a facility, which would be an extension of an existing compensatory programme that finances export shortfalls, could moreover sharply reduce the burden of interest rate capitalization, since it would be financed at less than market rates. This particular proposal continues to be a very commonsense solution to the payment problems of developing countries.

Fourthly, governments hold about 8% of Latin America's foreign debt. In the context of the Paris Club, OECD governments have been rescheduling amortization payments since 1982. Non-OECD governments have been doing the same in bilateral negotiations with the debtors. Creditors have, however, been generally resistant to providing relief on interest payments. Assuming an average interest rate of 7% on government-to-government debt, an emergency capitalization of interest on these liabilities on a temporary basis—as recently proposed in the Declaration of Montevideo—could raise roughly US\$ 2 billion in additional foreign exchange. This particular measure would be especially helpful for smaller debtor countries which have a proportionally greater amount of official obligations in their debt structure.

Fifthly, the financial power of multilateral official lenders was sharply eroded during the 1970s, and this undermined their mission as stabilizing anticyclical lenders.⁴⁹ Their ability to respond to the current crisis would be enhanced if they were provided with more funding. By raising the capital base of these institutions and/or changing their gearing ratios, they could act as more efficient intermediaries for channelling private funds into the financing of structural adjustment. The December Declaration of Montevideo called for a net increase in multilateral lending of 20% per annum over the next three years.

Finally, a new issue of Special Drawing Rights (SDRs) for developing countries would be a practical way of providing relief from debt burdens and economic stagnation.

c) *Flexibilizing bank regulation*

Greater flexibility in the application of banking regulations and accounting is fundamental to resolving the crisis. The commercial banks' ability to respond flexibly to the crisis is at present often handicapped by barriers of a legal and accounting nature.

In some OECD countries capitalization of interest and/or lower spreads for problem borrowers are interpreted as non-commercial "concessions" that detract from the value of the asset and require reserves allocations and/or writedowns. However, to the extent that a borrower's problems approximate to one of illiquidity, temporary concessions do not seriously jeopardize asset values; indeed they should be encouraged as a means by which those values can be preserved.

On the other hand, concessions granted to insolvent borrowers are bound to be reflected in a depreciation of the value of the asset. Yet bank regulatory authorities should recognize the systemic character of the crisis and thus deal with the consequent losses imaginatively, and in a way that will not jeopardize the viability of the lending institution. This will require the spreading of the costs of the concessions over a relatively prolonged period of time.

Alternatively, the banking authorities' enforcement of rules relating to correct valuation for insolvent borrowers should be translated into debt relief. As matters stand now, when authorities demand a writedown of an asset the banks customarily keep the face value of the loan on their books. Regulators should require that when a loan is written down there be a corresponding reduction in its face value, an action that will automatically reduce the debtor's interest obligations. Without such an alteration in book value the insolvent country's debt will grow exponentially even though the creditor has accepted the loss incurred through an erroneous credit decision.

Bank regulatory authorities might also play a more active role in stemming the commercial banking system's contribution to capital flight. The capital flight problem has been exacerbated by the banks' active solicitation of deposits from Latin American residents and by the refusal of OECD governments to provide their Latin American counterparts with information on interest earned from deposits by the latter's citizens in OECD banking systems.⁵⁰

The flight problem can also be attenuated to the extent that bank regulatory authorities actively "encourage" their banking institutions to maintain as a minimum, their real net credit balances in Latin America. Flight capital is procyclical by definition; a retreat by foreign commercial banks in the middle of a foreign exchange crisis merely lowers the expected returns on domestic assets and induces private agents to flee into foreign assets.

d) *Adjusting conditionality*

Conditionality has become one of the more polemical aspects of the adjustment process. Moreover, it has been multiplying steadily during the crisis and aggravating the already severe constraint on public policy brought about by the scarcity of foreign exchange.

First come the commercial banks which condition the adjustment process by the amount of resources they are willing to reschedule and/or lend and the terms and conditions on which that financing will be provided. Secondly, the banks normally link their co-operation to the country's submission to IMF stand-by programmes, which carry their own controversial brand of conditionality on the evolution of the macroeconomy.⁵¹ Thirdly, the Baker Initiative envisages a more important role for the World Bank in the adjustment process, but with this comes more conditionality as an integral part of the Bank's expanded lending for

so-called structural adjustment. Finally, much bilateral government-to-government financing is now subject to diverse forms of macro and microeconomic conditionality.

In so far as creditors were to make major concessions on interest rates and increase their loan commitments there would be a legitimate demand for conditionality in the adjustment process. In these circumstances, conditionality would form part of the necessary *quid pro quo* in debtor-creditor relations, as it provides lenders with an assurance that resources will be used in a way consistent with efficient structural adjustment and improved creditworthiness. But in its present form conditionality is progressively weighing down the adjustment process and fatigue is setting in among the debtors.

One aspect of the burdensomeness of conditionality relates to the fact that there are so many different agencies administering a dose of it, each with its own particular view point and interest. Thus, in Latin America it has now become increasingly difficult to successfully reconcile the different demands on public authorities made by the diverse creditors.

Furthermore, conventional conditionality also enforces an extreme degree of rigidity in economic policy. This is because the economic philosophy underlying it is in practice defined externally and has a homogeneous vision of the world based on a notion of automatic, dynamic market response to equilibrium pricing, liberalization of trade and finance, and privatization of the economy. Moreover, this vision of adjustment tends to be mechanically applied to any and all debtor countries, with limited attention to structural differences in their economies and divergent social preferences.⁵² Even more significantly, conventional conditionality also leaves economic growth as a residual in the adjustment process. This, coupled with what some have found to be a recessionary bias in conditionality,⁵³ means that the debtors' reward for compliance with the demands of their creditors is more often than not economic stagnation and aggravation of social tensions.

The fatigue debtors are experiencing on account of conditionality could be alleviated through some commonsense "adjustments" in creditor policy. First, Latin American authorities could be given more opportunity to design their own conditionality with a view to achieving structural adjustment and attaining bilaterally-negotiated targets concerning trade and current-account deficits.

Secondly, the processes of adjustment and stabilization should be considered separately. The practice of demanding external adjustment and stabilization simultaneously is extremely onerous for the debtors. On the one hand, some external adjustment policies such as devaluation tend in the short term to aggravate inflation. On the other, effective external adjustment—the creditors' legitimate area of concern—can in practice be achieved even while authorities temporarily postpone attention to stabilization matters. The shortcomings of the conventional approach, which demands progress on the two fronts simultaneously, are attested in the experience of some debtors: countries which have been adjusting quite successfully have found their rescheduling agreements and IMF finance aborted by a failure to meet one or more stabilization targets.

Thirdly, conditionality in whatever form becomes much more palatable when economic growth is an integral and explicit part of the programme. In

other words, when adjustment and conditionality are designed around explicit, reasonable growth targets it is much easier for authorities to justify policy changes to their political constituencies.

Finally, the introduction of creditor guarantees for reasonable economic growth during adjustment raises the issue of adequate amounts of foreign exchange. Recent empirical work has demonstrated that one of the major reasons for the recessionary bias in conditionality is that it has been accompanied by finance which is insufficient to support socially efficient adjustment.⁵⁴ Thus, until creditor governments make a greater financial contribution to the adjustment process, conditionality will be perceived by the debtors as a cost with very few benefits.

e) *Reducing obstacles to broader multilateral public policy initiatives*

It is thus clear that more comprehensive multilateral public policy is needed to end the debt crisis and promote socially efficient adjustment. It is frequently objected, however, that proposals for such bold initiatives are impracticable because of budgetary constraint in the OECD governments. However, this must be weighed against the following considerations.

First, much of the finance to support a socially efficient adjustment process can be secured via contingent liabilities: for example, public guarantees on commercial bank lending and support of expanded multilateral lending (where paid-in capital is traditionally low). Although these liabilities often have to be accounted for in budgetary processes, they will remain largely paper liabilities to the extent that more active public policy can prevent the debt problem in Latin America from degenerating into a case of severe insolvency.

Secondly, the commercial banks themselves can be made to bear a greater share of the costs of resolving the crisis (and thereby avoid an open bail-out) if banking regulation is flexibilized, as pointed out before, and those costs are allowed to be distributed over the future in an organized manner.

Thirdly, since 1982 the debtors have borne an overwhelming proportion of the costs of the crisis. This state of affairs has reached its limits, however. A greater share of the future costs of the crisis will have to be borne by the creditors and their governments. Moreover, the cost of more comprehensive public management of the debt problem today will be less than that which will be incurred should the debt crisis continue to drift and be determined by the force of events. It must be remembered that latent in the crisis are large costs for the industrialized countries. These include the deterioration of the real value of the creditors' assets in Latin America; should events in the debtor countries cause this real value to be translated into book value, destabilizing losses would be inflicted on the world's biggest banks.⁵⁵

3. Reducing the outward transfer of financial resources: unilateral action by the debtor countries

It has been established that in the present recessionary circumstances of Latin America a dollar of foreign financing has strong potential effects on investment and economic growth. However, without the help of a comprehensive and multilateral anticyclical initiative to reduce debt burdens there is only very

limited scope for raising finance through conventional channels. Thus, as long as OECD government policy on the debt problem remains hesitant, authorities in the debtor countries will be under increasing pressure to consider unilateral action that will reduce debt service and release foreign exchange for increasing imports and thereby accelerating economic growth.

To date, the most frequent method employed by governments unilaterally to relieve the foreign exchange bottleneck has been to begin an informal accumulation of arrears on debt service and to enter upon non-compliance with the IMF. Over the last three-and-a-half years this strategy has been employed at one time or another by most of the Latin American debtors. Generally, countries have eventually come to new terms with the creditors and have renewed not only payment on the debt but also their programmes with the IMF. However, there are an increasing number of exceptions to this rule.

In the case of several smaller debtors (Nicaragua, Bolivia and Honduras) the accumulation of arrears has now evolved into a *de facto* moratorium. Another country, Peru, declared that it would temporarily limit its public debt service payments to the equivalent of 10% of its exports. More recently, with the fall in petroleum prices, there has been widespread discussion in Latin America concerning the possibility of unilaterally establishing an interest rate below LIBOR (with capitalization). Meanwhile, the list of countries which have rejected, or have expressed intentions to reject, submission to an IMF programme continues to expand.

Another important initiative of the Latin American debtors has been their formation of the Cartagena Consensus to co-ordinate regional action bearing on the debt problem. The group is made up of Ministers of State—Foreign Relations and Finance—of the 11 member countries, who have been meeting regularly since June 1984 to discuss solutions to the debt crisis and to promote dialogue with the creditor countries. The group has avoided any pretension of being a debtors' cartel and has always confirmed Latin America's commitment to honour its foreign liabilities. Yet with time it has become an increasingly effective tool for improving the bargaining power of the debtors in their negotiations with a co-ordinated creditor cartel for a more equitable distribution of the costs of the crisis. In December 1985 the Cartagena Consensus affirmed in its Declaration of Montevideo that if international measures to resolve the debt problem were not soon forthcoming, the region would be confronted with an extremely serious situation which would inevitably compel it to limit its net transfers of resources in order to avert an aggravation of social and political instability which might forfeit all the ground gained by democratic consolidation processes.⁵⁶

In this respect, it is useful to remember the lessons of the past. Keynes, in his study of World War I debts, once observed that even though countries may be forced to service heavy debt burdens, a broader policy of enlightened self-interest on the part of creditor governments would suggest that relief be granted.⁵⁷ This is because an unduly heavy debt burden that stifles legitimate national aspirations for growth and development creates resentment, undermines international commitments and encourages debtor countries to look elsewhere for friends. To this insight is added the success of the post-World War II Marshall Plan which, through its emphasis on investment programmes

and economic growth, promoted political and economic commitments among a large group of countries and thereby contributed to one of the most prosperous periods in history. The message is clear: it is socially dangerous to permit creditors to myopically pursue financial discipline, while there is a very considerable pay-off for generosity in the management of excessive debt burdens.

C. ADJUSTMENT AND SOCIAL EQUITY

1. Deterioration of the social situation

In terms of equity and satisfaction of basic needs, the economic crisis and the stabilization and adjustment programmes applied in recent years have notably worsened a situation which was already disquieting. This deterioration has, of course, differed in the different countries of the region and is likewise due to different causes. Nevertheless, generally speaking it has been influenced by two factors: in the first place, the slump in the real income of vast sectors of the labour force caused by the contraction of economic activity and of employment, by restrictive wage policies and by the acceleration of inflation; secondly, the decline in public expenditure on education, health and housing which has taken place in many countries in consequence of the application of policies designed to reduce the fiscal deficit.

The fall in real wages has been very marked in most of the countries for which data are available. As can be seen in table 16, between 1982 and 1985 average real remunerations rose only in Colombia, Costa Rica and Argentina. In Argentina, however, this increase represented no more than a recovery from the enormous downward slide that had occurred in the period 1976-1982, while in Costa Rica it did not suffice to offset the tremendous reduction undergone by real remunerations between 1980 and 1982. On the other hand, in the biennium 1983-1985, the real value of wages dropped by 40% in Peru, 32% in Mexico, 18% in Uruguay, 15% in Chile and 7% in Brazil. During that space of time, the pay received by wage-earners in the lower income groups followed similar trends: except in Argentina and Colombia, the urban real minimum wage contracted sharply in all countries on which data for 1985 are to hand (see table 17). This trend is corroborated by the evolution of real wages in the construction sector, in which wages are normally higher than the legal minimum but lower than those paid in industry (see table 18).

As already remarked, employment too has followed a very unfavourable course. Notwithstanding that in the second half of 1985 unemployment rates were reduced in several countries of the region, they were still much higher than those recorded before the crisis (see table 4 and 5). Moreover, this increase in open unemployment affected young people in particular and was accompanied by a significant change in the socioeconomic level of the unemployed. Whereas traditionally they had been members of the secondary labour force from middle-income households, nowadays they also include many heads of low-income families. For example, it has been estimated that among the poorest 20% of families in Santiago, Chile, the proportion of heads of households out of work shot up from 10% in 1981 to nearly 25% in 1983.⁵⁸ This greater incidence of

unemployment among heads of households is also reflected in the systematic decline recorded between 1979 and 1982 in the percentage of total unemployment represented by those seeking work for the first time in Colombia, Costa Rica, Chile and Venezuela.⁵⁹ Lastly, in some countries the deterioration of the employment situation was also reflected in a marked increase in underemployment. Thus, between 1981 and 1983 employment in the urban informal sector —where much of the urban underemployment is concentrated— expanded by 44% in Costa Rica, by between 20% and 28% in Argentina, Brazil and Peru and by between 9% and 11% in Bolivia, Mexico and Panama.⁶⁰

To the repercussions of the increase in unemployment and underemployment have been superadded those of the reduction of public expenditure in the social sectors. As can be seen in table 19, between 1979 and 1983 the proportion of total government disbursements allocated to education and health shrank in 13 countries of the region and expanded in only four.

In some cases the effects of these retrenchements have been striking. In Costa Rica, for example, reductions in social expenditure resulted in a fall of 20% between 1979 and 1982, in the number of beneficiaries under school feeding and other supplementary feeding programmes, and doubled the number of children treated for serious malnutrition in the country's main rehabilitation centre between 1981 and 1982.⁶¹ In Peru, in its turn, in consequence of a cut in public resources the number of mothers receiving care under the Food Aid Programme plummeted by 54% between 1981 and 1984, that of nursing mothers and pre-school children dropped by 37% and that of children of school age fell by 17%, while cases of dysentery skyrocketed from 399 per 100 000 inhabitants in 1980 to 937 in 1984.⁶² Lastly, in Bolivia —where social expenditure shrank by 25% in real terms between 1981 and 1983— more than 78 000 children who ought to have been enrolled in basic education in 1983 were not entered.⁶³

However, it is not only in the immediate downturn of indicators like those mentioned above that the deterioration in the social situation caused by the crisis makes itself felt. Changes like the greater incidence of infectious and contagious diseases, the decrease in weight at birth, the larger number of abandoned children —all phenomena which tend to become more marked during periods of intensive and long-drawn-out recession— not only do immediate harm but also produce negative effects of a more lasting character which usually become fully apparent after some time has passed.⁶⁴ This dephasing occurs both because of the time it takes for these effects to materialize and because families use their resources and adapt their behaviour as far as possible in such a way as to avoid lowering still farther their often very precarious level of living.⁶⁵

The probable evolution of the poverty situation in Latin America up to the end of the century also illustrates the enduring consequences of the crisis. On the basis of certain reasonable assumptions it has been calculated that in the year 2000 there will be 20 million persons in Latin America in a state of poverty, who if the crisis had not occurred would have risen above that situation; the total number of poor would thus be 170 million (a figure equivalent to 30% of the population) instead of 159 million.⁶⁶

Possibly, moreover, the indicators of provision of public services may not accurately keep track of the negative changes that have actually taken place. For example, in almost all the countries of the region the rate of school attendance has gone on rising during the crisis years. Nevertheless, curtailment of the resources allocated to education may mean that in some cases this masks increased pupil/teacher or pupil/classroom ratios, smaller supplies of educational material and possibly less diligence in their class work on the part of teachers in consequence of the sharp reductions in their real wages (whether because of the loss of incentive or because they have to devote part of their time to other gainful activities).

2. Adjustment and equity: relations and policies

Considering in the first place, the deterioration that has already occurred in living conditions and, secondly, the probability that because of the external constraint the economic growth rate in many countries of the region will be relatively moderate during what remains of the present decade, while in addition the evolution of per capita consumption will be even slower in consequence of the need to raise the coefficient of domestic saving, it is obvious that in the future a much higher priority will have to be accorded to policies directed towards ensuring a more equitable distribution of the fruits of development. In particular it will be necessary to give reference to measures designed to reducing critical poverty and increasing equality of opportunities.

If considerations of social equity are to be allotted their proper place in the formulation of economic policy, the principles which have traditionally guided stabilization and adjustment programmes will have to be appreciably modified, and it will also be necessary to see that economic reactivation policies, besides promoting the recovery of production and employment, facilitate progress towards the shaping of a new development model. To that end it will be indispensable to systematically take into account the effects of global macroeconomic policies on the situation of the lower income groups and to adopt specific measures in the social sphere to alleviate poverty in the short term, and over the medium term to promote greater equality of opportunities.

On the macroeconomic level, policies must be based on the idea that attainment of these objectives depends both on a satisfactory structure of the various components of the major economic aggregates and on the global magnitude of these latter or their rates of increase. For example, if in order to restore the basic macroeconomic balances public expenditure must inevitably be cut or imports contracted, this should be done not indiscriminately, but concentrating on reductions in those items which have less effect on the levels of activity and employment and maintaining, as far as possible, those which make a more direct contribution to the satisfaction of the basic needs of the poorer groups.⁶⁷

Where specifically redistributive policies are concerned, they should basically include programmes of two types. In the first place, those guaranteeing a minimum monetary income, which is essential for the satisfaction of needs implying private expenditure (food, clothing, transport, etc.); secondly, direct measures adopted by the State to provide an adequate supply of goods and

services in key areas such as health, nutrition, education and housing. This second group of policies is reflected and crystallized in the State's social expenditure proper, whereas the former takes shape through policies designed to create jobs and to improve the production capacity of the poorer groups.

a) *Social policies*

As in recent years social public expenditure per capita has been considerably reduced in many countries of the region, its expansion is particularly necessary. It must be recognized, however, that in the short and even in the medium-term public resources will still be severely restricted. Hence the crucial importance that will attach to increasing the efficacy of social policies. This, in turn, calls for concentration of effort on the restructuring of global social expenditure and on enhancing its efficiency as regards benefiting the poorer groups.

Generally speaking, there are four basic mechanisms through which greater efficiency in social expenditure can be achieved. They are the following: i) rechanneling of global social expenditure into those items which are proportionally more favourable to the lower income groups; ii) restructuring of expenditure within each social sector, placing the accent on those components whereby coverage of the poorer groups can be broadened; iii) adequate identification of the groups selected as the targets of social policy, i.e., those that it is desired to benefit preferentially; iv) progressive replacement of generalized price subsidies on certain goods by direct transfers to the poorer groups.

In the light of the first of these principles, the emphasis in social expenditure should fall on health and education. The information to hand testifies to the fact that subsidies granted in these areas benefit mainly the poor and middle-income strata (see tables 20 and 21). This is partly because in respect of both health and education the higher income groups largely meet their own needs through private expenditure, since they can afford the heavier costs implied by better-quality services; in the case of health, moreover, it must be borne in mind that the members of poorer households are more likely to fall ill. On the other hand, as is shown in table 22, the structure of expenditure on social security does not primarily benefit the lower income groups, although there is plenty of room for improvement in its redistributive effect.

It is within each social sector, however, that there are greater possibilities of significantly increasing the efficacy of social expenditure as regards benefiting the lower income groups. Proper exploitation of the technical advances which make it possible to give the poorer groups wider coverage and at the same time to bring down costs; reallocation of expenditure towards areas inhabited mainly by those groups; and utilization of the linkages or positive externalities existing between the various components of social expenditure, are three elements which may quickly and substantially help to heighten the distributive efficacy of social expenditure.

These possibilities are significantly exemplified in the advantages that can be obtained by re-directing expenditure on health from individual curative medicine to preventive medicine and the protection and promotion of environmental sanitation. The fact is that preventive health techniques require far fewer resources, and particularly less expenditure on imported components,

than curative health care and, therefore, make it possible to look after a much larger number of beneficiaries with a smaller amount of resources.⁶⁸

On account of its very low cost in comparison with other options and because of the rapidity of its results, as well as in view of the priority that must be accorded to children as a target group for social policies, programmes in the health area can in many cases be organized around a central nucleus consisting in four basic techniques which, as UNICEF puts it, would constitute a veritable "pro-children revolution".⁶⁹ Among such techniques are oral rehydration therapy; expansion of mass immunization campaigns; control of children's growth by their mothers at home; and diffusion of scientific knowledge on breast feeding and proper weaning practices. These techniques are not only extremely efficacious, but reinforce one another. A very good case in point is that of oral rehydration therapy, which consists in administering a solution of salts and sugar to children suffering from diarrhea, to prevent their dehydration and subsequent death. In 1982, for example, this therapy was brought into generalized use in an area with 64 000 inhabitants in the Eastern region of Guatemala, where the main cause of infant mortality was dehydration induced by diarrhea. A year later, the number of infant deaths from diarrhea had been reduced by one-half. The total cost of putting this campaign into effect throughout the country was estimated at less than 5 U.S. cents per person, i.e., 0.2% of the country's total health budget. In Costa Rica, in its turn, the implementation of an oral rehydration therapy programme at the end of the last decade not only reduced the number of deaths from diarrhea and dehydration by 98%, but allowed enormous savings to be made. Whereas in 1977 the cost of medical attendance and hospital care for cases of diarrhea had been estimated at US\$ 3.5 million, the entire oral rehydration therapy programme was carried out at a cost of US\$ 232 000.⁷⁰

In the sphere of education, too, although such spectacular results in so short a time, cannot feasibly be expected, there is also plenty of room to improve its distributive effects and at the same time increase the social return on public expenditure. In developing countries, the social yield of education is not only greater as a rule than that of investment in physical capital, but is also especially high in primary education. In practice, in this latter the rate of return tends to hover between 22% and 27%, while in higher education it fluctuates around 12%.⁷¹ For this reason, and also in the light of redistributive considerations, it is necessary to give special preference to basic education, which clearly benefits the poorer children, and to reduce in relative terms the public resources allocated to higher education, which, in practice, is much more easily accessible to young people from higher-income families.⁷² Secondly, incentives must be created to encourage parents of poor families to keep their children at school, a matter which acquires particular importance in periods of intensive and long-drawn-out economic crises, such as that which the region has been facing in recent years. In periods of recession there is generally a rise in the rate of school drop-out among children from poorer families, mainly because of the need for the children to collaborate in the generation of family income. It is therefore indispensable to create incentives that will offset the "loss" of earnings which in the short term is implied for a low-income family by keeping a child at school, and to subsidize private expenditure relating to school attendance. According to

the resources available, the incentives may include free supply of teaching materials, clothing and footwear, provision of school breakfasts and lunches, and health check-ups for pupils from poorer families. Thus, an educational policy which places emphasis on basic education is recommendable on much the same grounds as one which accords priority to preventive medicine in the area of public health: there is a broad consensus as to its necessity, through it the coverage of poorer groups can be extended, and it fulfils the requisite of considering children as a focal group for social policy.

Nutrition is another sector in which public action may mitigate the negative social consequences of adjustment policies over the short term and help to lay the foundations for more equitable and dynamic development in the medium term. "Overcoming deficiencies in nutrition produces stronger, more energetic workers, reduces the number of work-days lost because of illness, lengthens the working life-span, and increases cognitive skills. The flow of earnings is thereby increased above what it would have been in the absence of improved nutrition and health."⁷³ And as UNICEF has rightly stressed, "it is important also to recognize that these nutritional benefits accrue not only by enhancing the productivity of workers in the recognized (or formal sector) part of the labour force, but to others also, especially but not only women engaged in household activities which may not be counted in national income but which greatly influence economic production and household living standards".⁷⁴

Furthermore, policies in this field are especially necessary because the nutritional state of the population, and in particular that of children, is affected when real household income decreases, and because the harm done by malnutrition to children and to pregnant or nursing mothers is very serious and lasting. Both on this account and in view of the contribution that a better nutritional state can make to the improvement of productivity, the maintenance of nutritional programmes during the phase of adjustment and their reinforcement during that of recovery are indispensable ingredients of more equitable development with a more human face.

Although there are many ways of improving nutritional levels, the most efficacious measures are those adopted in conjunction with the provision of other services such as those relating to health, education and environmental sanitation.⁷⁵

The possibilities of restructuring public expenditure in order to improve the living conditions of the poorer groups are also important in the case of housing. Given the shortage of available resources, this will in many cases necessitate limiting the size of the subsidies directly or indirectly granted to the middle or upper-middle income groups, which have often been the main beneficiaries of government housing programmes, so that these latter can be reoriented towards the poorer strata. Likewise, in order to increase the number of dwellings, some of the public sector effort must be concentrated on the construction of minimum units which are, however, provided with piped water, sewerage and electricity services. In addition to the expansion of coverage which can be achieved with the same resources, there are three reasons that justify this option. In the first place, it is essential that these services be available in housing units in order to consolidate and strengthen the favourable effects of expenditure on health and nutrition;⁷⁶ secondly, in the construction of piped

water, sewage and electricity networks, economies of scale are considerable; and lastly, supplying these minimum units to poorer families, by means of subsidies, permits more efficacious harmonization of public expenditure with the families' individual effort to complete and gradually enlarge the dwelling around the basic nucleus, in accordance with their needs and the resources at their disposal.⁷⁷

On the other hand, there are fewer redistributive possibilities in the sphere of social security for two reasons: first, because to be eligible for social security benefits it is generally necessary to be or to have been a worker in the modern sector of the economy, a condition which normally excludes the poorest groups; secondly, except in the case of family allowances, benefits under the system are calculated in proportion to the insured person's income and, therefore, tend to reproduce the inequities of overall income distribution.⁷⁸

As already noted, a third requisite for improving the efficiency of social expenditure is precise identification of the group which it is intended to benefit. Generally speaking, this group is constituted by the poorer population; more specifically, special emphasis must be placed on the mother-child binomial. Just as evidence has been found of the high rate of return on investment in human capital in general,⁷⁹ so too has it been established that the return on investment in children in particular is even better.⁸⁰ The reason is that in the latter case the opportunity cost is less, the period during which benefits are obtained from the investment is longer and the earlier years of life are decisive for a person's development.⁸¹ In addition to these general factors, it is also true that investment in poor children is socially more productive than investment in children in general, since they are a long way from the stage at which additional investment in human capital begins to show diminishing returns. Furthermore, where children from the higher income groups are concerned, public expenditure takes the place, up to a point, of private outlays which would have been made in any event. Lastly, the benefits of action in favour of children and young people from lower-income families strongly influence on their motivation to redouble their efforts to escape from the hardships of poverty.

