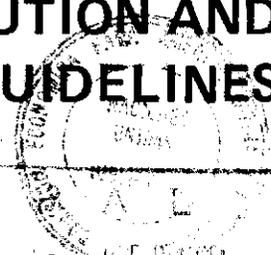


**POVERTY IN LATIN AMERICA:
SITUATION, EVOLUTION AND
POLICY GUIDELINES**



CEPAL
BIBLIOTECA DE DOCUMENTOS
SERVICIO EDITORIAL Y DE TRADUCCION



UNITED NATIONS

Economic Commission for Latin America

CEPAL

United Nations Development Programme

UNDP

**PROJECT ON
CRITICAL POVERTY
IN LATIN AMERICA**



UNITED NATIONS
ECONOMIC
AND
SOCIAL COUNCIL



LIMITED
E/CEPAL/PROY.1/1
20 June 1979
ENGLISH
ORIGINAL: SPANISH

CEPAL

Economic Commission for Latin America

POVERTY IN LATIN AMERICA: SITUATION, EVOLUTION AND
POLICY GUIDELINES

Sergio Molina S. and Sebastián Piñera

This study was prepared under project RLA-77/018. The views expressed in it are the exclusive responsibility of the authors.

79-5-1238

CONTENTS

	<u>Page</u>
Introduction	1
I. Poverty, basic needs and development	6
II. The elements of a diagnostic study	11
1. The magnitude of poverty and the characteristics of the poor	12
2. Some structural and operational aspects of the economy .	22
3. The characteristics of the state	46
4. Summary and conclusions	51
III. Guidelines for a development strategy to reduce or eradicate poverty in Latin America	53
Introduction	53
A. Distributive interventions and policies	55
1. Policies designed to increase the number and productivity of jobs generated by the economy and to extend the benefits of these increases to the poor groups	56
2. Policies designed to increase the number and productivity of the assets possessed by the poor groups	74
B. Redistributive interventions and policies	82
1. The tax burden	82
2. Public expenditure as an instrument for overcoming extreme poverty	85
C. Final considerations	98

100

100

100

100

100

100

100

100

This document is part of a series of publications in connexion with the Project on Critical Poverty in Latin America undertaken by CEPAL and UNDP with the participation of UNICEF, ILPES and CELADE.

It is issued in compliance with the Project's main objective of co-operating with the Governments of the region in fulfilling their aims of increasing the participation of the population in the benefits of development and of alleviating or eradicating critical poverty in their respective countries.

POVERTY IN LATIN AMERICA: SITUATION, EVOLUTION AND
POLICY GUIDELINES

INTRODUCTION

The concern for economic development that emerged after the Second World War gave rise to various theories and manifold efforts to achieve it. At both the theoretical and practical level the activities were based on the belief that a direct and automatic relationship existed between economic growth and an improvement in the living levels of the whole population. Accordingly, policies were oriented towards fostering an increase in per capita income on the understanding that economic prosperity would, within a reasonable period, bring about an equivalent improvement in the living conditions of the majority of the population.

The experience gained in these years, however, shows that the relationship is not automatic but requires corrective action by the State. Even in the more developed countries it has been necessary to establish corrective measures, since large sectors of their population are below what those societies consider to be the minimum threshold of life.

The Latin American governments and various international agencies, particularly those belonging to the United Nations system, have expressed their concern about the problem of critical poverty in the region. The former have expressed their decision to combat it in their respective countries, and this has been reflected in mandates compelling the international agencies to adopt measures in that sense.

Thus, the appraisals of the International Development Strategy adopted at Quito, Port of Spain and Guatemala by the governments of the member countries of CEPAL at its fifteenth, sixteenth and seventeenth sessions, respectively, express the interest of those governments in the problems of human well-being and social justice and their concern regarding situations of excessive inequality, large-scale poverty, chronic

/unemployment, inadequate

unemployment, inadequate basic social services and lack of participation of the majority population strata in the economic and social life of their countries.^{1/}

In spite of the recent papers on the poverty problem, there is still a marked lack of empirical studies on the situation in Latin America and of theoretical approaches on which to base the design of policies. It is therefore essential to allocate the necessary resources to satisfy these needs and at the same time to undertake the work of disseminating such empirical and theoretical information among those responsible for the formulation and implementation of development policies with the purpose of thus supporting the governments' intention to combat poverty.

These among other reasons led the United Nations Development Programme (UNDP) to submit for approval by the governments of the region a project aimed at analysing the situation of critical or extreme poverty in Latin America. The execution of this project, which was called Inter-Agency Project on Critical Poverty in Latin America, was entrusted to the Economic Commission for Latin America (CEPAL). The Project was initiated on 1 January 1978 and will be of 30 months duration.