Lastly, the fourth requisite for increasing the redistributive effects of public expenditure is the gradual replacement of general subsidies on prices of goods and services by a system of direct transfers to the poorer groups. There are basically three grounds for this change. In the first place, by lowering the cost of purchasing a good for all buyers, irrespectively of whether they are rich or poor, price subsidies often mean that a large amount of public resources is wasted as regards the objective of benefiting the lower income groups;⁸² secondly, and precisely for the foregoing reason, the negative effect on the purchasing power of the poorer groups that would be caused by the withdrawal of the subsidy can be neutralized by a direct transfer of income to these groups, a process which would signify saving part of the resources that were formerly used to finance the subsidy; and lastly, since the goods normally subsidized — fuels, food products — are internationally tradeable, the elimination of the subsidy and the consequent price increases would promote a reduction of demand for these goods and an increase in output, two changes which operate in favour of the adjustment process. While these principles of efficiency in subsidies policy are permanently valid, they become especially relevant when, as happens in many countries of the region today, the fiscal deficit has to be reduced and external adjustment

fostered, or when the object pursued is a reactivation which will maintain balances that are hard to achieve in the spheres under discussion.

b) *Job creation programmes*

As already noted, one of the major manifestations of the crisis in Latin America and the Caribbean has been the increase in unemployment and underemployment, a phenomenon which has helped to aggravate long-standing structural deficiencies. It goes without saying that the overcoming of these weaknesses through the generation of a sufficient number of productive and well-paid jobs is an essential requisite for permanently resolving the problems of poverty and inequality of opportunities. Obviously, however, this is a long-term solution, which depends not only on the achievement of a high and sustained rate of economic growth, but also on complex processes such as those linked to transformations of the structure of production, selection of suitable technologies and changes in the growth rate and skills of the labour force. Hence, while the adoption of policies aimed at increasing the rate of absorption of manpower over the medium term should not be neglected, it is also necessary to apply measures that will contribute to short-term relief of the unemployment and underemployment problems.

Two of the basic instruments that can be used to this end are special job creation programmes and subsidies on additional recruitment of labour in the private sector.⁸³

Special employment programmes constitute, in principle, an efficacious instrument for coping with poverty and massive underutilization of manpower problems in a time of recession.⁸⁴ These programmes can be drawn up in such a way as to afford the more needy groups two kinds of benefit: one —direct and individual— is represented by the income in cash or in kind which workers employed under the programme receive; and the other —of an indirect and social character, but no less efficacious— consists in the improvement in environmental living conditions which the programmes may signify for the poorer groups, in so far as the work executed under them —construction of streets, waterpipes and sewerage networks, schools, clinics, and social, sports and recreational centres; environmental sanitation projects; irrigation, drainage, reforestation, levelling and recovery of agricultural land, etc.— are concentrated in the urban settlements or neighbourhoods and rural areas where the poorer groups live. Secondly, such programmes can be implemented with a minimum use of equipment, and, in particular, of imported inputs and machinery, a characteristic which makes them particularly attractive in periods when foreign exchange is in short supply. Thirdly, the financial cost of these programmes is relatively low and so is their cost in terms of seepage, since neither the jobs they offer nor the wages they pay are likely to attract persons in the middle and upper income groups. Fourthly, they have the advantage of bringing about a rapid reduction in unemployment and a similarly immediate increase in the earnings of poor families. Lastly, they can be used to improve labour skills, thereby helping to raise the productivity of the economy over the medium term. To make the most of these potential advantages, however, it is necessary to allocate fairly considerable resources to planning and project selection and, above all, to the organization, management and control of the

works involved, requisites which are not always easy to meet, especially over the short term.

It is precisely the possibility of combining an increase in employment with the use of management capacity and capital resources which are at present temporarily underutilized that constitutes one of the attractions of the programmes for subsidizing additional recruitment of manpower. These programmes, moreover, have another favourable feature in comparison with direct employment programmes, i.e., the contribution they can make to export growth and import substitution. This characteristic is especially important in periods when insufficient import capacity constitutes the main constraint on economic reactivation and growth, and is in favourable contrast with the orientation of special employment programmes which, by their very nature, tend to be geared primarily to the production of non-tradeable goods and services. Even so, policies for subsidizing manpower recruitment are apt to be less effective in times of crisis, when enterprises' demand for manpower depends more upon their sales volumes and prospects than upon the cost of labour. Hence these policies are more efficacious in the phase of recovery, or when they are combined with export promotion or import substitution programmes.

c) *Policies improving the production capacity of the informal sector*

State action not only may supplement the income of poor families by means of social policies or employment programmes, but can and must also see to it that their productive capacity is increased.

Generally speaking, the sectors which should be targets of these policies are the urban informal sector, in which between 70% and 90% of the poor in Latin American cities find employment,⁸⁵ and the sector formed by small rural producers, who, although they seem to be less affected by the crisis than the urban poor,⁸⁶ formed the poorest group and the one with most precarious living conditions in the society. However, given on the one hand the enormous magnitude of these groups' unsatisfied needs, and, on the other, the shortage of available resources, it will be necessary to concentrate action in this sphere on a subgroup in each of the said sectors. These subgroups comprise small manufacturers and producers of non-personal services in the urban informal sector, and producers of internationally tradeable agricultural goods in the rural area. If well-directed government support could be relied on, the greater relative dynamism of each of these subgroups in its respective area would not only enable it to make the most of the role which, within its limitations, it can play in the reactivation process, but would also allow it gradually to absorb workers in the less productive segments (small shopkeepers or street vendors and workers in personal services in the urban informal sector, and producers of non-tradeable goods in the rural area). In this way, one of the important effects of the policy would be to initiate and promote a necessary structural change.

There are basically three policy measures designed to improve the production capacity of informal urban producers and small rural producers: first, the provision of an adequate supply of credit, which entails the creation of non-traditional mechanisms enabling the existing financial institutions to extend loans to producers of this type, and the establishment of new special loan and

guarantee funds; secondly, the rechannelling of a part of public sector demand towards the purchase of goods and services which can be produced at competitive costs in the informal sector (uniforms, furniture, school textbooks, repair services); thirdly, provision of technical assistance and opening-up and strengthening of marketing channels, whereby output can be increased and the sale of goods produced by the informal sector can be facilitated.

IV. STABILIZATION AND ECONOMIC ACTIVITY

A. THE CHALLENGE OF STABILIZATION

One of the most serious problems currently facing many Latin American economies is their extraordinarily high rate of inflation. Hence, along with the preservation of an adequate external balance and the resumption of the growth process, bringing down inflation is both a priority objective and a fundamental challenge of economic policy in many countries of the region.

Theoretically, there is no reason why the attainment of this objective need inevitably cause a recession. On the contrary, if —to use a well-known expression— inflation can be described as a process in which “too much money is chasing after too few goods”, it is hardly logical to try to reduce inflation by producing even fewer goods, as occurs during a recession. If this is often what has occurred in practice, it is because of the faulty design or implementation of stabilization programmes, not because it is theoretically inevitable.

Strictly speaking, from an analytical standpoint the reduction of inflation “merely” requires that the growth rate of the *nominal* value of the main economic variables (such as the exchange rate, interest rates and wages) be slowed down as evenly as possible. The reduction of inflation does not require that production be lowered nor that basic changes be made in economic variables in *real* terms. This is certainly one aspect in which the process of price stabilization differs from that of adjustment to external disequilibrium; in effect, to the extent that adjustment calls for a radical turnabout in the trade balance real costs will ensue, for such a turnabout in many instances will entail a decrease in the domestic supply of goods and services available, which is ultimately what determines the population's real standard of living.⁸⁷

That price stabilization not require recession is not merely a theoretical fine point. Although such cases are the exception rather than the rule, expansionary stabilization programmes have indeed been carried out, *inter alia*: the abrupt halt put to hyperinflation after the First World War in some countries,⁸⁸ and, more recently, the cases of Indonesia,⁸⁹ which managed to lower its inflation from 1 000% per year to 10% between 1965 and 1970 without sacrificing growth; Uruguay, which reduced inflation from 125% to 20% between 1968 and 1969 without falling into a recession and which slowed the rate of increase in consumer prices from 107% to 46% between 1974 and 1978 while, at the same time, expanding overall production by an average annual rate of 4%; Bolivia, which managed to reduce its inflation from 39% to 5.5% between 1974 and 1976 while growing by nearly 7% per

year; and Costa Rica, where inflation plunged from somewhat more than 100% in the third quarter of 1983 to 10% in late 1984 while the country's gross domestic product grew 6%.

To be sure, examples of the opposite phenomenon abound but, as previously mentioned, they are usually the result of poor design—in the case of both traditional stabilization programmes as well as those whose sole purpose is to repress inflation—or of faulty implementation.

B. THE FAILURE OF TRADITIONAL STABILIZATION PROGRAMMES

1. Causes

One may well ask why, if it is not inherently necessary, have stabilization programmes in the past in fact tended to lower output, and often by a considerable amount.

It is well known, of course, that if a country wants to bring down its rate of inflation, it needs to reduce the growth rate of nominal aggregate demand. This is not enough, however, since the deceleration in nominal demand may either have an impact on the rate of inflation (the desired result) or on the growth rate of production (an undesired result). Indeed, one of the main problems of present macroeconomic theory is how to explain the extent to which a decrease in demand divides itself between falls in prices or in production. In practice, this division depends on the specific policies adopted to stabilize prices as much as it does on inflationary expectations. If the various economic agents' expectations are substantially the same in this regard and, above all, if they are in line with the inflation target implicit in the country's monetary and fiscal policies, then the impact of a deceleration in nominal aggregate demand will fall largely on prices. On the other hand, if a considerable disparity exists between the public's inflationary expectations and the inflation target inherent in monetary and fiscal policy, the slowdown of demand will also fall on production, causing recession.

How inflationary expectations are handled is thus central for the success of a stabilization programme. Indeed, the failure of such programmes in Latin America has been largely due to the fact that they have been designed to have an effect only on demand or only on costs and have either neglected to steer expectations in the necessary direction or have attempted to control only some of the variables influencing them.

It is surely not surprising that stabilization programmes aimed at reducing inflation simply through price controls have failed since these have not, simultaneously, curbed monetary expansion to the necessary extent. Such programmes attack the symptoms rather than the causes of inflation; in such cases inflation is held down temporarily, but at the cost of shortages, balance-of-payment crises or a combination of both. Under such circumstances, inflation will inevitably make a reappearance after a time and, when it does, the rate of inflation is often even higher than before.

Programmes which have focused exclusively on limiting monetary expansion and reducing the fiscal deficit have not generally been successful either. While there is no theoretical or empirical doubt that in order to reduce

inflation it is essential to reduce monetary expansion as well, a policy which achieves the latter but without controlling cost pressures risks recession. If, for example, economic agents expect inflation to be greater than the inflation target implicit in monetary policy, prices will be set at a level higher than that which would permit total potential production to be purchased with the amount of money available. In such circumstances, the government will be faced with the dilemma of either maintaining its restrictive monetary policy (and thus bringing on a recession) or of abandoning its stabilization goal, thereby ratifying the economic agents' expectations of higher inflation through a passive monetary policy. This crucial dilemma is the reason why stabilization programmes whose basic focus has been the restriction of aggregate demand have often brought on contraction of economic activity or have had to be abandoned after a time. This has been particularly common in countries with a long history of inflation, because such a tradition generates expectations and mechanisms which, although they make it economically and politically easier to "live with" steadily and rapidly rising prices, also make it more difficult and costly to apply measures designed to reduce inflation.

This also explains the failure of stabilization programmes which, in addition to holding down demand, have controlled or frozen only one key price. For example, at different times various countries have attempted to curb inflation by applying restrictive monetary and wage policies. However, since they have allowed all other prices to be set freely and have not taken steps to guide expectations, inflation has decreased much more slowly than nominal wages, thus giving rise to Keynesian recessions, i.e., recessions due basically to a drop in real demand. In such cases, the social costs entailed in the failure of a stabilization programme are twofold, because in addition to a lower level of economic activity, income distribution also worsens.

In still other cases, attempts have been made to reduce inflation by means of exchange policies. To this end, exchange rates have been readjusted, not on the basis of past or present inflation, but rather on the basis of the inflation target set for some future period, in an effort to slow down the growth rate of prices and costs while, at the same time, guiding and equalizing economic agents' expectations of future inflation. In these instances the main cause of failure has been the fact that the rate of price increases for import-competing goods and non-tradeable goods and services declined much more slowly than the rate of devaluation. In practice, and in contrast to what would be expected to occur according to the "law of one price", imports initially tended to be sold at prices similar to those of their nearest domestic substitutes prior to the liberalization of trade rather than at their long-term value (the international price plus tariffs). In other words, at least at first, the convergence of the prices of domestic products and imports was "upwards" (towards domestic prices) rather than "downwards" (towards the international price). The resulting lag in the exchange rate often tended to generate a considerable disequilibrium in the balance of payments and a decline in economic activity. Initially, both of these phenomena were offset by substantial inflows of capital, but the persistent drop in the real exchange rate increasingly eroded the credibility of the exchange policy and also played a part in the gradual but steady displacement by imports of the domestic products which had to compete in the local market with such imports. As a result, levels of

activity and employment declined and the pressure for a devaluation mounted. As it became evident that the exchange policy could not be maintained without massive external borrowing, capital inflows also diminished. Thus, in the end, the exchange rate had to be sharply increased, and there was a consequent upsurge in inflation as well.

2. Analytical implications

In large part, traditional programmes have been based on erroneous analytical concepts of the inflationary process, especially when such processes have reached a certain level of persistence and intensity. In fact, neither the demand-pull nor the cost-push theory of inflation make an adequate distinction between the initial stimulus which sets off inflation or speeds it up and the mechanism or spiral which keeps inflation going once it has started. Strictly speaking, the distinction between demand-pull and cost-push inflation is only relevant for countries in which there are occasional outbreaks of inflation. In contrast, it is almost irrelevant for countries where inflation is a persistent phenomenon. In these cases, the debate regarding these two theories about the origin of inflation is not only fruitless but has often resulted in the implementation of poorly-designed stabilization programmes. In fact, when inflation is intense and continuous it is almost impossible to distinguish between demand-pull and cost-push pressures. At the most, phases can be identified in which one or the other appears to have predominated, since, in practice, inflation becomes a spiral in which both demand and costs are continually rising and in which its intensity is also influenced to a decisive degree by expectations. Moreover, expectations affect both demand (for goods and for money) and costs (wages, interest rates, the exchange rate).

Strictly speaking, if increases in price levels were due only to excessive spending, as is postulated in the demand-pull theory, rapid inflation could not exist at the same time as a deep recession, whereas, in reality, this situation occurs quite frequently. Such situations, however, cannot be convincingly explained by cost-push theories of inflation either, since according to these theories, a recession would be due to cost rigidities and, especially to wage inflexibility. Yet, if there is any outstanding feature of Latin America's experience during the past ten years, it is not the *rigidity* of relative prices but, on the contrary, their *astounding variability*. Indeed, the terms of trade have fluctuated by as much as 40% in a single year; the ratio between the prices of tradeable and non-tradeable goods (which is one means of measuring the real exchange rate) has varied by up to 50% in a single year in various countries while, in relation to wages, real increases in exchange rates have been even greater (as much as 100%); in cases where an abrupt liberalization of financial systems has been carried out, real interest rates have gone from an annual average of -40% to over +30% in a very short time; finally, as for the much-feared pressure exerted by wages—which is often pointed to as the sole or main cause of unemployment and recession—it should be remembered that in a number of the countries of the region, real wages have fallen by up to one-third in the space of just one year.

Thus, the truth is that the really significant type of rigidity (at least in countries with persistent inflation) is not so much of an institutional, trade union or political sort but is rather due to the rigidity of the inflationary expectations generated by the very process of continuous price increases. As a result of these expectations, almost all the factors which influence prices and costs (wages, rents, taxes, interest rates, exchange rates, credits) are adjusted either formally —through contracts or laws— or informally —through the market— in anticipation of future inflation.⁹⁰

If expectations of future inflation are correct, they do not create major disturbances in production or income distribution, this explains how a number of countries in the region have "lived with" severe inflation for many years without their economic growth being seriously affected. However, if the authorities try to reduce inflation more quickly than economic agents feel is possible, then their stabilization programmes will become ineffective: as already noted, if inflation is expected to be higher than the rate on which the stabilization programme is based, then part of the deceleration of nominal aggregate demand will affect production and a recession may ensue. This is why the most adverse effects associated with inflation tend to be produced either when it speeds up suddenly or when the authorities try to reduce it to a level lower than what the public expects.

This is also why the unemployment which results from stabilization programmes is not only or even mainly due to an increase in real wages. It is true that if the rise in nominal wages (whether because of expectations prevailing in the labour market or because a formal system of indexation exists) is greater than the increase in price levels provided for by the stabilization policy, real wages will climb and will tend to generate unemployment (of a neo-classical type) just as cost-push theoreticians fear. Nevertheless, experience demonstrates that unemployment and recessions can occur when real wages drop as well: if wages are adjusted in accordance with the inflation target which has been established, but producers expect higher inflation and set their prices accordingly, real wages will decrease, and in consequence, demand and sales of non-tradeable goods will also dwindle. Therefore, as long as this imbalance in the market for goods persists, production will drop and unemployment will rise. This will occur despite the decline in real wages, because the sectors oriented towards meeting domestic demand (which usually account for more than half of total production) will have a greater incentive to lay off personnel in response to the drop in sales than they will to hire more workers because their wages are lower.

C. THE COSTS OF INFLATION AND THE RISKS OF RECESSION INVOLVED IN STABILIZATION

Although in theory it is possible to reduce inflation without causing a recession (and this is what has in fact occurred in nearly half of the stabilization programmes applied in Latin America during the past 20 years), most of the successes in this respect have been achieved in countries facing either a sudden rise in inflation or a sharp increase in an already acute inflationary process tending to hyperinflation. In countries with long-standing and relatively stable

inflation, however, it has proved more difficult to make a significant reduction in the rate of price increases while also maintaining or expanding economic activity.

The different results achieved in these two types of cases are not due to mere chance. They can be explained analytically in terms of the very different costs of inflation and the similarly disparate risks involved in stabilization programmes, depending on the intensity and persistence of inflationary processes. The disadvantages or harmful effects of inflation are greatest in two types of situations. The first is when an outbreak of inflation of some intensity occurs in a situation in which price levels have traditionally been stable; this might be termed "occasional" inflation. The second is when an already high rate of inflation speeds up sharply, bringing with it the danger of hyperinflation. The costs of inflation are much lower, however, when inflation has persisted for a long time and its rate, although high, is relatively stable.

When outbreaks of inflation occur, the costs of inflation are primarily related to the distortions in the allocation of resources and in income distribution caused by the sudden and unexpected increase in prices. This is due to the fact that, when the rate of price increases suddenly speeds up in a situation where there is no "tradition of inflation", not all prices will rise at the same speed and not all social groups will be affected in the same way by these increases, nor will they have an equal ability to protect themselves from the effects. Thus, for example, if wages lag behind the overall movement in prices, a regressive redistribution of income will occur; if nominal interest rates do not keep pace with the new rate of inflation, saving is discouraged and unwarranted transfers of income from lenders to borrowers will occur; if the exchange rate falls behind, this will create incentives for imports and disincentives for exports which will tend to accentuate external imbalances. Naturally enough, the greater the intensity and unexpectedness of such an outbreak of inflation, the worse these problems will tend to be.

If inflation continues for several consecutive periods, however, the various economic agents and social groups will come to regard such ongoing price increases, rather than price stability, as being the "normal" situation. As a result, sooner or later they will develop mechanisms for protecting their real income against the effects of inflation. Hence, the key prices of the economy (wages, exchange rates, interest rates) will progressively be "indexed", as will taxes, rents and transactions involving installment payments. When this occurs, the adverse impact of inflation on the allocation of resources and the distribution of income will no longer be proportional to its rate (as is the case with occasional inflation) but rather to the differences between the expected and actual rates of inflation. When such differences are small—as normally occurs when the rate of inflation has shown no major variation for several years—the actual increases in prices will tend to be in keeping with economic agents' expectations and the negative repercussions of inflation will be slight. Thus, if an economy is extensively indexed, the costs of persistent and relatively stable inflation will be lower than those of occasional inflation, even if the rate of inflation is higher in the former case than in the latter. In this event, as attested to by the experience of various countries in the region, inflation will be a socially tolerable process which it is politically possible to "live with" and which is compatible with

satisfactory economic growth rates and acceptable margins of external imbalance.

Nevertheless, even in an economy with broad-based and widespread mechanisms of indexation, the costs of inflation will rise if prices begin to climb at a much faster rate, and if the economy slips towards hyperinflation the costs will become socially intolerable. Under these circumstances, the ever-greater erosion of the real value of any item priced in nominal terms means that increasingly large and frequent adjustments will have to be made in wages, the exchange rate, interest rates, rents and other contracts: rather than being modified once a year, they will have to be adjusted every six months, every quarter or even every month. This shortening of the terms of contracts complicates economic calculations enormously and makes planning almost impossible. Furthermore, when indexation is based on such short periods, any outside disturbance which causes or calls for a change in relative prices helps to spark a rapid increase in the rate of inflation and adds to its momentum. What is more, as inflation speeds up, economic agents attempt to dispose of their liquid balances ever more rapidly by purchasing goods or foreign exchange. Prices and the exchange rate therefore increase much faster than the money supply, and money ceases to perform its prime function as a means of payment. This, in turn, tends to result in a regression towards barter and further impedes the operation of the economic system.

For the above reasons, the costs of inflation usually take on the sinusoidal form shown in figure 15. During an initial stage, when inflation is a recent and unexpected phenomenon, its costs tend to be proportional to the rate of price increases. As inflation becomes persistent and, especially, if its rate is relatively stable, its costs diminish, primarily as a result of the emergence and expansion of indexation mechanisms. Its costs will begin to rise once again, however, if inflation goes beyond a critical threshold, after which it leads to a continual shortening of readjustment periods, thereby prompting the flight of capital and rendering economic calculations and planning virtually impossible.⁹¹

However, the chances of a stabilization plan being successful, for a given intensity and duration of the inflationary process involved, are not only dependent on the different levels and types of costs which inflation has during various phases or stages, but also by the risks of recession associated with the application of such a programme.

Generally speaking, these risks tend to be greater in the case of persistent inflation; in such cases, as has already been explained, inflationary expectations are very deeply-rooted and mechanisms of indexation exist which do a great deal to boost the momentum of the inflationary process. Hence, under such circumstances (as will be discussed in more detail later on), a stabilization programme which fails to guide expectations of inflation and which does not achieve a proper alignment between the reduction of the growth rate of aggregate demand, on the one hand, and a simultaneous and relatively even deceleration in the various components of costs, on the other hand, runs the risk of causing a drop in economic activity.

This risk is lower with occasional inflation, in which, precisely because of the absence of a long history of inflation, there are no indexation mechanisms and most economic agents base their actions on the assumption that the normal

situation is one of stability rather than of ongoing price increases. The risk of a stabilization programme causing a decrease in economic activity is also lower when its aim is to reduce hyperinflation, mainly because of the greater co-operation and support which the various social groups are willing to lend an anti-inflationary policy under such circumstances. The risks of a stabilization programme causing a recession therefore tend to follow a path similar to an inverted "U", as shown in figure 15.

The implications of the preceding analysis for economic policy are clear. Due, in part, to the fact that the costs of occasional inflation are high and are proportional to the intensity of the inflationary outbreak and, in part, to the fact that in such cases the risk of a stabilization programme prompting a drop in economic activity is lower, the decision to fight occasional inflation should be taken quickly in order to prevent a prolongation of the inflationary process and to avert the generation of indexation mechanisms and inflationary expectations which would later make it much more difficult to reduce the rate of price increases.

The enormous economic costs of hyperinflation and the threat it represents to political and institutional stability also make it clear why there can be no delay in applying a stabilization programme in such a situation.

An anti-inflationary policy is of lower priority and stabilization programmes tend to be postponed, however, when inflation is stable, even if it is high and persistent. As already explained, under such circumstances the existence of a broad-based and widely-used system of indexation markedly reduces the adverse effects of inflation, but it also increases the risk that a stabilization policy will lead to a recession. In practice, these two factors tend to lessen both the pressure on the government to implement an anti-inflationary programme and the amount of support which the better organized social groups are actually willing to give such a programme.

D. STABILIZATION POLICIES AND ECONOMIC ACTIVITY

In order to be successful, any stabilization programme must include policies designed to control aggregate demand, rectify relative prices, and guide expectations. However, the relative importance of each of these policies will vary depending on whether the situation is one of occasional inflation, persistent but relatively stable inflation, or acute and sharply accelerating inflation. In general, the more intense the inflation, the less important it is to correct relative prices since, in this case, the really crucial tasks are to guide expectations and control total demand. On the other hand, in combatting occasional inflation, it is essential to correct relative prices and to bring aggregate demand quickly under control in order to ward off inflationary expectations and prevent the creation of indexation mechanisms. Finally, when faced with persistent but relatively stable inflation, the most important step is to destroy its momentum; in order to do so, the reduction in the growth rate of total demand must be coupled with a simultaneous and relatively even slowdown in the various components of costs.

1. Occasional inflation

Although this is what may be termed "textbook" inflation, it is becoming less frequent in Latin America. Its analysis continues to be important, however, especially in order to interpret the Central American and Caribbean economies' experiences with inflation, since, until relatively recently these countries were able to maintain notably stable price levels for very extended periods of time.

This has changed in the past few years, however, as a result of major outbreaks of inflation in more than a few of these countries. The reasons for these outbreaks have varied. Sometimes they have stemmed from an excessive growth of total demand that has been financed by a very considerable increase in money supply or by an expansion of foreign indebtedness which cannot be sustained over the long term. In other cases, inflation has been sparked by sharp drops in the supply of agricultural products (with a consequent increase in food prices) or by rising costs resulting from increases in the international prices of widely-used imports or from devaluations carried out in response to a deterioration in the country's terms of trade.

Naturally, the extent to which it is necessary to apply each basic component of a stabilization programme (controlling aggregate demand, correcting key prices which have lagged behind, guiding expectations) will vary according to the cause of inflation. Thus, if an outbreak of inflation has been caused by excessive domestic spending, a strict control of demand will be of fundamental importance, although if the rate of price increases is significantly higher than international inflation, the control of aggregate demand should probably be coupled with a devaluation in order to regain international competitiveness.⁹²

However, if the outbreak has been caused by a disturbance in supply or, above all, by an increase in the exchange rate, a very severe restriction of aggregate demand may have recessionary effects; since a devaluation tends to push costs up, if nominal aggregate demand remains constant it will not be sufficient to buy up full employment output at the new price levels, and economic activity will therefore fall. Hence, in order to avoid such a decrease, nominal aggregate demand will have to be raised enough to permit all production to be sold at the new price levels, but not so much as to produce an additional rise in price levels, which would cancel out the desired devaluation in real terms.

A situation similar to that caused by an increase in the exchange rate, albeit less acute, occurs when certain commodity prices which have been held down (oil, food, public services) are decontrolled. The immediate effect of this is, of course, an increase in the prices of these goods and services. If the demand for them is relatively inelastic, then the demand for other goods will decrease and their production will also probably drop.⁹³ Therefore, in order to avoid a recession, decontrol should be accompanied by an increase in aggregate demand, even at the cost of allowing prices to stabilize at a higher level than before.

In addition to accurately identifying the reason for the outbreak of inflation and attacking its specific cause, the stabilization of price levels in a situation of occasional inflation calls for measures to discourage expectations of continuing inflation. Thus, an essential step is to supplement policies for

controlling aggregate demand and correcting price lags with an incomes and price policy. Such a policy must establish a set of relative prices which are not only in keeping with the new conditions —i.e., that are such as to ensure that there will be neither a recession (excess supply) nor a supply shortage (excess demand)— but which also are viewed as credible by the economic agents. If this latter requirement is not fulfilled, economic agents will base their actions on the assumption that inflation is going to continue and will therefore help to ensure that the outbreak of inflation actually does lead to persistent inflation.

How strict the incomes and prices policy should be will depend on the flexibility of prices and wages; the less flexible they are, the stricter the policy will have to be.⁹⁴ Because of this, and depending on how pressing the need to curb inflationary expectations is, it may be preferable either to establish a (temporary) policy under which prices and wages are fixed and controlled or to control only public-sector prices and wages while laying down guidelines indicating the desired evolution of private-sector prices and wages.

2. Persistent inflation

As previously noted, when inflation continues for several years, expectations that it is going to persist will be generated and will become ingrained. If mechanisms of indexation are widespread and if the future rate of inflation is gauged correctly, variations in relative prices will diminish and the transfer of income entailed by occasional or unexpected inflation will be reduced; as a result, many of the evils or costs typically associated with inflation will be lowered. Unfortunately, generalized expectations of inflation and widespread indexation not only make "living with" inflation more tolerable, but also make it more difficult to eradicate. Under these circumstances, any stabilization policy designed to slow down the rate of price increases by an amount greater than what the public believes possible will run the risk of causing a recession. Thus, in attempting to reduce persistent inflation, it is essential to guide expectations in such a way as to lower the rate of increase of key prices as simultaneously as possible, to the target level of inflation and to ensure that this slowdown is compatible with programmed monetary and fiscal restrictions.

a) *The simultaneous slowdown of key prices*

Decreasing the growth rate of the money supply and reducing the fiscal deficit constitute, in general, a necessary but not sufficient, condition for a successful stabilization programme. This is because, in practice, inflationary expectations do not respond immediately when restrictive monetary and fiscal policies begin to be applied. At first, the public is skeptical and wants to see results before believing that the authorities can bring inflation down to the target level. This is not unreasonable: after so many years of high inflation and after seeing numerous stabilization plans end in failure, economic agents have ample reason to doubt that a new anti-inflationary programme will be successful. Moreover, if they are to be persuaded to adjust their prices in accordance with the targeted rates of inflation, it is not enough for each of them to believe in the consistency and internal logic of the stabilization programme. Each agent must also think that all other agents are going to act in the same way.

If an economic agent believes that others are going to raise their prices by an amount greater than the programme's target level, then that agent will also set his prices at a level higher than that consistent with the target level of inflation. In this case, the restriction of nominal aggregate demand will have an adverse effect on production and inflation will slow down less than had been planned. This is why stabilization programmes, if they are to achieve their objectives and avoid a recession, must —in addition to controlling monetary expansion and the fiscal deficit— include a policy for simultaneous and evenly-applied “decelerated” indexing to guide or control the movement of the nominal values of variables such as wages, the exchange rate, interest rates and some key prices so that they will adjust (or decelerate) to the rate of inflation on which the monetary and fiscal policy is based.

Thus, in contrast to the direction taken by orthodox stabilization programmes, what would initially have to be done would be to control prices rather than free them. However, in contrast to what tends to occur with traditional price controls, the purpose of doing so would not be to repress inflation, but rather to move the key variables to their final equilibrium levels as quickly as possible.

b) *Consistency between the policy on key prices and monetary/fiscal control*

Just as it is not sufficient to try to control the expansion of aggregate demand by means of monetary and fiscal policy, neither is it sufficient merely to control prices and guide expectations: if, while controlling prices, an expansionary monetary and fiscal policy is continued, inflation will be held repressed but not eliminated. Under such circumstances, inflationary pressures will, for a time, not be manifested in an increase in price levels but rather in shortages, the appearance of black markets and a balance-of-payments disequilibrium; they will ultimately, lead, however, to another acceleration of inflation. One essential component of a successful stabilization programme is therefore to control monetary and fiscal expansion, because this fuels — although it does not necessarily cause— every inflationary process.

Not just any arbitrary target for the slowdown in inflation will do. It must be compatible with the monetary and fiscal controls which can actually be applied. If it is not, the programme will lack consistency and credibility, and expectations will ultimately push prices up above the programmed level. For example, if the monetary base is equivalent to 10% of the gross domestic product, if the projected fiscal deficit is 5% of the GDP, and if it can only be financed through Central Bank loans, then the monetary base will have to expand by 50% merely to cover the public-sector imbalance. Thus, unless there is a considerable increase in the demand for money or a very marked expansion of economic activity, inflation could not be cut to much less than 50% annually. A faster deceleration of key prices would not be consistent with the monetary and fiscal programme and would ultimately fail.

c) *The correction of price lags*

Another real difficulty facing stabilization programmes is that in most inflationary processes (except in the extreme, and improbable, case of a perfectly stable rate of inflation) the movement of prices, although widespread, is not

even. Thus, often as a consequence of previous unsuccessful stabilization efforts, the following values may lag significantly behind other prices: i) the exchange rate (which will have an adverse impact on the balance of payments), ii) the rates charged for public services (which will widen the fiscal deficit), iii) agricultural prices (which will slow the growth of staple food production), iv) interest rates (which will hamper an efficient allocation of investment and prompt a large-scale and unwarranted redistribution of income away from savers and towards debtors), and v) real wages (which will produce a regressive income redistribution and will tend to result in a contraction of those productive sectors aimed at the domestic market).

Thus, in order for a stabilization programme to have a lasting and effective impact rather than merely producing a temporary reduction in inflation, these imbalances in relative prices must be corrected. Unfortunately, the adjustment of prices which have lagged behind or which have been held down may be (mistakenly) seen by economic agents as an indicator of future inflation rather than simple as a corrective adjustment. If this happens, the level of inflation which is expected may be higher than the inflation target inherent in monetary and fiscal policy. For this reason, the number and size of such corrective adjustments should be kept to a minimum, for if there are many or very large adjustments, it is unlikely that the desired reduction in inflation can be obtained. Therefore, if the price lags do not jeopardize basic aspects of the economy (such as, for example, its external balance) it may also be preferable, especially if inflation is very high, to bring about a uniform reduction in the rate of increase of all prices until inflation is brought down to more manageable levels, and then to make corrective adjustments. On the other hand if the lags are very large and their correction cannot be put off it would appear best to correct the greatest lags first and only later to apply a programme for the simultaneous de-indexation of key prices.

3. Hyperinflation

As in the cases discussed above, controlling or halting an acute and mounting process of inflation or hyperinflation calls for the application of policies designed to restrict the growth rate of total demand, guide expectations and correct price lags. In this case, however, the first two policies take on special importance and special dimensions.

a) *Guiding expectations*

When the rate of inflation is not only very high but is also rising sharply and continuously, most prices begin to be adjusted according to an ever-smaller number of inflation indicators. In fact, under these circumstances the only indicators which are used for this purpose are those whose variations are very frequent, rapid and widely-publicized (e.g., the consumer price index, the open-market interest rate or the exchange rate on the parallel market).

If inflation speeds up even further, so that contracts come to be readjusted at intervals of less than one month, not even the consumer price index will serve these purposes, since it is usually published only on a monthly basis and with a slight time-lag. Under these conditions, most price adjustments are made on the

basis of variations in some key price which is free of controls, changes daily and for which information on its fluctuations is rapidly and readily available. Typically, the key price which is used is the exchange rate on the free market.

If this extreme is reached, then in order to control inflationary expectations and eliminate the momentum of inflation it will be essential to control the price of the dollar or to stabilize it at a level that is calculated to balance the supply and demand for foreign exchange. If this is done, and for the same reason that increases in domestic prices and inflationary expectations were previously adjusted in accordance with the ongoing rise in the parallel-market exchange rate, they will now begin to stabilize and the rate of inflation will therefore drop off sharply.

This process of winding down expectations —although it is of critical importance for the initial break-up of the inflationary spiral— does not, however, guarantee the success of the stabilization programme. In order to stabilize or moderate the increase in the exchange rate over an extended period rather than just temporarily, it is necessary, firstly, to have or obtain an adequate level of international reserves and, secondly, to apply fiscal, monetary and incomes policies which will expand nominal demand in line with the programme's inflation target. It is therefore essential that the lull in inflation which occurs immediately after the stabilization of exchange parities and the subsidence of expectations should be used to reduce the fiscal imbalance and the inflationary pressures exerted by the credit system as much as possible.

If inflation is very high and still mounting but has not reached such an extreme that virtually all prices are adjusted at very short intervals in accordance with the variations in the exchange rate on the parallel market, reducing inflationary expectations will also require, in addition to the stabilization of the exchange rate, an administrative freeze for a certain length of time of other key prices of the economy including wages. This course of action will have the same effect of sharply diminishing economic agents' inflationary expectations and making them mutually compatible, thereby fulfilling a function analogous to that performed by the setting of the exchange rate in the case previously analysed. Like the latter measure, however, even in the best of cases a freeze can only be a temporary expedient: in order for the decrease in the inflation rate which this will initially produce to be maintained and consolidated, the expansion of total expenditure will also have to be reduced.

b) *Controlling aggregate demand*

In situations of hyperinflation, the tasks of reducing the public-sector deficit and striking a greater balance between the supply and demand of foreign exchange can be greatly eased if the previously-discussed price control measures can manage to bring about a sharp reduction in inflationary expectations and so in the rate of price increases.

This is because a sharp drop in inflation will automatically reduce the losses of real tax revenues caused by the lag between the time when a transaction subject to taxes is carried out and the time when the tax is paid to the government. The recovery in the real value of taxes brought about by a drop in inflation may be very large and, of course, will be all the greater the higher the

prior rate of inflation, the sharper its reduction and the longer the delay involved in paying taxes.⁹⁵ Furthermore, as inflation drops, nominal interest rates also tend to decline; as a result, the public sector's finance expenditures—which in some cases account for almost the entire fiscal deficit—are reduced. Thus, in practice, if the rate of inflation slows significantly, a series of mechanisms that constitute "vicious circles" when inflation is speeding up (more inflation-lower real tax receipts-larger fiscal deficit-higher inflation, etc.), are converted into "virtuous circles" which automatically help to cut the fiscal deficit and, as a result, to reduce inflation.

Furthermore, when there is a considerable drop in inflation, the demand for money will tend to rise, thus making it possible to expand the money supply for quite some time without generating inflationary pressures. Under certain circumstances, the increase in the demand for money caused by a drop in inflation may, paradoxically, help to augment the yield of the "inflationary tax" and therefore to reduce the public deficit.⁹⁶ There will naturally be no such positive effect with zero-inflation, since the "inflationary tax" would then be equivalent to zero as well. In that event, either tax receipts will have to be increased or expenditure will have to be decreased in order to reduce the fiscal deficit.⁹⁷

c) *The correction of price lags*

When inflation is very rapid and, especially, when the economy is shifting towards hyperinflation, all prices will rise very frequently. This greatly reduces the seriousness of the problem posed by the de-synchronization of adjustments and distortions in relative prices, thus making it easier to freeze prices or bring about a sharp slowdown in the rate of indexation. Indeed, in such a situation the only prices which tend to lag behind are those controlled directly by the government, such as the official exchange rate and the rates charged by public enterprises. If this is the case, these prices should be corrected before the stabilization programme is begun, especially in order to build up economic agents' confidence in the programme's ability to produce a permanent rather than temporary decrease in inflation. This is important because economic agents are unlikely to believe that the stabilization policy will be a success if such basic price as the real exchange rate continues to lag far behind other prices or if State enterprises continue running large deficits because the rates they charge are too low in real terms.

E. STABILIZATION PROGRAMMES: SOME GUIDELINES AND GENERAL PRINCIPLES

1. The policy sequence

Both the chances of success and the possible costs of a stabilization programme are influenced by the order in which its various components are applied or their relation in time to other major policies.

Thus, in general, it seems wise to separate in time the application of adjustment policies (designed to reduce the external imbalance) from the

application of stabilization policies (designed to reduce inflation). Although the two have elements in common (e.g., the control of aggregate demand) which help both to achieve a balance in the external accounts and to slow the rate of price increases, there are other important components of adjustment policies (such as devaluation) which, although they help to reduce the external deficit, make it more difficult to achieve stabilization because of the upward pressure they exert on costs. Hence, if the exchange rate is raised substantially at the same time that demand is being sharply restricted, recessionary effects will tend to be produced unless the prices of non-tradeable goods are very downwardly flexible. In many cases, therefore, it may be preferable to carry out the adjustment programme first, even at the cost of producing some increase in the rate of inflation, and only then to put a stabilization programme into effect.

Indeed, this principle is applicable to all policies for correcting price lags, since they exert upward pressure on costs and therefore tend to have recessionary effects if they are applied at the same time as a policy designed to restrict total demand. It therefore appears best to make such corrections before initiating the rest of the stabilization programme. Once the necessary changes in relative prices have been made, stabilization policies can then be applied which are directed solely towards eliminating or reducing the momentum of inflation by controlling total demand and guiding expectations.

If the situation is one in which a recession must be avoided or minimized, then it will also be necessary to vary the policies to be applied in accordance with the nature of each phase of the stabilization programme (particularly in respect of monetary and fiscal policy) since, even if inflation is reduced substantially, some time will pass before the demand for money expands. Because of this lag, the money supply cannot be increased at the outset of the programme as much as it can and should be expanded once expectations of a lower rate of inflation have become widespread and have been consolidated. If monetary policy is adjusted too quickly on the assumption that the reduction of inflation will generate a greater demand for money, the success of the stabilization programme will be endangered because the demand for liquid balances will not rise very much initially. On the other hand, if the authorities keep the money supply under tight control (ignoring the fact that, after a time, the demand for money will grow due to the slowdown of inflation), a lack of liquidity, very high interest rates and a recession will ensure. Monetary policy should therefore be strict during the initial phase of the stabilization programme but should then gradually be made increasingly expansionary as inflationary expectations subside and as the public's demand for liquid balances consequently increases.

2. Price policies

As has already been pointed out, in order to avoid a contraction which would disturb economic activity it is vital that the rate of nominal changes in economic variables such as wages, the exchange rate, interest rates and the prices of certain key goods should decelerate simultaneously and in harmony with the inflation target implicit in the programmes of monetary and fiscal restraint. In order to achieve this it will in most cases be necessary to apply (at least temporarily) some form of price controls. The fundamental purpose of such a policy must be

to assure each economic agent, as far as possible, that in adjusting his price in accordance with the targeted level of inflation he will not suffer a systematic relative loss, as all other economic agents will be obliged to adjust their prices in accordance with the same target.

a) *Which prices are to be controlled?*

It is even more important to guide or control (and not hold down) the prices of certain goods when progress toward external equilibrium and domestic stabilization requires correction of certain relative prices, such as the exchange rate and the price of public services. Indeed, if no attempt is made to direct other prices towards their new equilibrium, it is highly likely that, at least initially, measures designed to raise the real exchange rate and the relative prices of public services will lead to considerable increases in the prices of other goods, essentially as a result of the reluctance of producers to accept a decline in their earnings caused by attempts to change relative prices, and also by their tendency to confuse this corrective adjustment with more generalized inflationary pressure. In contrast, it will be far easier to bring about this adjustment in relative prices if producers observe that, as a result of price control, the economic authorities limit rises to those goods whose prices were extremely low.

Naturally, there is no question of reducing inflationary pressure by administrative fixing of artificial prices, nor of setting up complex bureaucratic machinery to control them. What are required are relatively simple and easy-to-apply rules. In contrast with traditional price controls, which are primarily designed to set the prices of agricultural products, the suggested controls should centre on industrial prices, which in many cases are more sensitive to inflationary expectations and to oligopolistic influences. This effort should concentrate on control of the prices of the main enterprises, for reasons both of simplicity and because they are able to exercise a certain oligopolistic pressure on their suppliers and force them to accept prices in keeping with those of the products manufactured by the former. Moreover, large enterprises normally use technologies which are more capital-intensive, making it easier for them to temporarily absorb the drop in operating income which might be caused by the price-control policy, by lowering their profit margins. Another sector whose prices could be directed is that producing certain basic inputs for the construction industry. In many cases, government public-works and housing programmes generate a considerable proportion of the overall demand for such inputs and this consequently provides the opportunity to influence their price in accordance with the overall aims of anti-inflation policy.

b) *The rate of slowdown: a freeze or decelerated indexation?*

As has already been noted, the rate at which inflation may be slowed down is closely linked to the degree of monetary and fiscal control which is actually feasible, to the number of key prices in need of correction, to the degree to which they need to be adjusted and to inflationary expectations. Generally speaking, as has also been analysed above, it would seem preferable to apply the stabilization programme once the worst distortions in relative prices have been corrected. Once these readjustments have been carried out, there nevertheless remains the option between following a gradualist approach (progressively bringing down

the rate of inflation) or applying shock treatment (freezing prices at their present level).

There are a number of advantages in a freeze. First of all, it is easier to administer, since economic agents and the public at large know that, legally speaking, most prices should not rise.⁹⁸ Every purchaser thereby becomes a price inspector. Secondly, as it has a sharp initial impact, a freeze also helps to bring inflationary expectations to an abrupt halt. However, its effectiveness to a large extent depends on the authorities being really able to control expansion of public expenditure and the money supply and to ensure exchange-rate stability. Freezing prices without being able to exert firm control over fiscal, monetary and exchange variables carries the risk of failure for the stabilization policy, either because the public has no faith in it and puts pressure on the currency by making speculative purchases of foreign currency or goods, or because—even if the public has faith in such a policy—if in practice fiscal and monetary control is weak and partial, aggregate demand may rise well above what is compatible with a zero rate of inflation. The principal cost of the failure of a price freeze is the loss of confidence of the economic agents and the public in the government's capacity to control inflation: a confidence which, as has already been explained, is vital if any future attempt at stabilization is to succeed. It follows that ordering a price freeze without sufficient control over the fiscal and monetary variables, as well as over the exchange position, may prove disastrous.

In contrast, the gradualist alternatives—i.e., indexing prices and contracts, not backwards on the basis of past inflation, as is usually the case, but forwards, in accordance with the increasingly low targeted rate of inflation—possesses the advantage of making possible considerable slowdowns in the rate of price increases. (For example, reducing monthly inflation by half from one quarter to the next), even though the authorities may not yet possess complete control over aggregate demand. Moreover, initial fulfilment of the proposed inflation targets helps increase the confidence of the economic agents in their being met in the future, which makes it possible to gain time in order to control aggregate demand. Nevertheless, gradualism has its own problems. On the one hand, it requires greater administrative control over prices, since the public is unable to act as price inspectors as efficiently as in the case of a price freeze (it is easier to control a 0% increase in prices than, for example, a 2% or 5% one). In addition, precisely because the deceleration of the rate of inflation is gradual, inflationary expectations are more likely to remain for some time, particularly if a large number of economic agents believe that sooner or later the stabilization policy will fail.

c) *A dichotomy: credible prices versus equilibrium prices*

If prices are to be set, either by a price freeze or by decelerated indexation, it will be necessary to decide at what level they are to be set or frozen.

Since there is no question of attempting to suppress inflation completely, prices must be set at a level compatible with the inflation implicit in monetary and fiscal policy. While this is theoretically correct, it raises the problem of the programme's credibility. The best stabilization programme can fail if the public has no faith in it or if a large number of economic agents fear a lack of faith on the part of other economic agents and consequently act accordingly, bringing about,

for example, a "flight from the currency" to purchase goods or dollars. In other words, the public's conviction that the programme is going to fail in fact brings about this very failure, thus generating a self-fulfilling prophecy. This explains the importance of the credibility of a price policy.

This credibility is strengthened if prices are set not necessarily at their levels of equilibrium, but at levels at which the public believes they can be maintained and which discourage any potential run from the currency towards goods or towards the dollar. This is the logic of the principle of *overshooting*, above all in setting the exchange rate and the rate of interest. Unfortunately, such a policy also involves costs. Overshooting such prices —at least if an attempt is made to maintain them for some time at the very high real level at which they are initially set— generates recessionary pressures, since it brings aggregate demand below the level of equilibrium. Such recessionary pressure is aggravated if, for the same reasons, the prices of public services are set at higher levels than necessary, if the money supply is subject to excessive control (ignoring the fact that, as inflation slows down, the demand for money will rise after some time) or if real wages are reduced more than necessary.

There is thus a dichotomy between setting equilibrium prices —with the consequent risk that if the public has no faith in them the programme will fail— or overshooting in the case of some prices to develop credibility, with the risk of producing a recession. The most prudent approach, in setting the key prices which are most rapidly adjusted (the exchange rate and interest rates) would appear to be to overshoot somewhat initially to discourage a stampede from national currency towards the dollar or towards goods. As inflation dies down and the economic agents gain confidence in the programme it will be possible to lower the real exchange rate towards its long-term equilibrium level. Simultaneously, the money supply will have to be expanded at the same rate as the demand for money in order to supply the economy with sufficient liquidity and gradually reduce the real rate of interest.

In turn, while prices are frozen or subject to control, the key to deciding whether prices are out of balance or not is the presence of shortages or an excess of supply. If most prices had been set at an extremely low level, there would be widespread supply shortages; conversely, if there was a widespread excess of supply, it would imply that prices had been set at an extremely high level (with respect to wages).

d) *Ending the freeze*

If prices have been frozen or subject to control as part of the stabilization programme, there arises the problem of how to free them from control and thereby return to a more normal state of affairs in which most (if not all) prices are freely set by the market. Generally speaking, such liberalization must needs be gradual —so as to avoid generating expectations of an outburst of inflation— and must only be carried out once the indexation patterns have been altered and the terms of contracts lengthened. If this has not been done, any increase in prices caused by an ending of the freeze or by liberalization would not signify a once and for all rise, but would lead, through the mechanism of indexation, to immediate rises in wages and other costs, which would once again revive the inflationary spiral.

For this reason, it is advisable for the freeze to be ended selectively, beginning with competitive activities or those in which effective price control is more difficult in practice, as it is likely that these activities will have already carried out the price modifications they require. Any decision to end the freeze must also take into account the size of the establishment, initially reducing control over small and medium-sized enterprises while maintaining stricter control of prices in supermarkets, large enterprises and those producing basic inputs, where it is easier to gradually change over from a freeze to a system of "regulation", with "notified" or authorized prices.

3. Incomes policy

In order to facilitate a stabilization process which avoids both the danger of recession and that of excess demand, the price policy needs to be complemented by an incomes policy, a fundamental component of which is a wages policy, calling for the establishment of certain overall principles with regard to wage adjustments.

The main criterion here is that in order to maintain the purchasing power of wages during a process of stabilization it will be necessary for them to increase not only on the basis of past inflation but also on the basis of forecast inflation, and the frequency with which readjustments are granted will have to vary depending on whether the rate of inflation accelerates or declines.

During periods of declining inflation, indexation of the nominal wage on the basis of past inflation raises its purchasing power, since the average real annual wage (which is the pertinent one rises when the rate of inflation declines.⁹⁹ It follows that indexing wages on the basis of past inflation means that future inflation is sure to be similar to what it has been in the past, or that real wages will rise (which, depending on the initial conjuncture, may or may not be desirable). Conversely, if nominal wages are adjusted solely on the basis of future inflation, their purchasing power will fall even if the target is met, and even more so if it proves impossible to bring down inflation as much as forecast.¹⁰⁰

Consequently, to maintain real wages it will be necessary to readjust them on the basis both of past and of future inflation.¹⁰¹ Even so, this involves the risk that, if inflation fails to fall as much as forecast, real wages will decline or, if inflation slows down more than forecast, real wages will rise. It follows that a more stable and less risky formula would be: a) to readjust wages on the basis of both past and forecast inflation, and b) to readjust them once again when inflation reaches the target level —whether this occurs after 12 months, or after a longer or shorter period.¹⁰² This ensures that the average real wage for the period covered by the readjustment is the real wage which has been set as a target.

Moreover, incomes policy also needs to lay down guidelines for the level and evolution of interest rates. This does not of course mean setting them so as to be negative in real terms, as has often occurred in the past, since it is quite clear that not everybody can receive all the credit they require at subsidized rates. It is well known that a negative real rate of interest segments the market between those who have access to credit whose cost has been brought artificially

down by fixing the interest rate, and those who do not have such access. In order to take advantage of this cheap financing, the happy few tend to build over-sized or over-mechanized installations, or to use resources to purchase assets whose value is depressed as a result of tight credit, which tends to further concentrate wealth in the hands of the few. In addition, segmentation of the market inhibits the expansion of those activities with more restricted access to banks—traditionally the small and medium-sized firms, who generally use relatively more labour—obliging them to resort to credit from the curb markets at rates far higher than the equilibrium rate.

On the other hand, a real rate of interest much higher than would be normal raises problems also, at least when it is maintained for more than a certain time, since it leads to sharp rises in financial costs and ultimately helps bring down production. Moreover, as recent experience in a number of countries in the region has shown, it is clearly impossible for real interest rates of 25% to 30% to be paid for a long period in economies which are growing at an annual rate of 5% or 6%, without a financial crisis occurring.

Since the credit market adjusts rapidly in price (the rate of interest), disequilibria in other markets—for goods, currency, assets—tend to be reflected in it through absurdly high real interest rates which mirror the disequilibria in these other markets but are incapable of correcting them. Consequently, as long as these disequilibria persist, it will be necessary to maintain (or "suggest") a real rate of interest which is slightly higher than the international rate (but below the disequilibrium rate), as this represents the best approximation to the long-term equilibrium rate of interest.

The logical counterpart of this is that at such conjunctures credit will need to be rationed in quantity, and not only through price, until the excess demand caused by the imbalances existing in the other markets has disappeared. Meanwhile, it will be necessary to decide what part of the demand for credit is "legitimate" i.e., due to potential productive capacity which could be put into effect, and what part is "illegitimate", (i.e., due to the desire of the applicant to postpone liquidation of stocks or of assets or a drop in his prices). Of course, it is not always easy to make such a distinction or to put it into practice, but it is preferable to be guided by it than to risk a crisis throughout the financial system caused by charging extremely high real rates of interest which quite clearly can only be paid either exceptionally or temporarily.

4. Control of aggregate demand

As has already been pointed out, a slowdown in the rate of growth of aggregate demand constitutes a basic component of any anti-inflationary programme. Whether such a slowdown in the rate of growth of aggregate demand leads to a recession or not, however, depends both on the size of the cutback which is made in overall expenditure and on the way in which it is carried out, since—depending on the mechanisms used—the cut in expenditure can have the effect of either reducing the level of inflation or slowing down economic activity.

In the case of many stabilization programmes, the first thing affected by a cutback is government investment, thereby jeopardizing future growth. This

drawback is reinforced in the short term when the cutback in expenditure is centred on a small number of activities (such as public works and housing construction), which makes it virtually impossible for the readjustment to be carried out solely by means of drops in prices rather than production. Consequently, a cutback in public expenditure which concentrates on its imported element and which involves a smaller decline in public demand for domestically-produced goods has a greater likelihood of being absorbed through a deceleration in the rate of growth of prices rather than through drops in production.

Of course if it is desired to maintain expenditure on investment directed towards domestic sectors (or to reduce it to a lesser extent), it will be necessary to reduce current expenditure more sharply. This poses delicate problems of a political nature, since in most countries remunerations constitute the main component of current expenditure. Consequently, in so far as it is necessary to reduce overall government expenditure and an attempt is made to avoid sharp cutbacks in the level of public investment, it will probably be necessary to reduce the real amount of remunerations paid by the public sector. Although this is difficult from the political angle, it is likely that in the short term a reduction in the average wages of the public sector will prove preferable to its alternative: i.e., a cutback in employment, which generally not only has regressive consequences from the distributive point of view, but also tends to affect the volume of goods and services produced by the public sector.

Subsidies constitute another major item of current expenditure; consequently, in many cases it is necessary to reduce them in order to balance the fiscal budget. Though this decision may be inevitable, however, it must be adopted in a manner which minimizes its possible negative impact on the poorest sectors of the population.¹⁰³

A third means of reducing total government expenditure involves cutting outlays on defence. Although it is impossible to assess governmental decisions in this field solely or even principally from the economic viewpoint, it would seem reasonable to assume that in certain cases a cutback in such expenditure would allow considerable progress to be made towards restoring equilibrium in governmental finances and reducing the external deficit. This latter consequence would be of particular significance if the reduction in defence expenditure were focused on armaments, whose imported component is extremely high in most Latin American countries.

Nevertheless, in order to bring down the public sector deficit, which is often quite high, it does not suffice merely to reduce expenditures, but it is also necessary to raise revenues, which in turn requires an increase in tax collection and a rise in the prices and rates charged by State enterprises. No doubt both the mechanisms and procedures used to achieve this end and their relative importance will differ from one country to another. However, there are three ways of increasing public-sector income which have proved particularly effective in Latin America's recent experience.

The first of these is automatic indexation of taxes, which is particularly called for in countries with high inflation. In this respect, it is worth remembering that if the tax system is not indexed and the lag allowed for by law between the moment at which the tax is incurred and the moment at which it

must be paid is as little as three months, with a 40% annual rate of inflation the tax actually paid will drop by 10% in real terms for this reason alone.

The second involves control of tax evasion. Since this often reaches considerable proportions, it might be preferable to take steps to control it in order to increase fiscal revenue, rather than introducing new taxes or raising the existing rates, which are on occasions quite high, partly as a result of the scale of evasion. As recent experience has shown on a number of occasions, it is possible to reduce evasion considerably by introducing more efficient control. This requires, in addition to the fundamental need for a firm political will to enforce tax legislation, the following conditions, among others: a) thorough simplification of the tax system, both as regards the number of taxes and rates and exemptions as well as special or discriminatory systems, as this simplifies tax collection by traditional methods and is essential if it is to be backed up by modern systems of computerized control; b) transformation of the tax departments into specialized units within the government administration, endowed with sufficient means to carry out their tasks and possessing highly qualified and well-paid technicians, and c) the adoption and strict enforcement of sanctions for those who infringe tax law, since in addition to providing more efficient control this convinces taxpayers that it is economically more advantageous to pay their taxes than to run the risk involved in not doing so.

A third means of increasing public-sector revenues is by establishing and maintaining realistic prices and rates for the goods and services provided by State enterprises, some of which are often responsible for a major part of the overall government deficit. In addition to making a contribution to a better balance between public-sector income and expenditure, rises in rates and prices possess two further advantages. The first is the speed with which they increase the State's resources, which is normally far faster than in the case of changes in tax law; the second involves the corrections which are thus made in the system of relative prices and the positive impact these have on the process of adjustment. In a large number of cases the artificially low prices charged by State enterprises stimulate domestic consumption of tradeable goods, thereby helping to intensify the external disequilibrium, either by increasing imports or reducing the amount of goods available for export.

Moreover, and in order to prevent the restrictive credit policy which is normally part and parcel of stabilization programmes from having undesirable recessionary and redistributive consequences, it is vital to bear in mind that such a policy is in no way neutral. Credit restriction has a disproportional impact on those sectors which are particularly sensitive to variations in the interest rate and in the availability of credit, such as construction and agriculture, as well as small and medium-sized firms, which are generally unable to offer the same guarantees to the financial system as larger production units. Such activities and enterprises make particularly intensive use of labour and consequently if their level of production declines it tends to lead to a disproportionate fall in employment. For this reason it is desirable that, when applying a restrictive monetary policy, guidelines should be set which ensure maintenance of the share of total credit available for such activities and enterprises.

It is also important to bear in mind that however well conceived it may be, a stabilization programme is unlikely to fully achieve its inflation targets.

Consequently, the monetary and credit targets which are set should not be expressed in absolute terms—as is characteristically the case of agreements with the International Monetary Fund—but in relative terms, particularly as regards the reduction of inflation. Thus, for example, if the decline in inflation coincides in practice with that initially forecast, the planned reduction in the rate of growth of the money supply should be maintained. If, on the contrary, inflation declines less than planned—in which case strict maintenance of the planned monetary deceleration would run the risk of causing a decline in production—there should be flexibility to increase the rate of expansion of the means of payment in accordance with a predetermined criterion.

Notes

¹In the case of Barbados, Guyana, Jamaica and Trinidad and Tobago, data concerning trends in the per capita domestic product were available only up until 1984. However, the information available for 1985, although incomplete and of a preliminary nature, suggests that the cumulative variation in the per capita product during the 1981-1985 period does not differ significantly from the variation for the 1981-1984 period.

²Due to the considerable decreases in per capita income which occurred in the other countries, it is likely that they too experienced a notable decline in real wages.

³In this connection see section D of chapter III of this report, particularly, tables 16 and 17.

⁴The average monthly rate of consumer price increases in Argentina fell from 26.4% during the first half of 1985 to 2.9% during the following eight months. Likewise, between January-August 1985 and September 1985-February 1986, the average monthly variation in consumer prices dropped from 10.9% to 3.6% in Peru and from 61% to 11% in Bolivia.

⁵The specific nature and relative weight of the internal causes of the crisis have, of course, varied widely among the different countries. Thus, in some, and especially in a number of the Central American countries, a particularly decisive factor has been the effects of the sweeping political changes and the painful and drawn-out civil strife marking their recent history. In other countries such as Bolivia, Ecuador, Paraguay and Peru, the decline in economic activity and the rate of inflation were heightened by the effects of droughts, floods and other natural disasters which had a particularly strong effect on the agricultural sector and the transport system. In other cases, the adverse effects of the shortcomings or excesses of the economic policies that have been applied have been a more important factor. For a more comprehensive analysis of this subject see ECLAC, *Crisis and development: the present situation and future prospects of Latin America and the Caribbean: Vol. II, Onset of the crisis and the economic policy response: effects and options* (LC/L.332(Sem.22/2)/Add.1), April 1985.

⁶For a detailed analysis of the way in which these two policy packages have contributed to the adjustment process, see ECLAC, *Políticas de ajuste y renegociación de la deuda externa en América Latina*, "Cuadernos de la CEPAL" series, No. 48, Santiago, Chile, December 1984, pp. 95-102.

⁷In this regard, see Richard Lynn Ground, "Orthodox adjustment programmes in Latin America: a critical look at the policies of the International Monetary Fund", *CEPAL Review*, No. 23, August 1984, pp. 45-82.

⁸See José Pablo Arellano, *Hacia un ajuste externo con crecimiento en América Latina* (mimeograph), Economic Development Division of ECLAC, Santiago, September 1985.

⁹See the analysis of different mechanisms for reducing interest payments contained in section B of chapter III of this report.

¹⁰A compelling analysis of the role played by large-scale investment in the Brazilian adjustment process appears in: Antonio Barros de Castro and Francisco Eduardo Pires de Souza, *A economia brasileira em marcha forçada*, Editora Paz e Terra, Rio de Janeiro, Brazil, 1985.

¹¹Due to distributive considerations as well as in the interests of international competitiveness, this method of increasing total wages is especially preferable during the recovery phase.

¹²For a well-reasoned discussion of the need to make these changes in social policy in order to minimize the adjustment's adverse effects on the poorest groups of the population, see UNICEF, *Adjustment with a Human Face: Context, Contents and Economic Justification for a Broader Approach to Adjustment Policy* (mimeograph) (a paper presented at a seminar concerning adjustment policies as they relate to the most vulnerable groups in Latin America, held at Bogotá in February 1986). Some measures based on this approach are analysed in section C of chapter III of this report.

¹³These changes in relative prices help to restore external equilibrium through three mechanisms, namely: reduction of domestic demand for tradeable goods; expansion of production of these goods; and transfer of certain *potentially* tradeable goods to the category of goods which *effectively* are exported or replace imports.

¹⁴That is, which takes into account not only the level of the exchange rate but also the effect of tariff and other measures (prior deposits, quotas, bans, etc.) designed to raise the cost of imports or prevent their entry.

¹⁵In practice, if the incentives were general and evenly-matched, their effects would be equivalent to those of a rise in the exchange rate for foreign trade, but their administrative cost would be higher.

¹⁶The terms "subsidy" and "tariff rate" are used here only for the sake of brevity. Strictly speaking, what should be equalized are the global incentives provided to exports through subsidies, tax exemptions, preferential interest rates, etc., and the protection assigned to imports through tariffs, quotas, prior deposits, etc.

¹⁷This policy, based on the classic principle of "infant industries" and applied both to export and to import-substituting activities, has been an essential element in the development strategies followed by some of the countries of South-East Asia, and partly accounts for the notable growth and diversification of their exports of manufactures. In this connection, see Guillermo Perry, "Estrategias de desarrollo para América Latina: enseñanzas de la experiencia propia y ajena", a paper presented at the Expert Meeting on Crisis and Development in Latin America and the Caribbean organized by ECLAC in April 1985.

¹⁸Fulfilment of the last three requirements is particularly important in relation to expansion of exports of industrial products and constitutes another of the factors underlying the boom in some of the Asian countries' exports of manufactures.

¹⁹By its very nature capital flight is difficult to quantify. The phenomenon was under-way before the formal outbreak of the crisis in mid-1982. Some estimates place accumulated capital flight between 1976 and 1982 as high as US\$ 70 billion. Meanwhile, the Inter-American Development Bank estimates that capital flight was US\$ 19 billion, US\$ 9 billion and US\$ 5 billion, in 1983, 1984 and 1985 respectively. See Susan Erbe, "The flight of capital from developing countries", *Inter Economics*, November/December 1985, and *IMF Morning Press*, 20 February 1986.

²⁰ECLAC, "The problem of the external debt: gestation, development, crisis and prospects", LC/L.371(CEG.111/4), January 1986, p. 27.

²¹The statistical exercise was performed before the sharp fall in petroleum prices; whether the net effect will increase financing requirements is an empirical issue that will have to await the results of further statistical work.

²²Prior to the crisis the banking community's extension of new commitments rose vigorously, at an average rate in excess of 25% per annum between 1978 and 1982. Since nominal interest rates averaged approximately 15% over the same period, the average positive transfer of resources from the banks was equivalent to roughly 10% of outstanding commitments. Thus the full turnaround in resource flows is a staggering 19% (10% - (-9%)). Data on the banks' commitments are from Bank for International Settlements, *The Maturity Distribution of International Bank Lending: First Half of 1983*, December 1983; and *The Maturity Distribution of International Bank Lending: First Half of 1985*, December 1985.

²³Of course, at the root of the entire phenomenon of transfers is the relative bargaining strength of debtors and creditors. For an analytical focus on this subject that uses game theory and the framework of bilateral monopoly, see Guillermo O'Donnell, "External debt: Why don't our governments do the obvious?", *CEPAL Review*, No. 27, December 1985; and Robert Devlin, "La deuda externa versus el desarrollo económico: América Latina en la encrucijada", *Colección Estudios CIEPLAN*, No. 17, September 1985.

²⁴By way of example, the nine largest United States banks reduced their total claims in Latin America from 181% of capital in 1982 to 139% by March 1985. See Morgan Guaranty Trust Co., *World Financial Markets*, September 1985, p. 4.

²⁵For an analysis of LDC debt and bank stock prices see Steven Kyle and Jeffrey Sachs, "Developing country debt and the market value of large commercial banks", *National Bureau of Economic Research Working Paper* No. 1470, September 1984.

²⁶At the outbreak of the crisis the big international commercial banks were much more heavily exposed in Latin America than were most of the small and medium-sized banks. The large lenders realized that if they did not refinance part of the interest payments falling due many borrowers would have to default, and this in turn would impose destabilizing losses on them. The less exposed lenders, in contrast, were strongly inclined to withdraw from Latin America, even at the risk of defaults. It was the combined pressure of the big banks, OECD Central Banks and the IMF that kept most of the smaller lenders in the rescheduling exercises and ensured their participation in the administratively-organized new loan packages for the partial refinancing of interest. For more on this question — technically termed the "free rider" problem— see Devlin, *op.cit.*

²⁷See ECLAC, "Adjustment policies and renegotiation of the external debt", E/CEPAL/G.1299, 1984. Subsequently published under the title of *External Debt in Latin America: Adjustment Policies and Renegotiation*, Boulder, Colorado, Lynne Rienner Publishers, Inc. (in cooperation with the United Nations), 1985.

²⁸See, for instance, "Latin American Economic Conference", *CEPAL Review*, No. 22, April 1984.

²⁹The Initiative envisages new financing of US\$ 29 billion for 15 developing countries over the next 3 years. OECD government authorities are attempting to raise US\$ 20 billion from commercial banks and support US\$ 9 billion in new lending by multilateral agencies.

³⁰Cartagena Consensus, "Declaración de Montevideo", Montevideo, Uruguay, December 1985, p. 2 (mimeo).

³¹ECLAC, "Adjustment policies and renegotiation of the external debt", *op.cit.*

³²For history, see Charles Kindleberger, *Manias, Panics and Crashes*, New York, Basic Books Inc., 1978. For theory see Hyman Minsky, *Can "It" Happen Again?*, Armonk (New York), M.E. Sharpe, 1982; and Jack Guttentag and Richard Herring, "Commercial bank lending to developing countries: From overlending to underlending to structural reform", in Gordon Smith and John Cuddington, eds., *International Debt and the Developing Countries*, Washington, D.C., World Bank, 1985.

³³See Erik Ipsen, "After Mexico the regionals are in retreat", in *Euromoney*, January 1983, p. 65; and "US Regional Banks Cut Lending to Latin America", *Bank for International Settlements, Press Review*, 27 February 1984, p. 6.

³⁴See Jonathan Eaton and Lance Taylor, "Developing country finance and debt", Boston, Massachusetts, Massachusetts Institute of Technology, 1985, p. 59 (mimeo).

³⁵See the reference to Rimmer de Vries and to research by Richard Cooper and Jeffrey Sachs in Dragoslav Avramovic, "Debts in early 1985: An institutional impasse", Washington, D.C., 15 February 1985, p. 2 (mimeo). Subsequently published in *Journal of Development Planning*, No. 16, New York, United Nations, 1985.

³⁶Empirical work carried out by Saunders has found evidence of contagion in the current financial crisis. See Anthony Saunders, "An Examination of the Contagion Effect in the International Loan Market", Washington, D.C., International Monetary Fund, December 1983.

³⁷Another country which has suffered from contagion is Colombia. Even though its debt burden is relatively light and it has not had to reschedule, new autonomous credits from the banks have been difficult to secure. A partial indicator of its problem is the contraction of new Eurocredits, which fell by half between 1981 and 1982/1983. See Morgan Guaranty Trust Co., *World Financial Markets*, February 1983 and September/October 1985.

³⁸A bank loan is not a normal product for which payment is effected upon exchange. Thus returns are probabilistic and involve risk. Moreover, a bank's set of data is a small part of the universe and therefore marginal changes in information can have a substantial impact on perceptions of risk. Meanwhile, uncertainty and the high costs of gathering information arouse concern regarding the behaviour of competitors, which can generate herd instincts in the market. In times of prosperity, bad information is minimized and perceptions of risk become generalized and myopically overoptimistic; in turn, the appearance of a significant negative event can sharply invert the process. For more on this subject see Guttentag and Herring, *op.cit.* and Jack Guttentag and Richard Herring, "Credit rationing and financial disorder", *The Journal of Finance*, December 1984.

³⁹See "Latin American Economic Conference", *op.cit.* For details on the origins of the crisis see ECLAC, "The problem of the external debt: gestation, development, crisis and prospects", *op.cit.*, and "Adjustment policies and renegotiation of the external debt", *op.cit.*

⁴⁰Cartagena Consensus, *op.cit.*, p. 4.

⁴¹Spreads over LIBOR in the third round of rescheduling ranged between 1.13 and 1.66% (see table 10).

⁴²Banks are lending autonomously in the Eurocurrency market at rates as low as 1/4% over LIBOR. Rigorous bank accounting might question the value of loans carrying such low spreads, when they are for borrowers which are rescheduling debts. More will be said later on the issue of banking regulation.

⁴³In the case of the City of New York and the Chrysler Corporation the United States Government provided extensive guarantees on the debts of these entities. See Richard Weinert, "Reflexiones sobre la crisis de la deuda", *Revista FELABAN*, December 1983, pp. 75-76.

⁴⁴For an analytical overview of the proposals made with reference to increasing capital flows to Latin America, see Martine Guerguil, "The international financial crisis: diagnoses and prescriptions", *CEPAL Review*, No. 24, December 1984.

⁴⁵This is because the inflation component of the nominal interest compensates creditors for the erosion of the real value of debt and represents an effective "hidden" amortization of outstanding obligations. For more on this subject, see World Bank, *World Development Report*, 1985, Washington, D.C., p. 25.

⁴⁶Avramovic, *op.cit.*, p. 12. His data show that while disbursements from private banks to developing countries fell by US\$ 31 billion (36%) between 1981 and 1984, those from official creditors rose by only US\$ 3 billion (10%).

⁴⁷Kuczynsky estimates that there are US\$ 25 billion in committed but undisbursed funds for Latin American countries. See Pedro Pablo Kuczynsky, "At the Latin Debt Hospital", *New York Times*, 16 December 1985.

⁴⁸See ECLAC, "Adjustment policies and renegotiation of the external debt", *op.cit.*, table 20.

⁴⁹For example, until 1970 the IMF quotas were equivalent to approximately 10% of the value of world trade. When the crisis broke out in 1982 its quota position had fallen to 4%. As a consequence, the institution's capacity to respond to the crisis was greatly handicapped. Feinberg shows how the net flow of capital from banks to non-oil LDCs dropped by US\$ 34 billion between 1981-1983, while the IMF's net flows rose by only US\$ 4 billion. See Richard Feinberg, "LDC debt and the public sector rescue", *Challenge*, July-August 1985, p. 29.

⁵⁰See Carlos Diaz Alejandro, "Latin American debt: I don't think we are in Kansas any more", *Brookings Papers on Economic Activity*, No. 2, 1984.

⁵¹The debate surrounding IMF conditionality is analysed extensively in Richard L. Ground, "Orthodox adjustment programmes in Latin America: a critical look at the policies of the International Monetary Fund", *CEPAL Review*, No. 23, August 1984.

⁵²Albert Hirschman has designated the conventional approach as "mono-economics". In his view this is a policy which pays insufficient attention to the principles of development economics, which are founded on the uniqueness of each economy and the need to design policies and instruments that directly address the specific obstacles to development. See Alejandro Foxley, "El problema de la deuda externa visto desde América Latina", *Colección Estudios CIEPLAN*, No. 18, December 1985, p. 59.

⁵³See Richard L. Ground, *op.cit.*

⁵⁴See Richard L. Ground, "Perturbaciones, déficit, crisis y políticas de ajuste: un enfoque normativo", *El Trimestre Económico* (forthcoming, 1986).

⁵⁵Most Latin American loans are trading well below par. Prior to the fall in petroleum prices in February 1986, discounts were as follows: Argentina, 30%; Brazil, 20%; Bolivia, 80%; Chile, 35%; Mexico, 15%; Nicaragua, 90%; Peru, 50%; and Venezuela, 10%. Only in the cases of Bolivia and Nicaragua —two small debtors that have been in *de facto* moratoria— have creditors been forced to write down their loans in order to approximate to market valuation. Peru's limitation of interest payments will mean that its loans will be written down as well.

⁵⁶Cartagena Consensus, *op.cit.*, p. 6.

⁵⁷John Maynard Keynes, *The Economic Consequences of the Peace*, New York, Harcourt, Brace Howe, 1920, pp. 278-279.

⁵⁸See Luis Riveros, "Desempleo, distribución del ingreso y política social", *Estudios Públicos*, No. 20, Santiago, Spring 1985.

⁵⁹See PREALC, "El perfil del desempleo", provisional text, Santiago, 1984.

⁶⁰See PREALC, *Más allá de la crisis*, Santiago, 1985.

⁶¹See UNICEF, *The State of the World's Children*, 1984, New York, 1984.

⁶²See *Peru 1985* (Message to the Nation from the President of the Republic, Fernando

Belaunde Terry), Lima, 1985.

⁶³This number was equivalent to 8.5% of the enrolment that should have been recorded in that year. In this connection, see Rolando Morales, *La crisis económica en Bolivia y su impacto en las condiciones de vida de los niños*, La Paz, UNICEF, 1985.

⁶⁴See Roberto Macedo, "La crisis económica y el bienestar de la infancia en Brasil: estudio del Estado de São Paulo", in Jolly and Cornia, *Efectos de la recesión mundial sobre la infancia*, UNICEF, Madrid, Siglo XXI, 1984.

⁶⁵This point is illustrated by the fact that in Bolivia the savings of families as a whole came to be negative in 1983; whereas in 1980 family savings had represented 32% of the country's total saving, in 1983 the corresponding proportion was the equivalent of -2% (see R. Morales, *op.cit.*).

⁶⁶See Enrique de la Piedra, "La pobreza en América Latina: perspectivas y marco global de políticas", *Apuntes*, No. 17, Lima, Universidad del Pacífico, 1985.

⁶⁷For two recent studies which enlarge upon this thesis see: ECLAC, *La pobreza en América Latina: dimensiones y políticas* (final report of the Inter-Institutional Project on Critical Poverty in Latin America), *Estudios e Informes de la CEPAL* series, No. 54, Santiago, Chile, 1985; and UNICEF, "Adjustment with a human face: context, contents and economic justification for a broader approach to adjustment policy" (provisional text), paper presented at the seminar on adjustment policies and the most vulnerable groups in Latin America, held in Bogotá in February 1986.

⁶⁸See Pan-American Health Organization, *Health for all in the year 2000*, Washington, 1982; and World Bank, *World Development Report, 1984*, Washington, 1980, particularly pages 53-59.

⁶⁹See UNICEF, *The state of the world's children, 1984*, New York, 1984.

⁷⁰*Ibid.*

⁷¹See World Bank, *op.cit.*, p. 49.

⁷²In view of this fact, university education free of charge implies a considerable real transfer of public resources to the most affluent sectors of society. Hence, from the distributive standpoint, a preferable system is one which expects users to pay part of the cost of university education and under which a system of scholarships or long-term loans exists for students with less resources. Such a system would make it possible to save a by no means negligible amount of resources which could be used to expand and improve basic education.

⁷³See Alan Berg, *Malnourished people - A policy view*, Washington, D.C., World Bank Poverty and Basic Needs Series, June 1981, p. 14.

⁷⁴UNICEF, "Adjustment with a human face", *op.cit.*, p. 21.

⁷⁵See James E. Austin, *Confronting urban malnutrition. The design of nutrition programs*, Washington, D.C., Bank Staff Occasional Paper 28, 1980.

⁷⁶See Terence R. Lee, "Abastecimiento de agua: una necesidad básica", in Rolando Franco (editor), *Pobreza, necesidades básicas y desarrollo*, Santiago, Chile, CEPAL/ILPES/UNICEF, 1982.

⁷⁷The return on these efforts can be considerably increased through mechanisms which promote and facilitate self-help building methods, such as, for example, the provision of credit or of prefabricated components mass-produced at a low unit cost.

⁷⁸See ECLAC, "El desarrollo de la seguridad social en América Latina", *Estudios e Informes de la CEPAL* series No. 43, Santiago, Chile, 1985.

⁷⁹See, for example, *World Bank, World Development Report, 1980, op.cit.*

⁸⁰For an analysis of the superiority of investment in children over investment in human capital in general and of the superiority of investment in poor children over investment in children in general, see Fernando Galofré, "Infancia y juventud: criterios para la formulación de políticas", in Rolando Franco (editor) *Pobreza, necesidades básicas y desarrollo, op.cit.*

⁸¹For example, 90% of brain development has already been completed at 5 years of age.

⁸²In Peru in 1980, for example, the rural lower stratum—which represented the poorest 46% of the population—received barely 16% of total subsidies, whereas the richest 7% reaped the benefit of 13% of them. It should be noted that these figures correspond to a year in which there had been a considerable decrease in the subsidy on fuel prices, which, in the period 1977-1979, absorbed 64% of total expenditure on subsidies. As the fuel subsidy manifestly favours the urban strata, the incidence of subsidies must have been even more inequitable in the period in question.

⁸³See Enrique de la Piedra, "Generación de ingresos para grupos pobres: análisis de dos instrumentos de creación de empleos adicionales", in ILPES, *Boletín de Planificación*, No. 15, Santiago, Chile, 1982; and Emilio Klein and Jose Wurgarf, "La creación de empleos en períodos de crisis", in PREALC, *Investigaciones sobre empleo*, No. 24, Santiago, Chile, 1985.

⁸⁴Various countries in Latin America and the Caribbean have had a certain amount of experience in this respect. It includes an Emergency Employment Plan in Panama; a Minimum Employment Programme and an Employment Programme for Heads of Households in Chile; a Special Employment Programme in Jamaica; and an Employment Programme and a Support for Temporary Income Programme in Peru.

⁸⁵See Víctor Tokman, "Pobreza urbana y empleo: líneas de acción", in CEPAL/UNDP, *¿Se puede superar la pobreza?*, Santiago, Chile, 1980.

⁸⁶See Oscar Altimir, "Pobreza, distribución del ingreso y bienestar infantil en América Latina: Situación antes y después de la recesión", in Jolly and Cornia, *op.cit.*

⁸⁷The decline in the domestic availability of goods and services will take place when the turnaround from a trade deficit to a trade surplus, as a proportion of the gross domestic product, is higher than the latter's rate of growth.

⁸⁸In this respect, see T. Sargent, "The end of four big inflations". *NBER Conference Paper*, No. 890, National Bureau of Economic Research, New York, 1981.

⁸⁹See G. Papenek, "Comments . . ." in W. Cline and S. Weintraub (eds.), *Economic Stabilization in Developing Countries*, The Brookings Institution, 1981.

⁹⁰Of course, although the role played by the inflexibility of expectations is increasingly apparent when the process of readjustment of prices and costs is institutionalized by means of a system of formal indexation, such inflexibility is equally significant and real even when there is no such system.

⁹¹Although it is useful for heuristic purposes, figure 15 does not purport to explain exactly when one phase ends and another begins. This is mainly due to the complex nature of the variable on the horizontal axis, which takes into account both the intensity and the duration of inflation.

⁹²In this respect it is interesting to observe that of the eight countries in the region (Barbados, Bolivia, Costa Rica, Ecuador, Jamaica, Mexico, Nicaragua and Trinidad and Tobago) which maintained a fixed exchange rate between 1960 and 1970 and whose inflation in the 1970s was considerably higher than international inflation, Barbados alone has been able to avoid devaluation since then.

⁹³There is no doubt that this would occur in the case of non-tradeable goods, whose production cannot, by definition, exceed domestic demand.

⁹⁴Generally speaking, the greater the relative weight in GNP of agriculture, exports and imports, the lower tariff and non-tariff barriers, the less organized the labour market and the less oligopolistic the industrial sector, the more flexible are prices and wages and the less need there is to apply a strict incomes policy.

⁹⁵For example, assuming monthly inflation were to fall from 30% to 3% and that the lag in the payment of taxes were only one month, the increase in the real value of tax receipts would be 26%.

⁹⁶For example, if annual inflation were initially 400% and the volume of money represented 5% of the gross domestic product, the inflationary tax yield is equivalent to 4% of the product, as with this level of inflation money loses 80% of its purchasing power per year. On the other hand, if inflation were to fall to 50% and, as a result, the demand for money rose to 20% of the gross domestic product, the yield of the inflationary tax would be equivalent to 6.5% of the product.

⁹⁷This is one of the reasons why, from a fiscal point of view, it is far harder to bring down a "moderate" level of inflation to zero than to bring down an extremely high level of inflation to "moderate" levels (as was assumed in the example given in the previous note).

⁹⁸Most, but not all prices, since in practice it is extremely difficult to freeze the prices of perishable goods and those which are subject to heavy seasonal variations, such as vegetables and fruit.

⁹⁹If the nominal wage remains at 100 for a year, and inflation is 100%, the real average annual wage is approximately 75; 100 on the first day of the year and 50 on the last. It follows that if the nominal wage is doubled the following year (200), the real wage at the beginning of the year is 100, and if inflation slows down to 50%, the real wage falls to 67 at the end of the year (200:300); i.e., the average wage is approximately 83, i.e., 11% higher than the previous year.

¹⁰⁰In line with the previous example, if an attempt is made to bring down inflation to 50% in year 2 (after 100% inflation in year 1), and nominal wages are readjusted by 50%, these will rise at the beginning of the year from 100 to 150 in nominal terms and from 50 (100:200) to 75 (150:200) in real terms. If inflation slows to 50%, at the end of year 2 real wages will be 50 (150:300); i.e., on average in year 2 a real wage of approximately 63 will have been paid, i.e., 16% lower than in year 1.

¹⁰¹In the specific example given above, if it is wished to maintain the real wage at the same level as in year 1, and 50% inflation is expected, it will be necessary to adjust nominal wages by 80%, raising them from 100 to 180 so that in real terms they rise to 90 (180:200) at the beginning of the year, and later fall during the year to 60 (180:300) at the end. Thus the real average wage for the year will be approximately 75 in year 2, i.e., it will keep the real value it had in year 1.

¹⁰²In the specific example given above, wages are readjusted by 80% at the beginning of year 2 and will again be adjusted when inflation reaches 50%. If the latter reaches 50% after 12 months, this leads to the same case as above: an annual readjustment. If inflation reaches 50% after 10 months, the readjustment will be brought forward, as the average wage for the 10 months will already have reached the level of 75 which is the real wage set as a target, while the contrary will be true if the rise in prices does not reach 50% until more than 12 months have passed.

¹⁰³As noted in section D of chapter III of this document, the main mechanism for achieving this aim is the replacement of price subsidies —which reduce the purchase price of the subsidized good for all those who buy it, whether rich or poor— with direct monetary transfers to the neediest groups.

STATISTICS TABLES

Table 1

LATIN AMERICA AND THE CARIBBEAN: MAIN ECONOMIC INDICATORS^a

Indicators	1980	1981	1982	1983	1984	1985 ^b
	Indexes (1980 = 100)					
Gross domestic product at market prices	100.0	100.4	99.0	96.5	99.6	102.3
Population (millions of inhabitants)	356	364	373	381	390	399
Per capita gross domestic product	100.0	98.1	94.4	89.9	90.7	91.1
Per capita gross national income	100.0	96.2	89.7	85.1	86.1	86.0
	Growth rates					
Gross domestic product	5.3	0.4	-1.5	-2.5	3.3	2.7
Per capita gross domestic product	2.8	-1.9	-3.7	-4.7	0.9	0.4
Per capita gross national income	3.7	-3.8	-6.8	-5.1	1.2	-0.1
Consumer prices ^c	56.1	57.6	84.8	131.1	185.2	274.5
Terms of trade (goods)	5.1	-7.6	-8.9	-1.8	4.1	-2.9
Purchasing power of exports of goods	12.4	0.3	-7.5	5.2	11.6	-4.6
Current value of exports of goods	32.3	7.6	-8.9	0.1	11.5	-5.7
Current value of imports of goods	34.9	7.8	-19.8	-28.5	5.0	-1.9
	Billions of dollars					
Exports of goods	89.1	95.9	87.4	87.5	97.5	91.9
Imports of goods	90.5	97.6	78.3	56.0	58.8	57.6
Merchandise trade balance	-1.4	-1.7	9.1	31.5	38.7	34.3
Net payments of profits and interest	17.9	27.1	38.7	54.2	36.1	35.1
Balance on current account ^d	-28.1	-40.1	-40.9	-7.4	-1.0	-4.4
Net movement of capital ^e	29.5	37.3	19.8	3.0	10.3	4.7
Global balance ^f	1.4	-2.8	-21.0	-4.4	9.3	0.3
Total gross external debt	222.5	277.7	318.4	344.0	360.4	368.0

Source: ECLAC, on the basis of official figures.

^aThe figures on the gross domestic product and consumer prices refer to the group formed by the countries included in tables 2, except Cuba (23 countries) and 3, respectively, the index of per capita gross domestic product and the data on the external sector relate to the same countries, minus Cuba and the English-speaking Caribbean countries.

^bProvisional estimates, subject to revision.

^cVariation from December to December.

^dIncludes long- and short-term capital.

^eIncludes net unrequited private transfer payments.

^fRelates to the variation in international reserves (of reserve sign) plus counterpart entries.

Table 2

LATIN AMERICA AND THE CARIBBEAN: EVOLUTION OF TOTAL GROSS DOMESTIC PRODUCT

Country	Annual growth rates					Cumulative variation
	1981	1982	1983	1984	1985 ^e	1981-1985 ^e
Argentina	-6.7	-6.3	3.0	2.1	-4.1	-11.8
Barbados	-2.7	-4.5	0.3	3.0	...	-4.3 ^b
Bolivia	-0.3	-6.6	-7.3	-3.1	-2.1	-18.1
Brazil	-2.0	1.4	-2.7	4.8	8.2	9.5
Colombia	2.3	1.0	1.2	3.6	2.6	11.2
Costa Rica	-2.4	-7.3	2.7	7.3	1.6	1.3
Cuba ^c	15.1	3.1	3.8	7.4	4.5	38.2
Chile	5.2	-13.1	-0.5	6.2	2.3	-1.2
Ecuador	3.8	1.1	-1.6	4.6	2.7	11.0
El Salvador	-8.4	-5.7	-1.0	1.4	1.4	-12.0
Guatemala	0.9	-3.4	-2.8	0.2	-0.9	-5.9
Guyana	-0.7	-10.8	-10.3	5.8	...	-15.9 ^b
Haiti	-1.5	-4.0	0.2	2.8	1.2	-1.5
Honduras	0.7	-0.6	-1.2	2.6	1.6	3.0
Jamaica	2.5	-0.3	1.4	-1.5	...	0.7 ^d
Mexico	8.3	-	-5.2	3.5	2.5	9.0
Nicaragua	5.3	-1.2	4.7	-1.5	-2.7	4.4
Panama	4.0	4.9	-0.1	-0.4	3.3	12.2
Paraguay	8.7	-0.7	-3.0	3.3	4.0	12.5
Peru	3.7	-0.2	-12.0	4.4	2.0	-3.0
Dominican Republic	3.9	1.3	4.6	0.7	-2.2	8.4
Trinidad and Tobago	-0.9	2.5	-7.1	-4.5	...	-9.9 ^b
Uruguay	1.0	-10.7	-5.9	-1.2	0.4	-15.7
Venezuela	-1.0	-1.3	-5.6	-1.0	-1.2	-9.6
Latin America and the Caribbean^f	0.4	-1.5	-2.5	3.2	2.7	2.2
Latin America and the Caribbean, excluding Brazil and Cuba	1.5	-2.7	-2.4	2.5	0.2	-1.0

Source: ECLAC, on the basis of official figures.

^aProvisional estimates subject to revision.^bCumulative variation 1981-1984.^cRelates to total social product.^dExcluding Cuba.

Table 3

LATIN AMERICA AND THE CARIBBEAN: EVOLUTION OF PER CAPITA GROSS DOMESTIC PRODUCT

Country	Annual growth rates					Cumulative variation
	1981	1982	1983	1984	1985 ^a	1981-1985 ^a
Argentina	-8.2	-7.8	1.4	0.5	-5.5	-18.5
Barbados	-3.5	-5.2	-0.5	1.8	...	-7.3
Bolivia	-2.9	-9.0	-9.7	-5.6	-4.7	-28.4
Brazil	-4.2	-0.9	-4.9	2.5	5.8	-2.0
Colombia	0.1	-1.1	-1.0	1.4	0.5	-0.1
Costa Rica	-5.0	-9.7	-	4.6	-1.0	-11.2
Cuba ^b	14.4	2.5	3.2	6.8	3.8	34.1
Chile	3.6	-14.4	-2.1	4.5	0.8	-8.7
Ecuador	0.8	-1.8	-4.4	1.7	-0.2	-3.9
El Salvador	-11.0	-8.4	-3.8	-1.5	-1.6	-24.0
Guatemala	-1.8	-6.1	-5.5	-2.6	-3.7	-18.3
Guyana	-2.6	-12.6	-12.0	3.9	...	-22.2 ^c
Haiti	-3.9	-6.4	-2.3	0.2	-1.4	-13.1
Honduras	-2.8	-4.0	-4.5	-0.8	-1.7	-13.0
Jamaica	1.1	-1.6	-	-1.7	...	-2.2 ^c
Mexico	5.4	-2.6	-7.6	0.9	-	-4.3
Nicaragua	2.0	-4.4	1.3	-4.8	-5.9	-11.6
Panama	1.7	2.7	-2.2	-2.5	1.1	0.7
Paraguay	5.4	-3.6	-5.9	0.2	1.1	-3.2
Peru	1.0	-2.7	-14.3	1.8	-0.6	-14.8
Dominican Republic	1.5	-1.1	2.2	-1.6	-4.4	-3.5
Trinidad and Tobago	-1.5	1.6	-8.0	-5.5	...	-13.0 ^d
Uruguay	0.3	-11.3	-6.5	-1.9	-0.3	-18.6
Venezuela	-3.9	-4.1	-8.2	-3.7	-3.8	-21.6
Latin America and the Caribbean ^d	-1.9	-3.7	-4.7	0.9	0.4	-8.8
Latin America and the Caribbean, excluding Brazil and Cuba	-0.9	-5.0	-4.7	0.1	-2.1	-12.1

Source: ECLAC, on the basis of official figures for the gross domestic product. The population figures are taken from CELADE estimates published in *Boletín Demográfico*, Vol. XVIII, Nº 35, January 1985.

^aProvisional estimates subject to revision.

^bRefers to total social product.

^cCumulative variation 1981-1984.

^dExcluding Cuba.

Table 4

LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT

(Average annual rates)

Country	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Argentina ^a	3.7	4.9	3.3	3.3	2.5	2.6	4.7	5.3	4.6	4.6	6.3
Bolivia ^b	...	...	7.9	4.5	7.6	7.5	9.7	9.4	12.1	12.6	...
Brazil ^c	...	...	...	6.8	6.4	7.2	7.9	6.3	6.7	7.1	5.3
Colombia ^d	11.0	10.6	9.0	9.0	8.9	9.7	8.2	9.3	11.8	13.5	14.1
Costa Rica ^e	...	5.4	5.1	5.8	5.3	6.0	9.1	9.9	8.6	6.6	6.7
Chile ^f	15.0	16.3	13.9	13.3	13.4	11.7	9.0	20.0	19.0	18.5	17.0
Honduras ^g	...	...	...	...	...	8.8	9.0	9.2	9.5	10.7	11.7
Mexico ^h	7.2	6.8	8.3	6.9	5.7	4.5	4.2	4.1	6.7	6.0	5.0
Nicaragua ⁱ	...	...	...	...	...	18.3	15.8	19.9	15.2	16.3	...
Panama ^j	8.6	9.0	...	9.6	11.6	9.8	11.8	10.3	11.4	11.1	11.5
Paraguay ^k	...	6.7	5.4	4.1	5.9	4.1	2.2	5.6	8.4	7.4	...
Peru ^l	...	8.4	9.4	10.4	11.2	10.9	10.4	10.6	13.9	16.4	...
Uruguay ^m	...	12.7	11.8	10.1	8.3	7.4	6.7	11.9	15.5	14.0	13.1
Venezuela ⁿ	8.3	6.8	5.5	5.1	5.8	6.6	6.8	7.8	10.5	12.9	13.3

Source: ECLAC and PREALC, on the basis of official figures.

^aNational urban, average April-October. ^bLa Paz, 1977. 1978 and 1979: second semester; 1980, average May-October; 1983 and 1984, second semester. ^cMetropolitan area of Rio de Janeiro, São Paulo, Belo Horizonte, Porto Alegre, Salvador and Recife, average for 12 months; 1980, average June-December.

^dBogotá, Baranquilla, Medellín and Cali, average for March, June, September and December. ^eNational Urban, average for March, July and November; 1984, average March and November. ^fGreater Santiago, average for four quarters; as from August 1983 data relate to the metropolitan area of Santiago.

^gNational averages. ^hMetropolitan areas of Mexico City, Guadalajara and Monterrey, average for four quarters; 1985, average for three quarters. ⁱNon-agricultural activities. ^jNational urban; 1980 corresponds to urban unemployment recorded in the population census taken in that year; 1981, 1982 and 1985, metropolitan area.

^kAsunción, Fernando de la Maza, Lambaré and urban areas of Luque and San Lorenzo, annual average; 1981, first semester; 1983, average September, October and November; 1984, average August and September. ^lNon-agricultural activities. ^mMontevideo, average for four quarters. ⁿNational urban, average for two semesters; 1984 and 1985, national average.

Table 5
LATIN AMERICA AND THE CARIBBEAN: EVOLUTION OF RATE OF
UNEMPLOYMENT IN PRINCIPAL CITIES

	1980	1981	1982	1983	1984	1985	1984				1985 ^e			
							I	II	III	IV	I	II	III	IV
							Latin America^a	6.2	6.6	7.0	8.1	8.2	7.8	8.6	8.3	8.5	7.6	8.1	7.7	7.5	...
Argentina^f														
Capital and Greater														
Buenos Aires	2.3	4.5	4.7	4.0	3.8	5.3	...	4.0	...	3.6	...	5.6	...	4.9
Córdoba	2.4	3.8	4.4	5.0	4.8	5.0	...	4.4	...	5.1	...	5.3	...	4.7
Greater Mendoza	2.3	4.8	4.1	4.5	4.5	3.7	...	5.0	...	3.9	...	3.7	...	3.7
Rosario	3.4	5.8	8.4	6.3	6.7	10.7	...	7.0	...	6.3	...	11.1	...	10.2
Brazil^g														
Rio de Janeiro	7.5	8.6	6.6	6.2	6.8	4.9	6.9	7.4	6.7	6.0	6.0	5.4	4.5	3.6
São Paulo	5.7	7.3	6.0	6.8	6.8	5.0	7.8	7.5	6.7	5.1	6.1	5.8	4.8	3.5
Recife	6.9	8.6	7.5	8.0	9.0	7.2	8.9	9.6	9.9	7.5	7.8	8.4	7.3	5.4
Porto Alegre	4.5	5.8	5.3	6.7	7.0	5.4	7.6	8.2	6.9	5.3	5.8	6.3	5.6	4.0
Colombia^h														
Bogotá	7.9	5.5	7.4	9.4	12.2	12.8	12.6	12.0	11.8	12.4	13.7	13.2	12.6	11.7
Barranquilla	8.1	11.1	10.4	13.8	13.8	15.7	14.4	13.1	15.3	12.4	14.3	17.9	17.5	13.1
Medellín	14.7	13.1	13.3	17.0	16.4	16.0	16.1	17.1	15.3	17.1	16.1	16.5	15.6	15.7
Cali	10.0	9.0	9.6	11.6	13.3	14.4	13.4	12.9	14.5	12.5	13.4	15.4	15.2	13.7
Mexicoⁱ														
México City	4.3	3.9	4.0	6.3	5.8	5.1	5.4	5.3	6.4	6.2	5.7	4.3	5.2	...
Guadalajara	5.0	5.8	5.0	7.4	6.1	3.8	6.9	5.7	6.0	5.7	3.9	3.5	3.9	...
Monterrey	5.2	4.2	4.9	9.8	7.5	5.8	8.3	7.0	8.5	6.2	6.9	5.1	5.4	...
Asunción (Paraguay)^j	3.9	2.2	5.6	8.4	7.4	...	...	...	7.4	...	...	...	...	...
Caracas (Venezuela)^k	6.7	5.7	7.0	9.9	13.2	12.5	13.5	12.8	13.8	12.6	...	12.5	...	...
Lima (Peru)^l	7.1	6.8	6.6	9.0	8.9	...	...	8.9	...	...	...	...	...	...
La Paz (Bolivia)^m	7.5	...	9.4	12.8	12.6	...	...	...	12.9	12.2	...	...	...	...
Montevideo (Uruguay)ⁿ	7.4	6.6	11.9	15.5	14.0	13.1	14.6	14.1	14.7	12.7	13.7	13.2	13.6	12.0
San José (Costa Rica)^o	5.6	9.3	10.5	8.5	6.6	6.5	7.9	...	...	5.2	6.3	...	7.4	5.9
Santiago (Chile)^p	11.7	9.0	20.0	18.9	18.5	17.0	18.3	18.4	19.0	18.1	17.3	17.2	18.5	15.1

Source: ECLAC, on the basis of official data.

^a Provisional figures. ^b Weighted average for the 25 cities with the largest population in Latin America. Havana, Santo Domingo, Fortaleza, Curitiba, Guayaquil, San Juan (Puerto Rico) and Guatemala City are excluded, for want of comparable data. ^c Figures for April and October. ^d Quarterly averages. ^e Figures for March, July, September and December. ^f Metropolitan area; quarterly averages. ^g Including Fernando de la Maza, Lambaré and the urban areas of Luque and San Fernando; 1981, first semester; 1982, first quarter; 1983, average for September, October and November; 1984, average for August, September and October. ^h Metropolitan area; 1980 to 1983, average for two semesters; 1984, quarterly averages; 1985, first semester. ⁱ Metropolitan area; 1980, April; 1981 to 1984, June. ^j 1980, May to October; 1982 to 1984, average for June to December. ^k 1980, average for two semesters; 1981, quarterly averages. ^l Figures for March, July and November; 1984, March and November only. ^m Greater Santiago, quarterly averages. As from August 1983, data refer to the Metropolitan Region of Santiago.

Table 6

LATIN AMERICA AND THE CARIBBEAN: EMPLOYMENT IN MANUFACTURING

(1980 = 100)

	1981	1982	1983	1984	1985 ^a	1984				1985 ^a			
						I	II	III	IV	I	II	III	IV
Argentina ^b	87.4	82.8	85.5	88.0	88.7	88.3	87.4	87.1	88.9	92.9	84.6	...	...
Brazil ^c	93.1	88.5	81.6	81.5	88.1	79.5	80.6	81.9	83.9	86.0	87.3	88.8	90.7
Colombia ^d	95.5	90.5	84.5	83.6	82.4	82.7	83.3	83.8	84.6	81.9	82.4	82.8	...
Costa Rica ^e	100.4	102.1	123.6	131.8	...	128.8	...	...	134.7	...	...	...	...
Chile ^f	102.2	80.9	78.8	90.3	95.5	81.4	89.4	93.5	97.0	95.2	96.2	87.9	102.8
Ecuador ^g	108.5	110.1	105.3	104.5	...	103.5	101.8	106.2	106.5	...	...	...	...
Panama ^h	101.6	101.4	97.4	91.9	...	93.0	90.9	...	...	...	...	...	...
Mexico ⁱ	105.6	103.0	93.1	92.2	94.5	91.2	91.8	92.8	92.9	93.1	95.0	95.2	94.0
Peru ^j	101.1	94.7	94.3	84.4	83.3	86.1	84.1	83.5	83.7	83.5	83.7	83.0	83.1
Venezuela ^k	102.4	102.3	96.8	98.0	...	...	96.9	...	101.1	...	...	...	...
Percentage variation ^l													
Argentina ^b	-12.6	-5.3	3.3	2.9	1.0	1.6	1.8	4.3	3.8	5.1	-3.2	...	...
Brazil ^c	-6.9	-4.9	-7.8	-0.2	8.2	-5.0	-2.1	1.2	5.3	8.2	8.4	8.4	8.2
Colombia ^d	-4.5	-5.2	-6.6	-1.1	-1.1	-3.3	-1.4	0.2	0.5	-0.9	-1.1	-1.2	...
Costa Rica ^e	0.4	1.7	21.4	6.6	...	25.7	...	...	-2.1	...	...	...	...
Chile ^f	2.2	-20.8	-2.7	14.7	5.8	8.0	17.9	13.0	19.5	16.9	7.7	-5.9	6.0
Ecuador ^g	8.5	1.4	-4.4	-0.7	...	-1.7	-2.8	0.7	1.1	...	...	...	...
Panama ^h	1.6	-0.2	-4.0	-6.3	...	-5.2	-7.4	...	...	...	...	...	...
Mexico ⁱ	5.6	-2.5	-9.6	-1.0	2.6	-3.5	-2.4	0.1	1.9	2.1	3.5	2.6	2.8
Peru ^j	1.1	-1.4	-5.4	-10.5	-1.3	-11.9	-12.0	-9.9	-8.2	-3.1	-0.5	-0.6	-0.7
Venezuela ^k	2.4	-0.1	-5.4	2.3	...	...	0.3	...	4.2	...	...	...	...

Source: ECLAC, on the basis of official figures.

^a Provisional figures. ^b Personnel gainfully employed in productive activities, 1985, January to June. ^c Personnel employed in industry in the State of São Paulo. ^d Total employment in manufacturing industry, 1985, January to September. ^e Wage-earning population employed in industry in the metropolitan area of San José, average for March, June and November, 1984, March and November. ^f Personnel employed in manufacturing industry in Greater Santiago. Quarterly averages. As from August 1983, data relate to the Metropolitan Region of Santiago. ^g Personnel employed in manufacturing. Average for four quarters. ^h Personnel employed in manufacturing in the districts of Panama and Colón. Quarterly averages, 1984, January to June. ⁱ Personnel employed in manufacturing. Quarterly averages, 1985, January to October. ^j Index of employment in manufacturing in the metropolitan area of Lima. Quarterly averages. ^k Personnel employed in manufacturing. Average for two semesters. ^l In relation to the same period in the preceding year.

Table 7
LATIN AMERICA AND THE CARIBBEAN: EVOLUTION OF CONSUMER PRICES

(Variations from December to December)

Country	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Latin America ^a	62.3	40.0	39.0	54.1	56.1	57.6	84.8	131.1	185.2	274.5
Latin America, excluding Bolivia and Cuba	63.2	40.5	39.5	54.3	56.6	58.2	81.3	127.8	152.0	141.8
Argentina	347.5	150.4	169.8	139.7	87.6	131.2	208.7	433.7	688.0	385.4
Barbados	3.9	9.9	11.3	16.8	16.1	12.3	6.9	5.5	5.1	3.0 ^b
Bolivia	5.5	10.5	13.5	45.5	23.9	25.2	296.5	328.5	2 177.2	8 170.5
Brazil ^c	44.8	43.1	38.1	76.0	95.3	91.2	97.9	179.2	203.3	223.0
Colombia ^d	25.9	29.3	17.8	29.8	26.5	27.5	24.1	16.5	18.3	22.5
Costa Rica	4.4	5.3	8.1	13.2	17.8	65.1	81.7	10.7	17.3	10.9
Chile	174.3	65.5	30.3	38.9	31.2	9.5	20.7	23.6	23.0	26.4
Ecuador ^e	13.1	9.8	11.8	9.0	14.5	17.9	24.3	52.5	25.1	24.4
El Salvador	5.2	14.9	14.6	14.8	18.6	11.6	13.8	15.5	9.8	32.1
Guatemala	18.9	7.4	9.1	13.7	9.1	8.7	-2.0	15.4	5.2	31.5
Guyana	9.2	9.0	20.0	19.4	8.5	29.1	...	...	...	...
Haiti ^f	-1.4	5.5	5.5	15.4	15.3	16.4	6.2	12.2	6.1	15.0
Honduras	5.6	7.7	5.4	22.5	11.5	9.2	8.8	7.8	3.7	4.2
Jamaica	8.3	14.1	49.4	19.8	28.6	4.8	7.0	16.7	31.2	22.8 ^g
Mexico	27.2	20.7	16.2	20.0	29.8	28.7	98.8	80.8	59.2	63.7
Nicaragua	6.2	10.2	4.3	70.3	24.8	23.2	22.2	32.9	50.2	334.5
Panama	4.8	4.8	5.0	10.0	14.4	4.8	3.7	2.0	0.9	0.8 ^h
Paraguay	3.4	9.4	16.8	35.7	8.9	15.0	4.2	14.1	29.8	24.0
Peru	44.7	32.4	73.7	66.7	59.7	72.7	72.9	125.1	111.5	158.3
Dominican Republic ⁱ	7.0	8.5	1.8	26.2	4.2	7.4	7.1	9.8	40.9	39.4 ^j
Trinidad and Tobago	12.0	11.4	8.8	19.5	16.6	11.6	10.8	15.4	14.1	6.9 ^k
Uruguay	39.9	57.3	46.0	83.1	42.8	29.4	20.5	51.5	66.1	83.0
Venezuela	6.9	8.1	7.1	20.5	19.6	10.8	7.9	7.0	13.3	5.8

Source: International Monetary Fund, *International Financial Statistics*, November 1984, and official information supplied by the countries.
^aExcluding Cuba. ^bVariation between October 1985 and October 1984. ^cUp to 1979, figures represent the Consumer Price Index in the city of Rio de Janeiro; from 1980 onwards, the variation in the national total. ^dUp to 1980, figures represent the variation in the Consumer Price Index for manual workers; from 1981 onwards the variation in the national total, including manual workers and employees. ^eUp to 1982, figures represent the variation in the Consumer Price Index in the city of Quito; from 1983 onwards, the variation in the national total. ^fVariation between September 1985 and September 1984. ^gVariation between November 1985 and November 1984. ^hUp to 1982, refers to the variation in the Consumer Price Index for the City of Santo Domingo; from 1983 onwards, refers to variation in the national total.

Table 8
LATIN AMERICA AND THE CARIBBEAN: NET INFLOW OF CAPITAL
AND TRANSFERS OF RESOURCES

(Billions of dollars and percentages)

Year	Net inflow of capital	Net payments of profits and interest	Transfers of resources (3)=(1)-(2)	Exports of goods and services	Transfers of resources/ exports of goods and services ^e (5)=(3)/(4)
	(1)	(2)	(3)	(4)	(5)
1973	7.9	4.2	3.7	28.9	12.8
1974	11.4	5.0	6.4	43.6	14.7
1975	14.2	5.5	8.7	41.1	21.2
1976	17.8	6.8	11.0	47.3	23.3
1977	17.1	8.2	8.9	55.9	15.9
1978	26.1	10.2	15.9	61.3	25.9
1979	29.0	13.6	15.4	82.0	18.8
1980	29.5	17.9	11.6	107.6	10.8
1981	37.3	27.1	10.2	116.1	8.8
1982	19.8	38.7	-18.9	103.2	-18.3
1983	3.0	34.2	-31.2	102.4	-30.5
1984	10.3	36.1	-25.8	113.9	-22.7
1985 ^a	4.7	35.1	-30.4	108.0	-28.1

Source: 1973-1984: International Monetary Fund, *Balance of Payments Yearbook*, 1985; ECLAC, on the basis of official data.
^aPercentages. ^bProvisional estimates subject to revision.

Table 9

LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL INTEREST PAYMENTS TO EXPORTS OF GOODS AND SERVICES*

(Percentages)

	1978	1979	1980	1981	1982	1983	1984	1985 ^b
Latin America	15.5	17.4	19.9	27.6	40.5	35.9	35.7	36.0
Oil-exporting countries	16.0	15.7	16.6	22.6	35.1	32.4	32.2	32.0
Bolivia	13.7	18.1	24.5	32.1	43.5	44.4	63.1	60.0
Ecuador	10.3	13.6	18.2	24.3	30.1	27.4	27.8	24.5
Mexico	24.0	24.8	23.3	29.0	46.0	39.3	40.2	37.0
Peru	21.2	14.7	16.0	24.1	25.1	29.8	34.0	34.5
Venezuela	7.2	6.9	8.1	12.7	21.0	21.6	17.5	22.5
Non-oil-exporting countries	15.1	18.8	23.1	32.7	45.2	39.4	38.7	40.0
Argentina	9.6	12.8	22.0	35.5	53.6	58.4	58.7	54.5
Brazil	24.5	31.5	34.1	40.4	57.1	43.5	38.7	45.5
Colombia	7.7	10.1	11.8	21.8	25.8	26.5	23.6	23.0
Costa Rica	9.9	12.8	18.0	28.0	36.1	32.8	30.7	28.0
Chile	17.0	16.5	19.3	38.8	49.5	39.4	50.0	46.5
El Salvador	5.1	5.3	5.9	7.9	11.9	12.3	13.2	14.0
Guatemala	3.6	3.1	5.3	7.5	7.8	8.7	8.9	11.5
Haiti	2.8	3.3	2.0	2.5	2.2	2.4	5.3	5.0
Honduras	8.2	8.6	10.6	14.5	22.4	16.4	17.1	17.0
Nicaragua	9.3	9.7	17.8	22.2	32.2	14.3	11.7	17.0
Paraguay	8.5	10.7	14.3	16.4	15.6	16.4	14.3	13.0
Dominican Republic	14.0	14.4	14.7	20.2	22.6	24.5	19.7	18.5
Uruguay	10.4	9.0	11.0	12.9	22.4	24.8	33.8	35.5

Source: 1978-1981: ECLAC, on the basis of data from the International Monetary Fund; 1985: ECLAC, on the basis of official data.
*Interest payments include those on the short-term debt. ^bProvisional estimates subject to revision.

Table 10

LATIN AMERICA AND THE CARIBBEAN: TERMS OF RESCHEDULING OF EXTERNAL DEBT WITH THE
INTERNATIONAL PRIVATE BANKS, 1982-1985 a/

Country	First round 1982/1983			Second round 1983/1984			Third round 1984/1985		
	Spread over LIBOR (%)	Matu- rity (years)	Commis- sions <u>b/</u>	Spread over LIBOR (%)	Matu- rity (years)	Commis- sions <u>b/</u>	Spread over LIBOR (%)	Matu- rity (years)	Commis- sions <u>b/</u>
Argentina	2.16 <u>c/</u>	6.8 <u>c/</u>	1.25 <u>c/</u>	-	-	-	1.44	11.5	0.15
Brazil	2.32	8.0	1.50	2.00	9.0	1.00	...	...	...
Costa Rica	2.25	8.0	1.00	-	-	-	1.66	9.4	1.00
Cuba	2.25	7.0	1.25	1.88	9.0	0.88	1.50	10.0	0.38
Chile	2.16	7.0	1.25	1.75	9.0	0.63	1.42	12.0	0.08
Ecuador	2.28	6.7	1.25	1.75	9.0	0.88	1.39	11.9	-
Honduras	2.38	7.0	1.38	-	-	-	1.58	11.0	0.88
Mexico	1.95	7.6	1.05	1.50	10.0	0.63	1.13	14.0	-
Panama	2.25	6.0	1.50	-	-	-	1.40	11.7	0.05
Peru	2.25	8.0	1.25	1.75 <u>d/</u>	9.0 <u>d/</u>	0.75 <u>d/</u>	...	...	...
Dominican Republic	2.25 <u>c/</u>	6.0 <u>c/</u>	1.25 <u>c/</u>	-	-	-	1.38	13.0	-
Uruguay	2.25	6.0	1.41	-	-	-	1.38	12.0	-
Venezuela	-	-	-	-	-	-	1.13	12.5	-

Source: ECLAC, Economic Development Division, on the basis of official information from the countries and from various national and international sources.

a/ Each column shows the terms agreed upon with the banks for rescheduled maturities and/or new credits. When the country negotiated both a maturity rescheduling and new loans, the figure represents a weighted average of the two components.

b/ Calculated as a percentage of the total amount of the transaction and paid once and for all at the time of signing the loan contracts.

c/ This agreement never came into force. The corresponding maturities were finally incorporated in the agreement concerted during the third round.

d/ This agreement has not been terminated.

Table 11

LATIN AMERICA AND THE CARIBBEAN: FOREIGN DIRECT INVESTMENT AND MEDIUM- AND LONG-TERM LOANS

	Millions of dollars						Millions of dollars at 1970 prices <u>a/</u>					
	Direct investment			Loans <u>b/</u>			Direct investment			Loans <u>b/</u>		
	Net inflow	Profit remittances	Balance	Net inflow	Interest paid	Balance	Net inflow	Profit remittances	Balance	Net inflow	Interest paid	Balance
Average 1961-1965	330	-1 147	-817	511	-410	101	383	-1 334	-951	604	-475	129
Average 1966-1970	726	-1 676	-950	1 661	-886	775	760	-1 761	-1 001	1 728	-926	802
Average 1971-1975	1 712	-2 219	-507	7 740	-2 973	4 767	1 202	-1 618	-416	5 245	-2 025	3 220
Average 1976-1980	3 710	-3 312	398	18 968	-13 017	5 951	1 570	-1 442	128	8 159	-5 382	2 777
1978	3 814	-3 447	367	19 142	-10 328	8 814	1 764	-1 595	169	8 857	-4 779	4 078
1979	4 921	-3 960	961	20 803	-15 705	5 098	1 994	-1 605	389	8 432	-6 366	2 066
1980	5 482	-3 966	1 516	27 887	-25 379	2 508	1 907	-1 379	528	9 703	-8 830	873
1981	7 171	-4 933	2 238	38 148	-37 295	853	2 345	-1 613	732	12 478	-12 199	279
1982	5 691	-4 934	757	17 840	-46 697	-28 857	1 859	-1 611	248	5 828	-15 255	-9 427
1983	3 128	-3 174	-46	1 444	-39 846	-38 402	1 026	-1 041	-15	473	-13 077	-12 604
1984	...	-3 183	...	...	-43 449	...	...	-1 037	...	...	-14 166	...

Source: ECLAC, Economic Development Division, on the basis of International Monetary Fund, Balance of Payments Yearbook, 1985.

a/ Relates to nominal figures deflated by the unit value index of imports of goods and services.

b/ Includes bonds.

Table 12

BANK EUROCURRENCY CREDITS

(Billions of dollars)

	1981	1982	1983	1984	<u>First semester</u>	
					1984	1985
<u>Total</u>	<u>96.5</u>	<u>100.5</u>	<u>51.8</u>	<u>36.6</u>	<u>15.7</u>	<u>12.5</u>
Industrialized countries	45.1	43.6	22.7	16.4	8.1	5.7
Developing countries	48.1	53.5	26.7	17.1	6.2	4.2
Voluntary loans	(48.1)	(42.3)	(13.0)	(10.6)	(5.4)	(3.0)
Involuntary loans <u>a/</u>	(-)	(11.2)	(13.7)	(6.5)	(0.8)	(1.2)
Others	3.3	3.4	2.4	3.1	1.4	2.6

Source: Bank for International Settlements, International Banking and Financial Market Developments, Basle, October 1985, p. 12.

a/ Loans forming part of the debt rescheduling process.

Table 13

LATIN AMERICA AND THE CARIBBEAN: EXPOSURE OF THE UNITED STATES BANKS, BY SIZE OF INSTITUTION a/
(Billions of dollars)

	June 1982				September 1985				1982/1985 (%)			
	Total	Nine largest banks	Next 15 banks	The rest <u>b/</u>	Total	Nine largest banks	Next 15 banks	The rest <u>b/</u>	Total	Nine largest banks	Next 15 banks	The rest <u>b/</u>
<u>Latin America</u>	<u>32.5</u>	<u>49.1</u>	<u>16.4</u>	<u>17.0</u>	<u>82.0</u>	<u>52.6</u>	<u>15.2</u>	<u>14.2</u>	<u>-0.6</u>	<u>7.1</u>	<u>-7.3</u>	<u>-16.5</u>
Argentina	8.8	5.6	1.8	1.4	8.5	6.0	1.6	0.9	-3.4	7.1	-11.1	-35.7
Brazil	20.5	12.3	4.2	4.0	23.9	16.0	4.5	3.4	16.6	30.1	7.1	-15.0
Colombia	3.0	2.0	0.5	0.5	2.6 <u>c/</u>	1.9	0.4	0.3	-13.3 <u>c/</u>	-5.0	-20.0	-40.0
Chile	6.1	3.3	1.2	1.6	5.9	3.6	1.0	1.3	-3.3	9.1	-16.7	-18.8
Mexico	25.2	13.6	5.2	6.4	24.8	13.9	5.0	5.9	-1.6	2.2	-3.9	-7.8
Peru	2.3	1.3	0.6	0.4	1.7	1.0	0.4	0.3	-26.1	-23.1	-33.3	-25.0
Venezuela	10.7	7.2	1.9	1.6	10.0	7.1	1.7	1.2	-6.5	-1.3	-10.5	-25.0

Source: United States Federal Financial Institutions Examination Council.

a/ Excluding Panama.

b/ Comprising a total of 143 banks.

c/ At the end of 1985 Colombia obtained a Eurocurrency credit of one billion dollars, which increased the exposure of the United States banks in that country.

Table 14

LATIN AMERICA AND THE CARIBBEAN: OFFICIAL RESERVES
AND TOTAL BANK DEPOSITS OUTSIDE THE REGION

(Billions of dollars)

	Deposits outside the region, September 1985 (1)	Gross inter- national reserves, September 1985 (2)	Deposits outside the region as a percentage of international reserves (3)=(1)/(2)
<u>Latin America and the Caribbean</u>	<u>83 389</u>	<u>33 264</u>	<u>250.7</u>
Argentina	9 020	2 162	417.2
Bolivia	207	166	124.7
Brazil	16 722	10 851 ^{a/}	154.1
Colombia	3 433	1 095	314.4
Costa Rica	193	453	42.6
Chile	2 774	1 586	174.9
Ecuador	2 006	582	344.7
El Salvador	106	180	58.9
Guatemala	1 305	213	612.7
Haiti	120	6	2 000.0
Honduras	133	110	120.9
Mexico	21 537	4 512 ^{a/}	477.3
Nicaragua	195	***	***
Paraguay	458	522	87.7
Peru	2 551	1 296 ^{b/}	196.8
Dominican Republic	255	165	154.5
Uruguay	2 491	148	1 683.1
Venezuela	19 873	9 217	215.6

Source: ECLAC, Economic Development Division, on the basis of data supplied by the Bank for International Settlements and the International Monetary Fund.

^{a/} August 1985.

^{b/} July 1985.

Table 15

SELECTED MEASURES BY UNITED STATES COMMERCIAL BANKS AND THE UNITED STATES GOVERNMENT TO RESCUE PROBLEM DOMESTIC BORROWERS

Measures adopted	
FARMERS	<ol style="list-style-type: none"> 1. The government-owned Farmers' Home Administration can guarantee up to 90% of a loan restructured by a commercial bank, provided it has agreed to writedown 10% of the loan principal. Alternatively, the bank can take the writedown in the form of a lower interest rate. 2. The Federal Reserve System instructed bank regulators to refrain from action which would discourage banks from exercising appropriate forbearance when these latter are co-operating with farmers having problem debts. 3. The Federal Reserve System encouraged banks to extend due dates on loans and in some cases grant additional credits.
THE INTERNATIONAL HARVESTER CORPORATION	<ol style="list-style-type: none"> 1. Private banks consolidated short-term loans into medium-term liabilities. 2. The banks granted new loans. 3. Interest rates were capped; when interest rates rose above the designated levels payment of part of the interest was deferred. 4. The banks converted substantial amounts of interest and principal into equity.
REAL ESTATE INVESTMENT TRUSTS (REITS)	<ol style="list-style-type: none"> 1. New lending by the banks took place to refinance interest payments and allow firms to finish construction projects. 2. The banks swapped debt for real estate. 3. The banks established below-market interest rates.

Source: Based on data collected by the Washington Office of ECLAC and on Richard Weinert, "Banks and bankruptcy", Foreign Policy, No. 50, Spring 1983.

Table 16

LATIN AMERICA AND THE CARIBBEAN: EVOLUTION OF AVERAGE REAL WAGES

Country	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 ^a
Annual average indexes (1980 = 100)											
Argentina ^b	119.6	80.5	79.3	77.9	89.5	100.0	89.4	80.1	103.6	131.5	114.3
Brazil ^c	80.9	28.7	89.1	93.9	95.1	100.0	108.5	121.6	112.7	105.1	113.1
Colombia ^d	86.5	88.5	83.5	93.2	99.3	100.0	101.4	105.2	110.4	118.7	114.0
Costa Rica ^e	70.2	79.6	87.0	94.7	99.2	100.0	88.3	70.8	72.5	84.7	92.2
Chile ^f	69.5	70.5	79.6	84.7	91.8	100.0	109.1	108.7	97.1	97.4	93.0
Mexico ^g	98.8	107.4	109.1	106.2	104.5	100.0	103.0	107.5	76.2	71.7	73.1
Peru ^h	119.9	130.0	108.7	94.9	88.9	100.0	98.2	100.4	83.6	70.8	59.7
Uruguay ⁱ	136.5	128.5	113.2	109.1	100.3	100.0	107.5	107.2	85.0	77.3	88.0
Percentage variation ^j											
Argentina ^b	-5.9	-32.7	-1.5	-1.8	14.3	11.8	-10.6	-10.4	29.3	26.9	-13.0
Brazil ^c	9.9	5.9	4.0	5.4	1.3	5.2	8.5	12.1	-7.3	-6.7	7.8
Colombia ^d	-1.8	2.2	-5.6	11.5	0.5	0.8	1.1	3.7	5.0	7.5	-3.3
Costa Rica ^e	-3.7	-13.2	9.4	8.8	4.8	0.8	-11.7	-19.8	10.9	7.8	8.9
Chile ^f	-4.2	1.4	12.9	6.5	8.3	9.0	9.1	-0.4	-10.6	0.3	-4.5
Mexico ^g	5.6	8.6	1.6	-2.7	-1.6	-4.3	3.0	4.3	-29.1	-5.9	1.9
Peru ^h	-14.9	8.5	-16.6	-12.7	-6.3	12.4	-1.8	2.2	-16.7	-15.3	-15.7
Uruguay ⁱ	-8.8	-5.8	-11.9	-3.6	-8.1	-0.4	7.5	-0.3	-20.7	-9.1	14.1

Source: ECLAC and PREALC, on the basis of official data.

^aProvisional figures.

^bWages of manual workers in manufacturing.

^cAverage wages in basic industries, deflated by the Rio de Janeiro CPI; 1985, average

January to November.

^dWages of manual workers in manufacturing; 1985, average January to September.

^eDeclared wages of workers covered by Social

Security; 1985, January to November.

^fAverage wages of manual workers in non-agricultural sectors.

^gAverage wages in manufacturing; 1985, average

January to July.

^hWages of manual workers in the private sector in the metropolitan area of Lima; 1985, average January to October.

ⁱIndex of average

real wages.

^jIn relation to the same period in the preceding year.

Table 17

LATIN AMERICA AND THE CARIBBEAN: EVOLUTION OF URBAN REAL MINIMUM WAGE

(1980 = 100)

Country	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 ^e
Argentina ^b	104.0	99.7	81.0	85.3	100.0	97.8	97.2	136.9	163.7	127.5
Brazil ^c	...	...	97.7	97.5	100.0	104.4	104.9	93.0	86.0	88.2
Colombia ^d	75.1	77.9	89.5	97.5	100.0	99.4	103.7	108.3	113.1	110.0
Costa Rica ^b	79.5	86.2	96.0	98.5	100.0	90.5	85.7	99.3	104.5	112.2
Chile ^f	67.5	-79.6	100.7	99.8	100.0	115.9	116.6	93.9	80.2	76.1
Ecuador ^f	60.5	53.8	48.1	60.4	100.0	86.2	75.9	63.6	62.8	59.7
El Salvador ^g	100.8	90.3	40.3	87.7	100.0	96.8	86.7	76.6	76.9	66.4
Guatemala ^h	85.0	77.6	70.0	62.5	100.0	107.5	107.5	102.5	99.1	...
Haiti ^h	...	74.3	94.1	85.8	100.0	96.3	100.8	94.0	87.1	...
Honduras ⁱ	112.3	104.6	100.0	109.2	100.0	105.0	104.4	96.4	92.1	89.0
Mexico ^j	113.5	-112.5	108.6	107.2	100.0	101.9	92.7	76.6	72.3	71.7
Nicaragua ^k	116.1	118.1	119.8	112.7	100.0	90.2	74.4	56.7	63.6	...
Panama ^l	126.0	120.5	115.7	113.6	100.0	93.2	89.4	87.6	86.0	...
Paraguay ^m	100.6	92.0	94.8	92.4	100.0	103.2	101.1	93.6	93.4	99.1
Peru ⁿ	107.3	94.2	72.3	80.8	100.0	83.0	77.1	79.4	62.3	53.3
Dominican Republic ^b	...	...	94.7	105.0	100.0	93.0	86.3	80.8	82.2	...
Uruguay ^o	171.5	114.7	113.6	104.8	100.0	103.4	104.6	89.6	89.9	94.1
Venezuela ^p	78.9	73.2	68.2	60.7	100.0	86.1	78.6	73.9	65.8	...
Percentage variation										
Argentina ^b	-48.2	-4.1	-18.8	13.7	17.3	-2.2	0.1	39.9	22.5	-26.7
Brazil ^c	...	...	...	-0.2	2.6	4.4	0.4	-11.3	-7.5	2.6
Colombia ^d	-6.2	3.7	13.1	10.7	2.5	-0.6	4.4	4.4	5.0	-3.2
Costa Rica ^b	14.8	8.4	11.4	2.6	1.6	-9.5	-5.3	15.9	5.2	7.4
Chile ^f	10.8	17.9	26.5	-0.9	0.2	15.9	0.7	-19.5	-14.6	-5.2
Ecuador ^f	...	-11.2	-10.6	25.7	65.5	-13.8	-11.9	-16.2	-1.3	-5.0
El Salvador ^g	9.5	-10.7	-	-2.9	8.6	-3.2	-10.4	-11.6	0.3	-13.6
Guatemala ^h	-10.6	-8.7	-9.7	-10.7	59.9	7.5	-	-4.7	-3.3	...
Haiti ^h	...	...	26.6	-8.8	16.5	-3.7	4.7	-6.7	-7.3	...
Honduras ⁱ	-4.7	-6.9	-4.4	11.5	-8.3	5.0	-0.6	-7.7	-0.4	-3.3
Mexico ^j	11.6	-0.9	-3.4	-1.3	-6.7	1.9	-9.0	-17.4	-5.6	-0.9
Nicaragua ^k	3.1	1.7	1.4	-5.9	-11.3	-9.8	-17.5	-23.8	12.2	...
Panama ^l	-3.8	-4.4	-4.0	-1.8	-12.0	-6.8	-4.1	-2.0	-1.8	...
Paraguay ^m	...	-8.3	3.1	-2.5	8.2	3.2	-2.0	-7.5	-0.2	9.0
Peru ⁿ	...	-12.2	-23.2	11.7	27.8	-17.0	-7.1	2.9	-21.5	-12.7
Dominican Republic ^b	...	...	...	9.7	-4.8	-7.0	-7.2	-6.4	1.7	...
Uruguay ^o	-3.1	-33.5	-0.5	-7.7	-4.6	3.4	1.2	-14.3	0.3	4.7
Venezuela ^p	-7.1	-7.2	-6.8	-11.0	64.7	-13.9	-8.7	-6.0	-10.9	...

Source: ECLAC, on the basis of official data.

^a Provisional figures.^b National minimum wage; 1985, January to May.^c Minimum wage for the city of Rio de Janeiro, deflated by the corresponding CPI.^d Minimum wage for upper urban sector.^e Minimum income.^f Overall minimum living wage, calculated on the basis annual minimum living wages and legal supplementary benefits.^g Minimum wage for non-agricultural activities in San Salvador.^h Minimum daily wage paid in industrial firms.ⁱ Minimum wage in the Central District and San Pedro Sula, for manufacturing industry.^j Minimum wage in Mexico City, deflated by the corresponding CPI.^k Minimum current wage for all activities except construction.^l Minimum wage in Asunción and Puerto Stroessner, 1985, January to August.^m Minimum wage in the metropolitan area of Lima for non-agricultural activities; 1985, January to October.ⁿ National minimum wage for workers over 18 years of age.^o National minimum wage for non-agricultural activities.

Table 18

**LATIN AMERICA AND THE CARIBBEAN: EVOLUTION OF REAL WAGES
IN THE CONSTRUCTION SECTOR**

(1980 = 100)

Country	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985 ^a
Argentina ^b	152.5	120.8	84.7	84.6	100.0	91.3	82.5	125.6	149.0	109.0
Brazil ^c	100.0	110.1	107.0	99.3	100.0	96.0	94.2	83.0	80.0	82.8
Colombia ^d	73.8	68.7	78.9	89.0	100.0	102.0	102.4	106.9	108.9	106.1
Costa Rica ^e	86.8	87.1	94.7	103.3	100.0	85.1	66.0	79.8	79.6	...
Chile ^f	78.0	81.3	84.8	91.9	100.0	105.6	100.2	75.0	73.4	61.4
Guatemala ^g	91.8	89.9	88.4	95.2	100.0	122.2	121.7	109.5	...	...
Honduras ^h	105.7	94.8	89.7	107.2	100.0	104.5	102.2	94.4	90.1	87.1
Mexico ⁱ	98.7	103.9	103.9	104.6	100.0	103.3	101.1	78.0	72.7	70.6
Nicaragua ^j	157.8	134.2	137.1	116.8	100.0	99.5	94.1	96.9	96.3	...
Paraguay ^k	111.0	110.0	116.9	103.8	100.0	104.7	98.5	87.2	89.3	...
Peru ^l	125.6	105.8	93.0	95.1	100.0	99.0	108.5	91.6	78.0	61.6
Uruguay ^m	147.5	125.9	120.5	108.3	100.0	110.5	104.9	80.1	64.7	70.4
Venezuela ⁿ	...	94.7	100.7	100.8	100.0	99.0	...	...	...	...
Percentage variation ^o										
Argentina ^b	-43.9	-20.8	-29.9	-0.1	18.2	-8.7	-9.6	52.2	18.6	-27.4
Brazil ^c	8.9	10.1	-2.8	-7.2	0.7	-4.0	-1.3	-12.4	-3.6	3.5
Colombia ^d	-3.5	-6.9	14.9	12.8	12.3	2.0	0.4	4.5	1.8	-3.9
Costa Rica ^e	...	0.3	8.8	9.1	-3.2	-14.9	-22.4	20.8	7.7	...
Chile ^f	4.8	4.2	4.3	8.4	8.8	5.6	-5.1	-25.2	-2.2	-16.4
Guatemala ^g	29.6	-2.1	-1.7	7.7	5.0	22.2	-0.4	-10.0	...	...
Honduras ^h	-4.8	-10.3	-5.4	19.0	-6.7	4.5	-2.2	-7.7	-4.5	-3.3
Mexico ⁱ	11.0	5.2	-	0.7	-4.4	3.3	-2.1	-22.8	-6.8	-4.1
Nicaragua ^j	-11.6	-2.6	2.2	-15.2	-14.0	-0.5	-5.4	3.0	-0.6	...
Paraguay ^k	9.8	-0.9	6.3	-11.1	-3.8	4.7	-6.0	-11.5	2.5	...
Peru ^l	-11.2	-15.8	12.1	2.3	5.2	-1.0	9.6	-15.5	-15.1	-22.3
Uruguay ^m	0.2	-14.6	-4.8	-10.1	-7.7	10.5	-5.0	-23.6	-19.2	7.6
Venezuela ⁿ	...	...	6.3	0.2	-0.2	-1.0	...	...	...	...

Source: ECLAC, on the basis of official data.

^aProvisional figures. ^bAverage cost of labour, including social security contributions, in the Federal Capital. Average for 12 months; 1985, January to October. ^cHourly wage for the post category in Rio de Janeiro. Average for 12 months; 1983: January to October. ^dAverage cost of labour in Bogotá. Average for 12 months; 1983, January to October. ^eAverage wage according to household surveys. Average for March, July and November; 1976, average for July and November; 1984, March only. ^f1976 to 1983: salaries and wages for medium-type building, 1984 and 1985: average wages in the sector. Average for 12 months. ^gAverage wages for workers covered by Social Security. Annual average. ^hMinimum wage in the Central District and San Pedro Sula. ⁱAverage cost of labour in the country. Average for 12 months; 1985, January to November. ^jAverage wage for workers covered by Social Security. Average for 12 months; 1984, January to July. ^kAverage wage for manual workers in Asunción. Average for June and December. ^lAverage wage in the metropolitan area of Lima. Average for February, May, August and November; 1985, average for February, May and August. ^mAverage cost of labour in the country. Average for 12 months; 1984, January to November. ⁿAverage wage per person employed in the urban sector, according to household survey. Second semester of each year. ^oIn relation to the same period in the preceding year.

Table 19

**LATIN AMERICA AND THE CARIBBEAN: PUBLIC EXPENDITURE ON
EDUCATION AND HEALTH**

(As a percentage of total public expenditure)

	Education		Health		Total (education plus health)	
	1979	1983	1979	1983	1979	1983
Argentina	8.3	7.6	1.7	1.4	10.0	9.0
Barbados	21.7	18.5	10.3	10.6	32.0	29.1
Belize	12.1	17.2	8.1	9.0	20.2	26.2
Bolivia	30.6	26.9	8.6	3.1	39.2	30.0
Brazil	5.4	3.7	7.4	7.3	13.8	11.0
Costa Rica	24.8	19.4	25.0	22.5	49.8	41.9
Chile	14.7	13.8	6.5	6.0	21.2	19.8
El Salvador	19.6	16.6	8.7	8.4	28.3	25.0
Guyana	13.2	8.3	3.6	4.9	16.8	13.2
Mexico	18.7	11.0	3.9	1.2	22.6	12.2
Panama	13.5	11.0 ^a	12.2	13.1 ^a	25.7	24.1 ^a
Paraguay	12.6	12.0 ^a	3.7	3.7 ^a	16.3	15.7 ^a
Peru	13.8	18.5 ^a	6.1	6.2 ^a	19.9	24.7 ^a
Dominican Republic	13.7	15.3	9.1	10.6	22.8	25.9
Saint Vincent	23.1	16.6	13.9	11.3	37.0	27.9
Uruguay	9.4	6.5	4.7	3.4	14.1	9.9
Venezuela	18.3	19.1	8.5	8.6	24.8	27.7

Source: International Monetary Fund, *Government Finance Statistics*.

^a1982.

Table 20

**LATIN AMERICA AND THE CARIBBEAN: DISTRIBUTION OF EDUCATION SUBSIDIES,
BY QUINTILES OF FAMILY INCOME**

(Percentages)

	Argentina	Costa Rica	Chile	Dominican Republic	Uruguay
Quintiles					
First poorest.	28.3	19.9	25.8	10.6	31.4
Second poorest	19.9	22.4	22.6	13.6	21.0
Third poorest	17.9	16.7	18.5	17.8	17.9
Fourth poorest	17.0	21.0	15.0	24.9	16.2
Fifth poorest	16.9	19.9	18.1	33.0	13.5
Total	100.0	100.0	100.0	100.0	100.0

Source: Joint Programme on Latin American Economic Integration (ECIEL)/Inter-American Development Bank (IDB) research in progress on the distributive effect of social public expenditure.

Table 21

**LATIN AMERICA AND THE CARIBBEAN: DISTRIBUTION OF HEALTH SUBSIDIES,
BY QUINTILES OF FAMILY INCOME**

(Percentages)

	Argentina	Costa Rica	Chile	Dominican Republic	Uruguay
Quintiles					
First poorest	51.2	30.0	22.3	41.3	34.0
Second poorest	17.4	18.9	29.0	16.1	29.7
Third poorest	18.8	21.0	21.5	20.1	16.1
Fourth poorest	8.3	16.9	15.9	13.5	8.4
Fifth poorest	4.3	13.2	11.3	9.0	11.8
Total	100.0	100.0	100.0	100.0	100.0

Source: ECIEL/IDB research in progress on the distributive effect of social public expenditure.

Table 22

**LATIN AMERICA AND THE CARIBBEAN: DISTRIBUTION OF SOCIAL SECURITY SUBSIDIES,
BY QUINTILES OF FAMILY INCOME**

(Percentages)

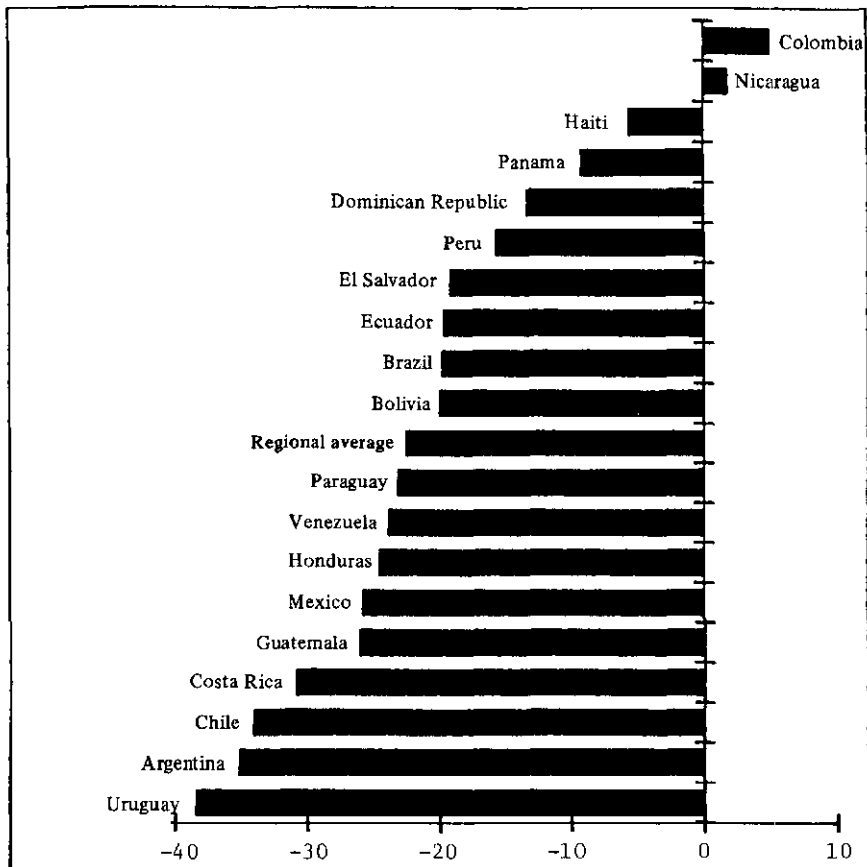
	Argentina	Costa Rica	Chile	Dominican Republic	Uruguay
Quintiles					
First poorest	9.9	9.3	6.2	8.6	10.3
Second poorest	13.3	9.5	12.3	16.4	16.1
Third poorest	19.5	15.7	15.5	28.2	18.8
Fourth poorest	23.0	33.1	23.8	37.5	23.8
Fifth poorest	34.3	32.4	42.3	9.3	31.1
Total	100.0	100.0	100.0	100.0	100.0

Source: ECIEL/IDB research in progress on the distributive effect of social public expenditure.

FIGURES

Figure 1
**LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC
 FIXED CAPITAL FORMATION**

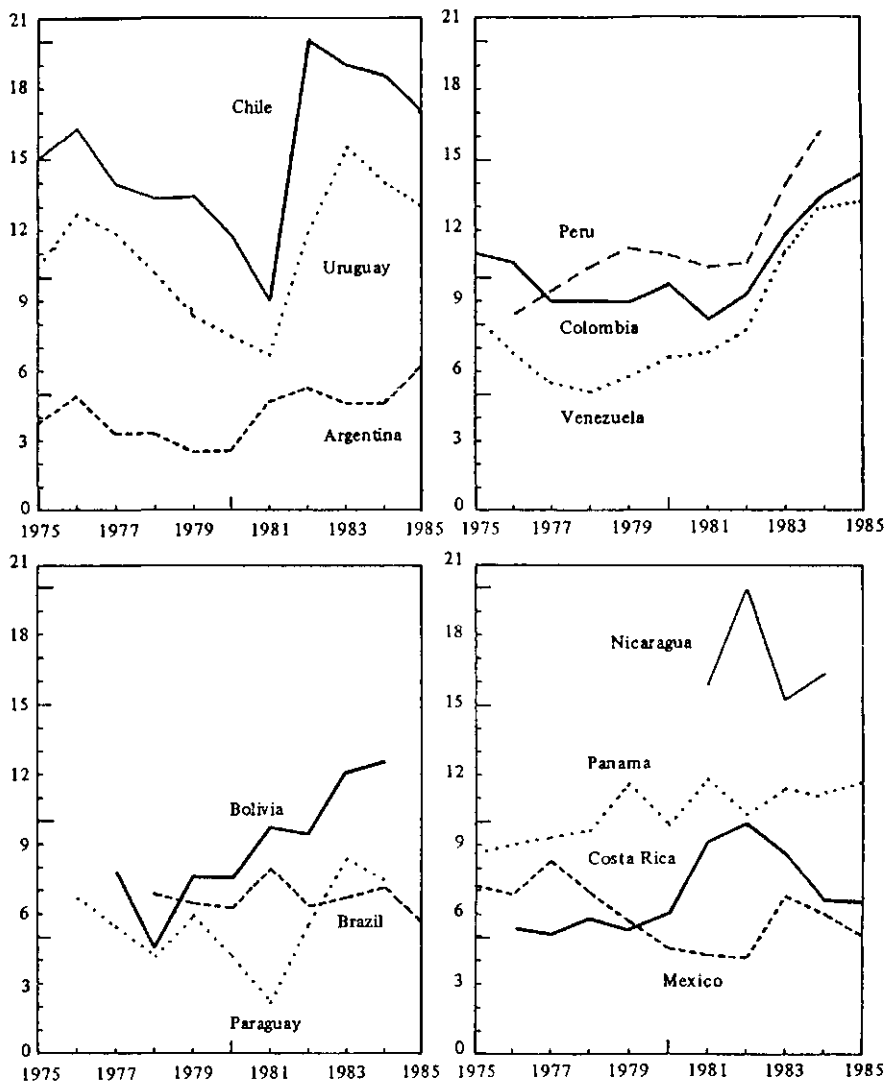
(Percentage variation, 1982-1984 average/1980-1981 average)



Source: ECLAC, on the basis of official data.

Figure 2
**LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT
 IN SELECTED COUNTRIES**

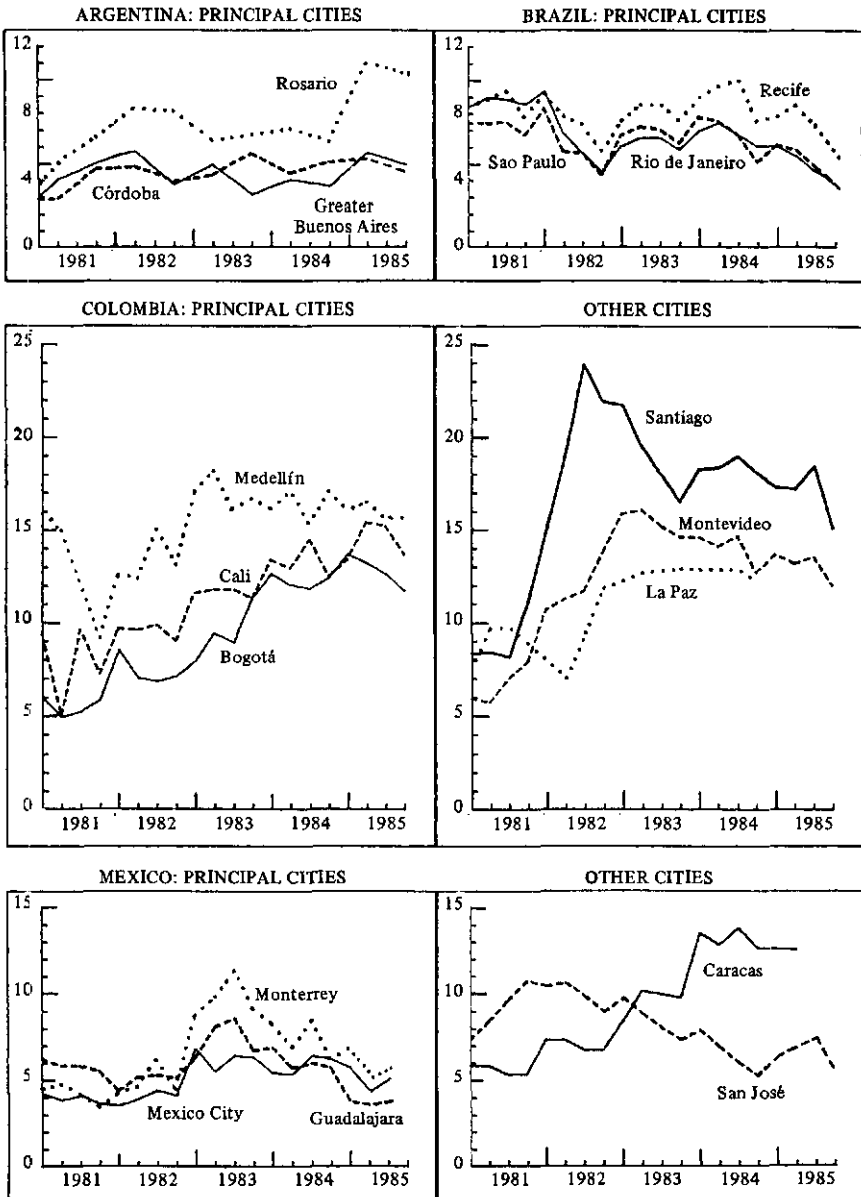
(Annual average rates)



Source: ECLAC, on the basis of official data.

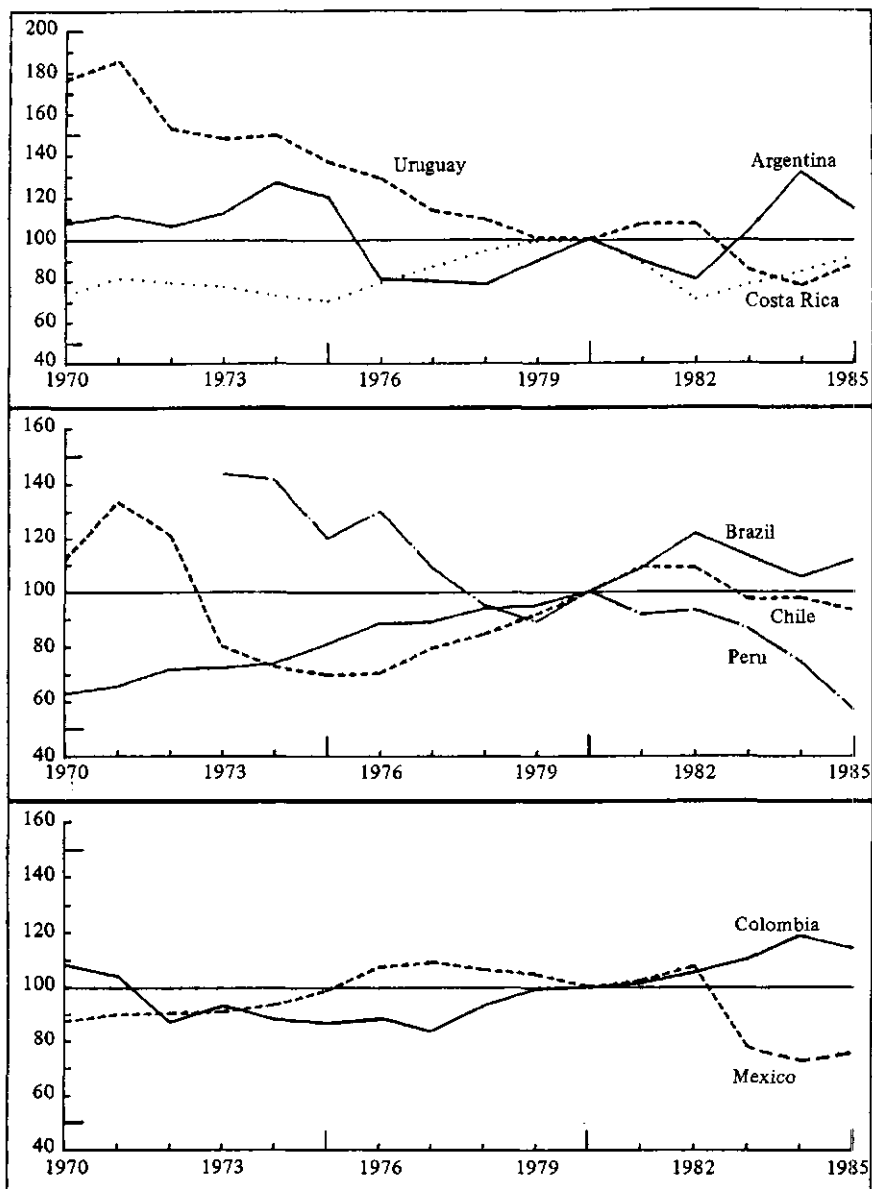
Figure 3

LATIN AMERICA AND THE CARIBBEAN: UNEMPLOYMENT IN SOME PRINCIPAL CITIES



Source: ECLAC, on the basis of official data.

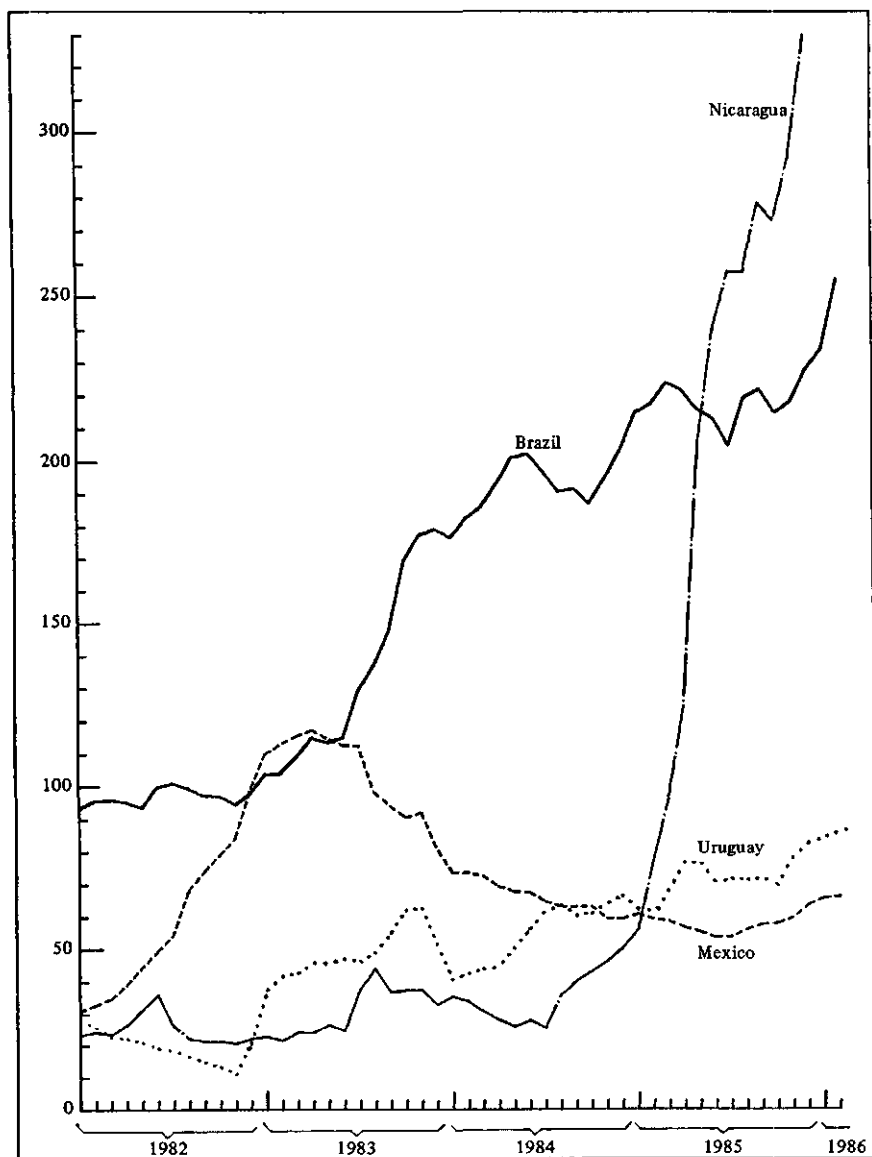
Figure 4
**LATIN AMERICA AND THE CARIBBEAN: REAL AVERAGE
 WAGES IN SELECTED COUNTRIES**
(Indexes 1980 = 100)



Source: ECLAC, on the basis of official data.

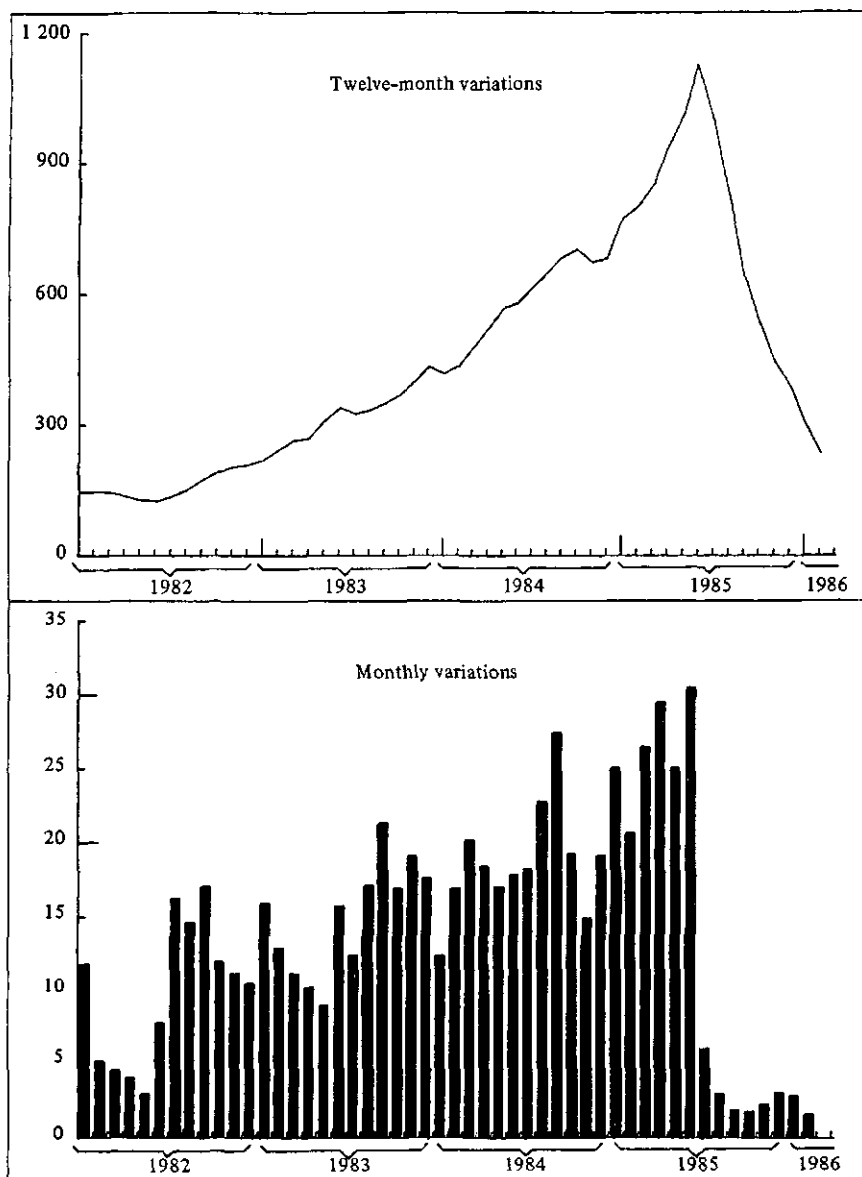
Figure 5

LATIN AMERICA AND THE CARIBBEAN: TWELVE-MONTH VARIATIONS IN THE CONSUMER PRICE INDEX OF SELECTED COUNTRIES



Source: ECLAC, on the basis of official data.

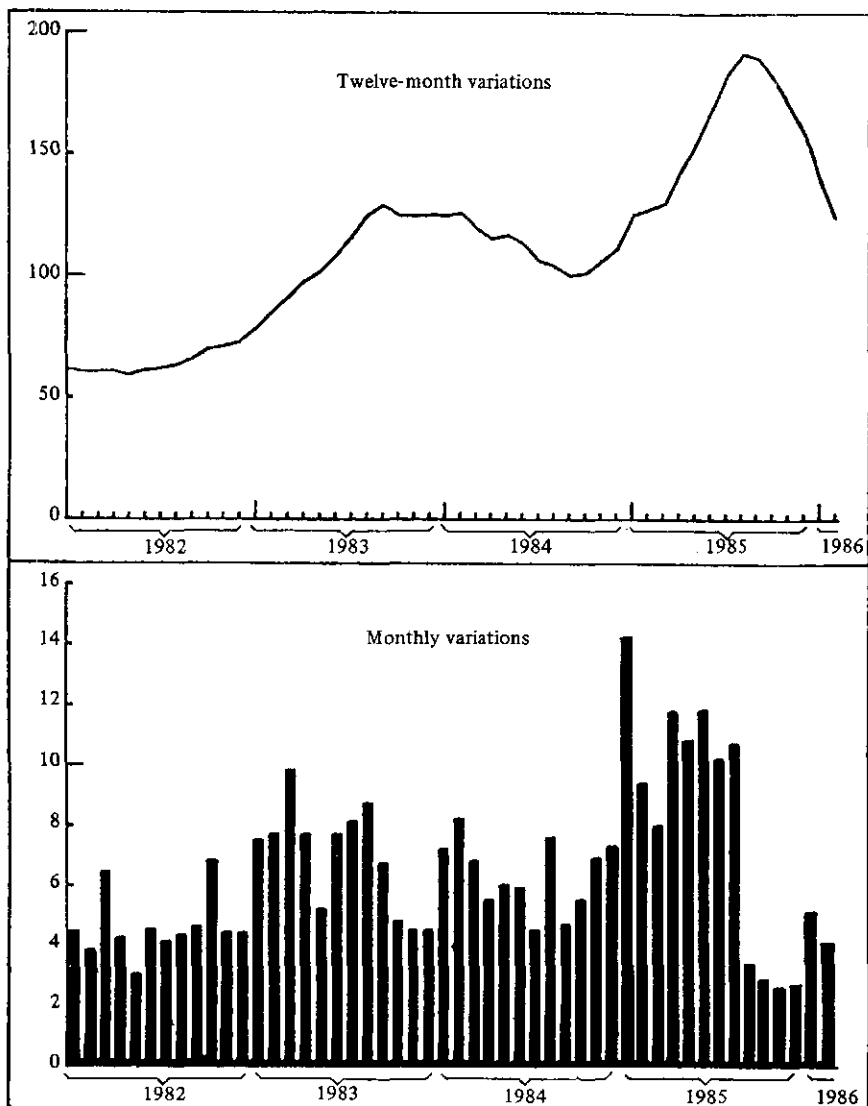
Figure 6
ARGENTINA: CONSUMER PRICE INDEX



Source: ECLAC, on the basis of official data.

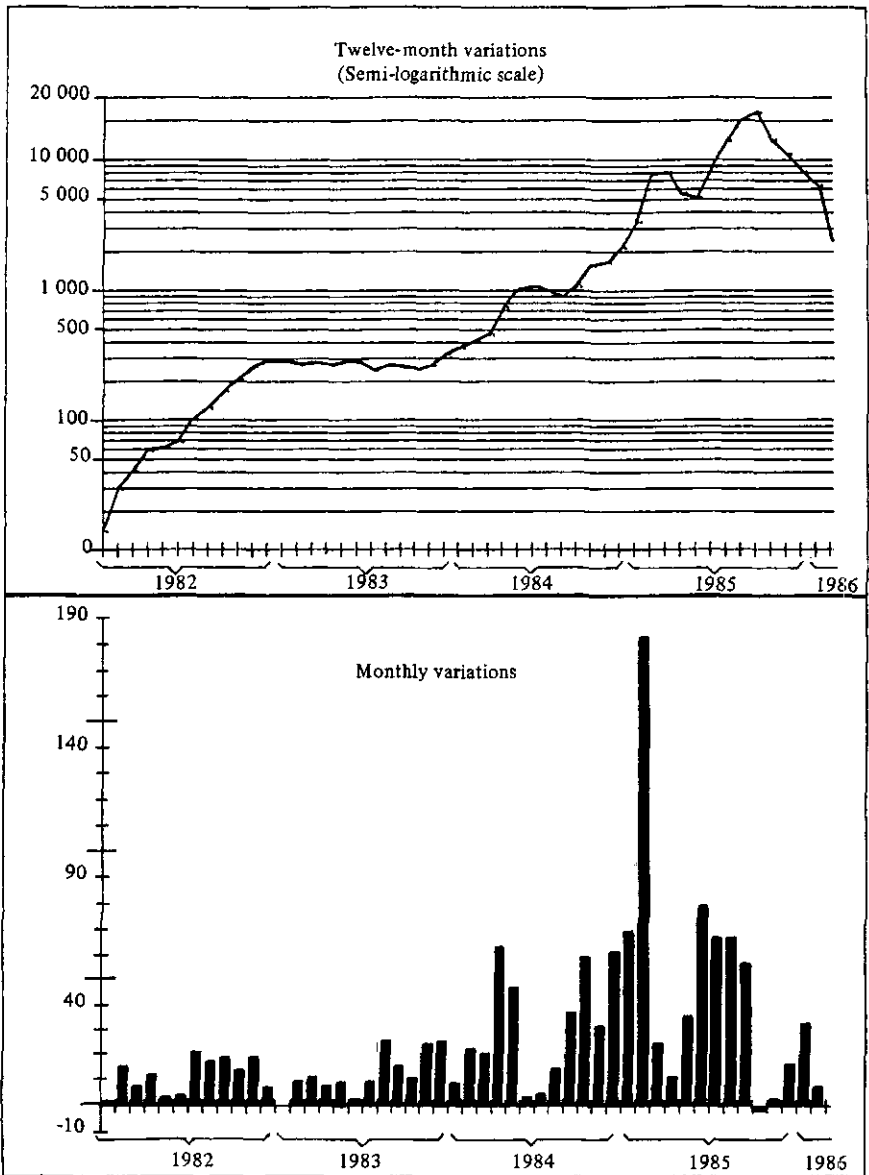
Figure 7

PERU: CONSUMER PRICE INDEX



Source: ECLAC, on the basis of official data.

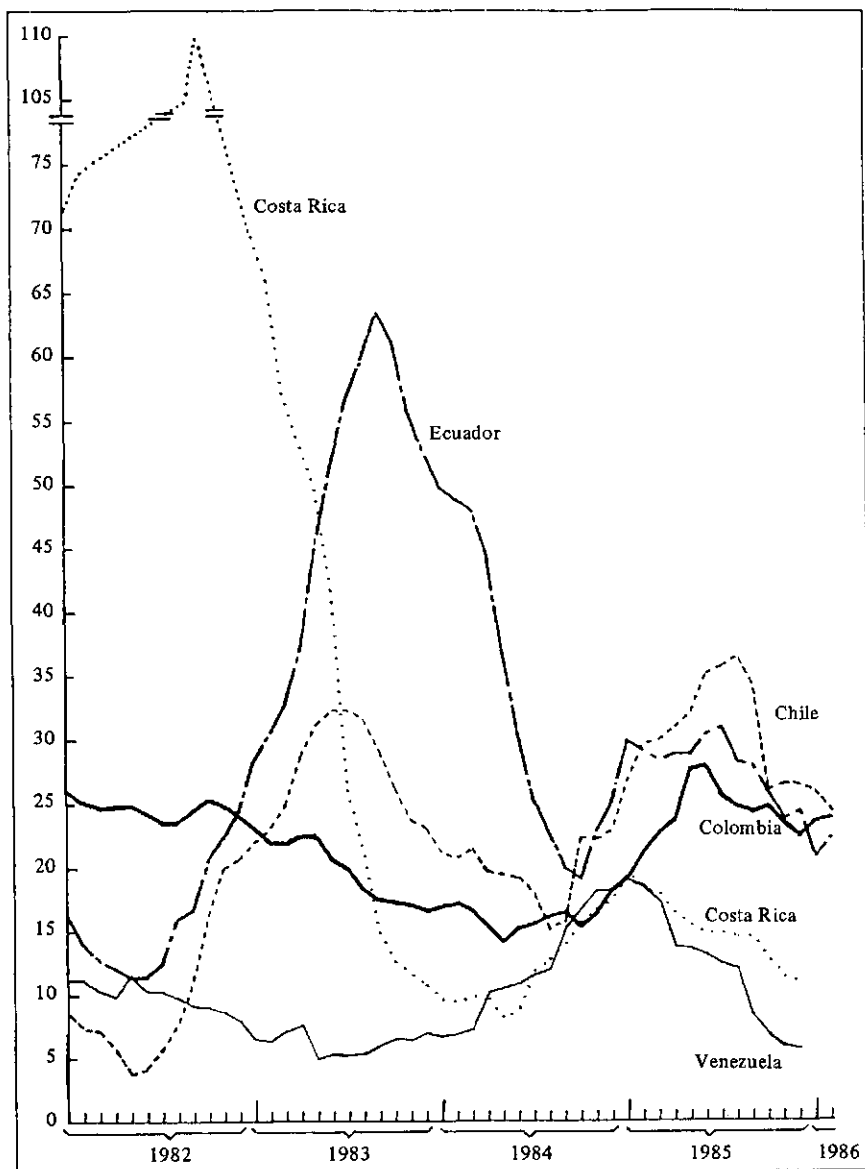
Figure 8
BOLIVIA: CONSUMER PRICE INDEX



Source: ECLAC, on the basis of official data.

Figure 9

LATIN AMERICA AND THE CARIBBEAN: TWELVE-MONTH VARIATIONS IN THE CONSUMER PRICE INDEX OF SELECTED COUNTRIES

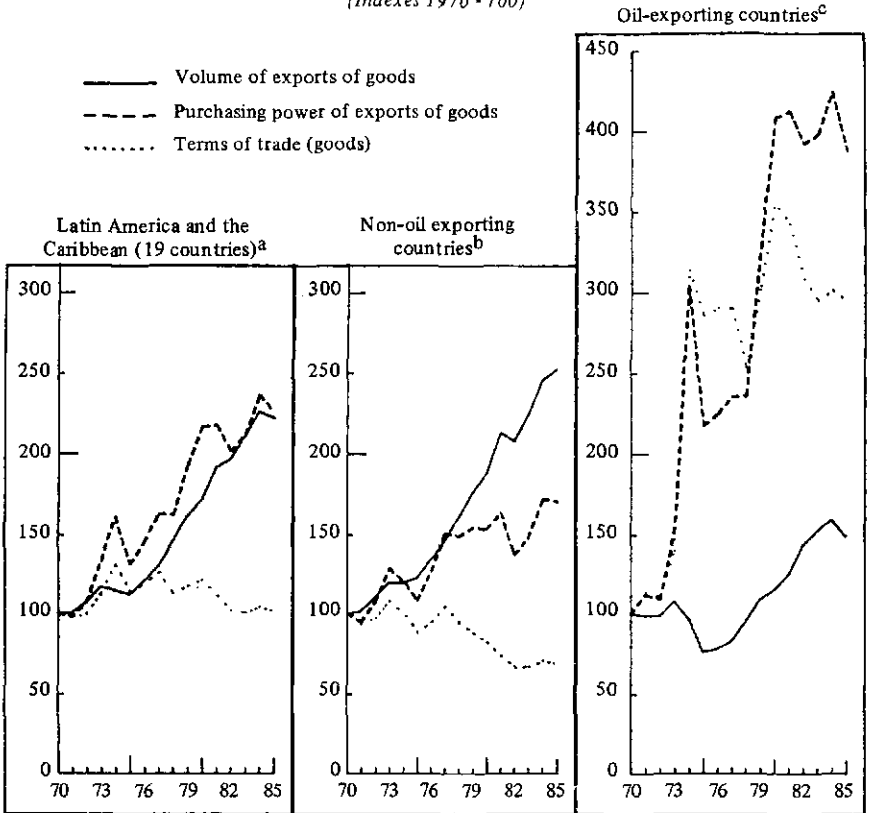


Source: ECLAC, on the basis of official data

Figure 10

LATIN AMERICA AND THE CARIBBEAN: TERMS OF TRADE, VOLUME AND PURCHASING POWER OF EXPORTS (GOODS)

(Indexes 1970 = 100)



Source: ECLAC, on the basis of official data.

^aArgentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

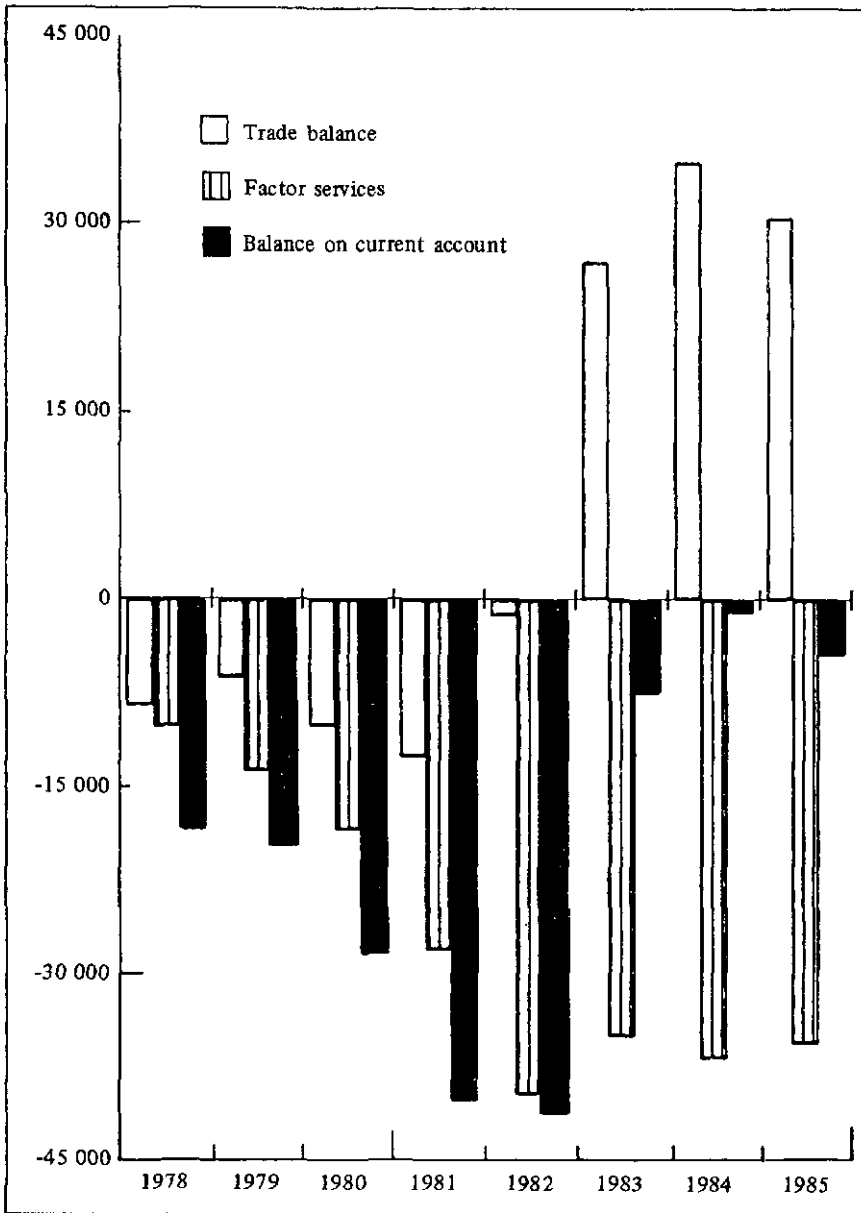
^bFrom 1970 to 1975, includes the following 16 countries: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay.

From 1976 onwards, Mexico and Peru are not included. ^cFrom 1970 onwards, includes Bolivia, Ecuador and Venezuela; from 1976 onwards, includes Mexico and Peru in addition to those three countries.

Figure 11

LATIN AMERICA AND THE CARIBBEAN: MAIN COMPONENTS OF THE CURRENT ACCOUNT

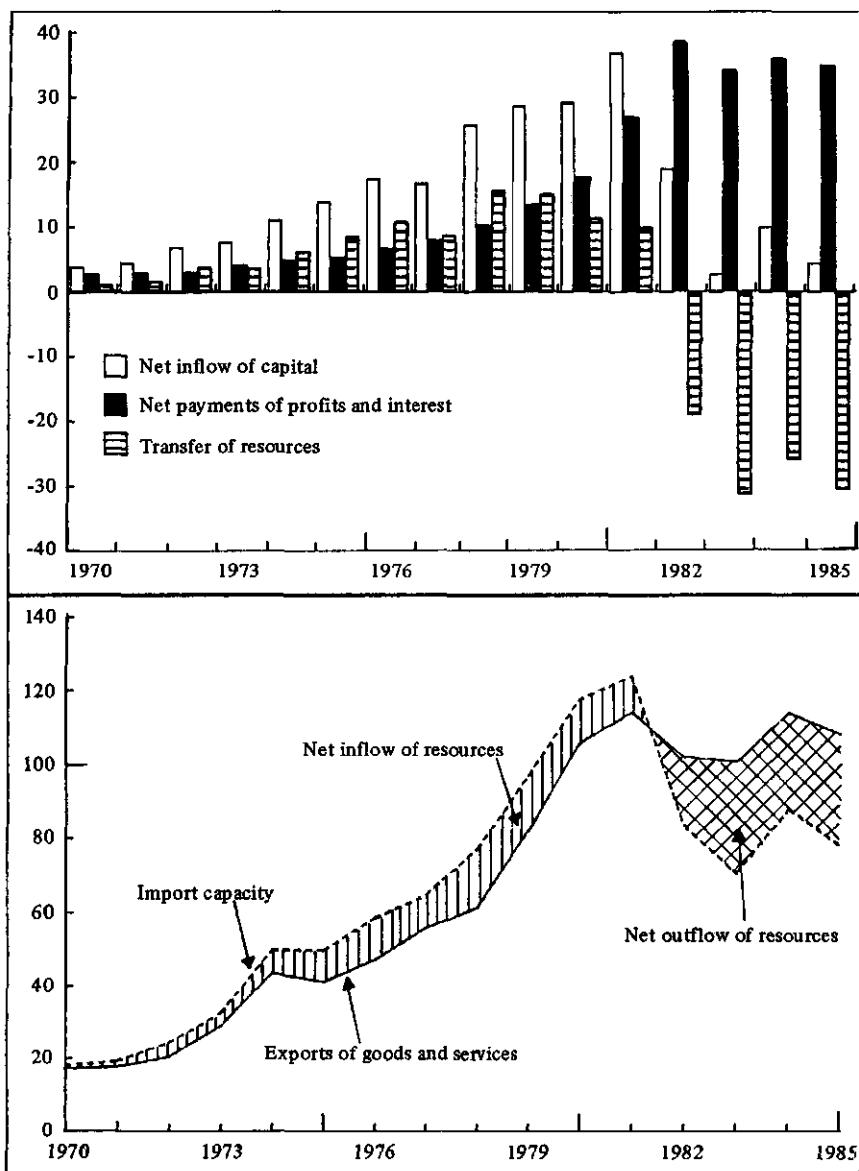
(Millions of dollars)



Source: ECLAC, on the basis of data provided by the International Monetary Fund and official figures.

Figure 12
**LATIN AMERICA AND THE CARIBBEAN: NET CAPITAL INFLOW
 AND TRANSFER OF RESOURCES**

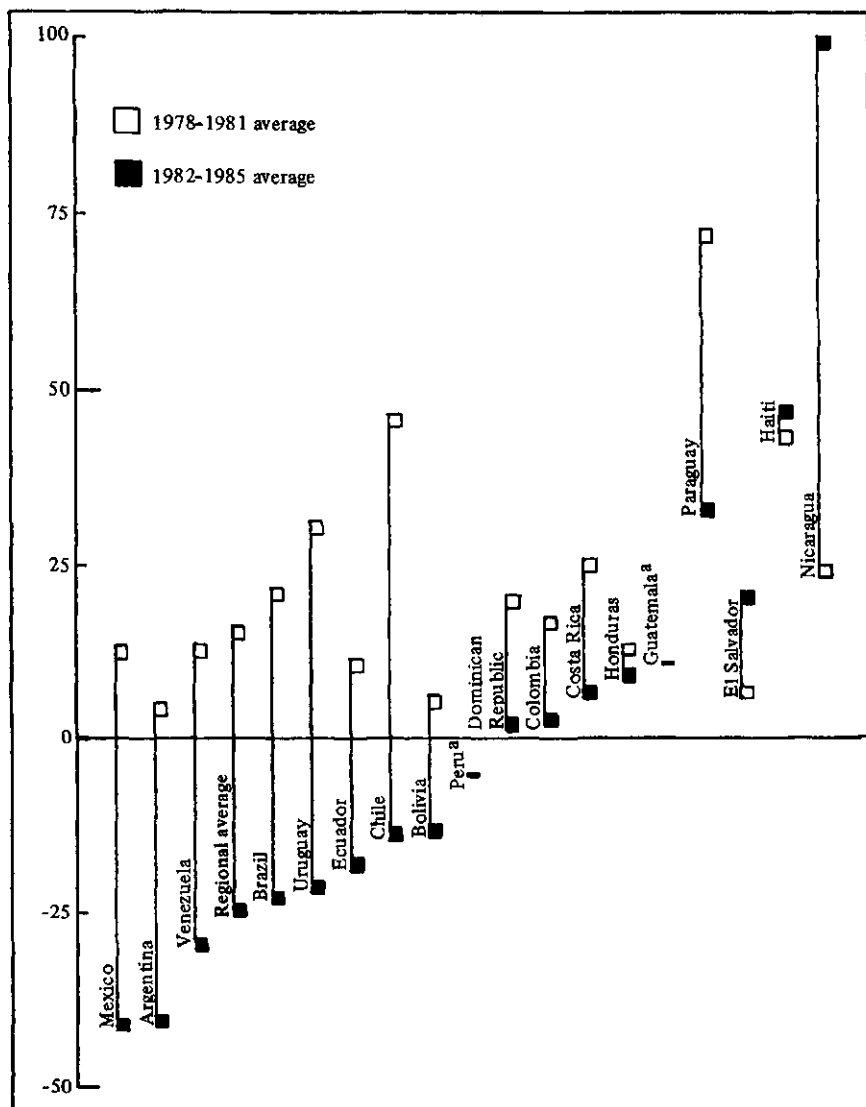
(Billions of dollars)



Source: ECLAC, on the basis of data provided by the International Monetary Fund and official figures.

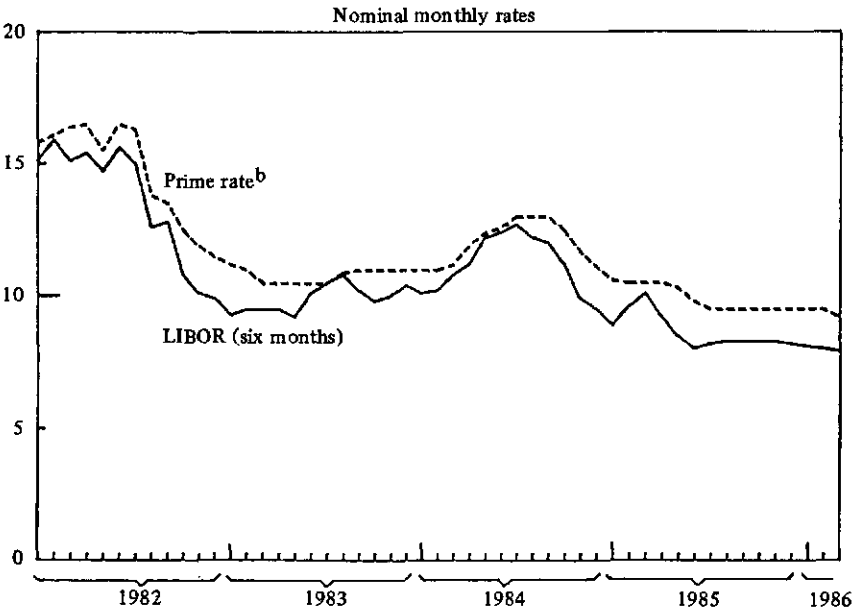
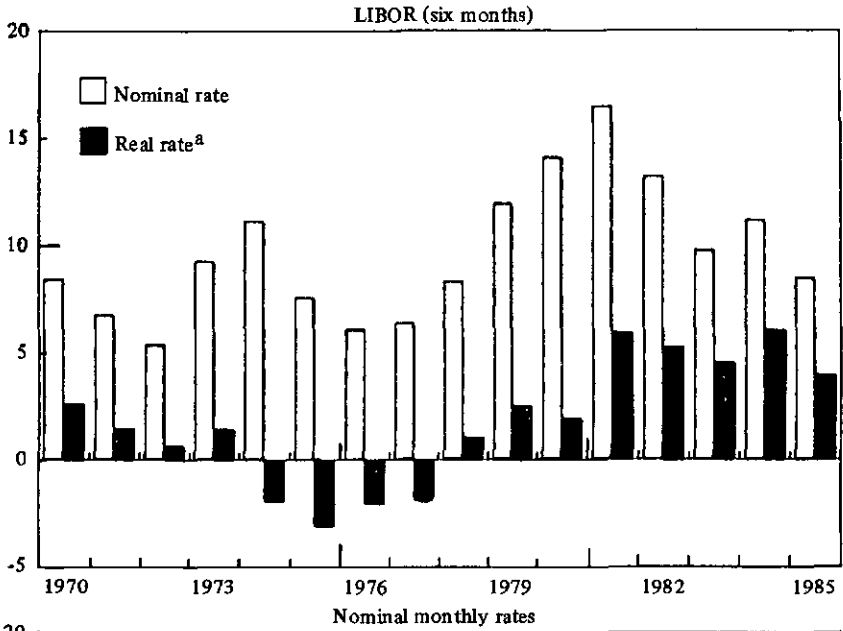
Figure 13
**LATIN AMERICA AND THE CARIBBEAN: RATIO BETWEEN THE TRANSFER OF
 RESOURCES AND EXPORTS OF GOODS AND SERVICES**

(Percentages)



Source: ECLAC, on the basis of official data.
^aAverages are the same for both periods.

Figure 14
INTERNATIONAL INTEREST RATES
(Percentages)



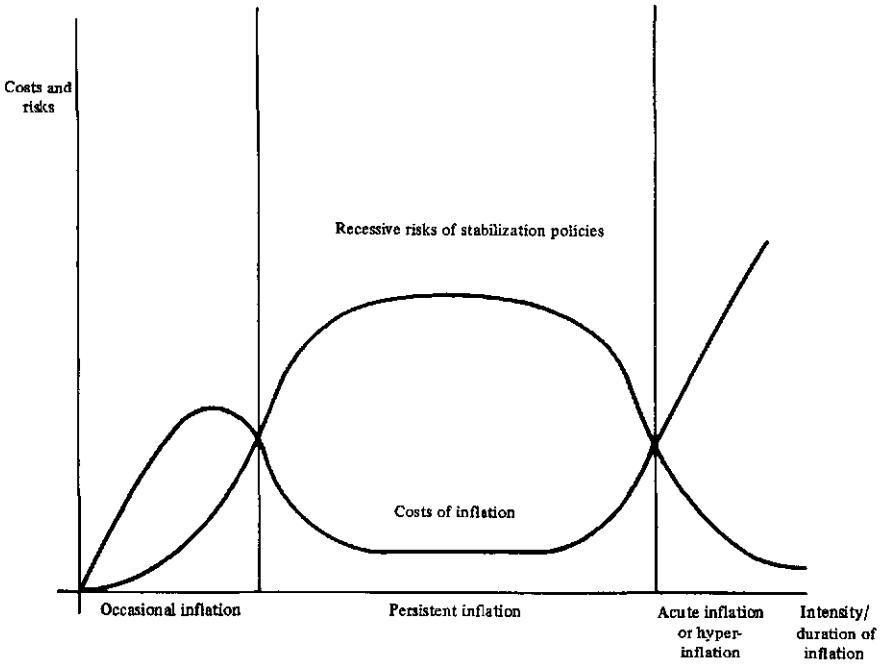
Source: ECLAC, on the basis of data from Morgan Guaranty Trust, *World Financial Markets, Economic Report of the President*, Washington, February 1985, and International Monetary Fund, *International Financial Statistics*.

^aNominal rate deflated by the consumer price index of the industrialized countries.

^bPreferential rate granted by United States banks to their best clients.

Figure 15

RELATIVE COSTS OF INFLATION AND THE RECESSIVE RISKS OF STABILIZATION PROGRAMMES





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