The ultimate objective of the Project is to co-operate with the governments in fulfilling their aims of alleviating or eradicating critical poverty in their respective countries. With this end in view, the following immediate objectives were established:

(a) To obtain more knowledge about and systematically organize information on critical poverty in Latin America;

(b) To prepare an analytical outline as a guide to the design of national development strategies which would include the eradication of critical poverty as one of their objectives; and

^{1/} See also the Universal Declaration of Human Rights (article 25), the Declaration on Social Progress and Development (articles 5 and 10), and the International Development Strategy for the Second United Nations Development Decade (Goals and objectives), contained in United Nations General Assembly resolutions 217 (III) of 10 December 1948, 2542 (XXIV) of 11 December 1969, and 2626 (XXV) of 24 October 1970, respectively, and also the Convention Concerning Employment Policy (article 1) adopted at the eighth session of the General Conference of the ILO, 1964.

(c) To devise criteria and methods for the governments to evaluate the efficiency of different actions and programmes aimed at eradicating or alleviating critical poverty.

In order to achieve these objectives, a number of studies were initiated simultaneously.

First, a methodology had to be devised which would enable a homogeneous poverty line to be defined for the various countries.^{2/} This task was facilitated by the fact that, in a joint project, CEPAL and the World Bank had made considerable progress in a study on income distribution in the region, using information obtained from household surveys, censuses and other official sources.^{3/}

With the methodology devised, poverty lines were determined for 11 countries. On the basis of this information and of that provided by the studies on income distribution, the incidence and severity of poverty were estimated for a group of countries of the region; that is to say, the percentage of families which were below the poverty line, and the gap between the average income of those families and the average for the poverty line.

The second step was to apply the same methodology to earlier periods in order to analyse the evolution of poverty over time. Available information limited this study to only six countries which altogether represented about 70% of the population and the gross product of Latin America in 1977.^{4/}

^{2/} See, Sebastián Piñera, "Definición, medición y análisis de la pobreza: Aspectos conceptuales y metodológicos", PPC/CDE/02.1, Santiago, Chile, May 1978. Mimeographed document prepared as part of the Inter-Agency Project on Critical Poverty in Latin America.

^{3/} CEPAL/IBRD, "La dimensión de la pobreza en América Latina", E/CEPAL/L.180, mimeographed document, 22 September 1978.

^{4/} See, Sebastián Piñera, "¿Se benefician los pobres del crecimiento económico?", PPC/CDE/06.1, Santiago, Chile, October 1978. Annexes for each country: Brazil, Chile, Colombia, Costa Rica, Mexico and Peru. Mimeographed document prepared as part of the Inter-Agency Project on Critical Poverty in Latin America.

The studies deal with the magnitude of poverty measured in terms of family income. To complete these estimates work began on other studies based on determining the gaps in four sectors representing basic needs: nutrition, education, health and housing.

In addition to determining the magnitude of poverty it seemed necessary to ascertain the socio-economic and demographic characteristics of poor families, i.e., poverty profiles. In those studies the main features of poor households and their members have been identified, including geographical location, educational levels, employment characteristics, access to markets, access to public goods, ownership of factors, demographic behaviour and forms of organization and participation. So far studies have been initiated on poverty profiles for eight countries of the region.

Following this stage of research, whose purpose was to obtain more knowledge about and systematically organize information on critical poverty in Latin America, the present document was prepared and, on the basis of the information already compiled, is intended to help prepare a conceptual framework as a guide to the design of strategies and the adoption of criteria for evaluating the effectiveness of policies aimed at eradicating or alleviating critical poverty.

The subject is dealt with in three chapters. The first contains an analysis of the concepts of poverty, basic needs and development and a brief summary of development strategies; the second reviews the main elements of a diagnostic study of the characteristics of poverty and the poor, of the structure and operation of the economy of the Latin American countries, and of the State; and the third discusses areas of intervention and policy guidelines for overcoming the existing poverty situation.

In this last chapter, it should be noted that an attempt has been made to provide an outline for identifying areas of intervention, and a broad spectrum of possible policies is indicated which, since they do not relate to specific situations, are necessarily of a general nature.

It should also be noted that the situation considered here is that prevailing in mixed economies where by the very nature of the system private ownership co-exists with public ownership as the market mechanism with State intervention. It is a well-known fact that the relative

/importance of

importance of private and public ownership, the role of the market and State intervention varies considerably from country to country and, therefore, different policies should be implemented in different situations. Accordingly, the guidelines furnished in this document are not intended for general application.

Finally, the international dimension has not been included in the present document, that is, the form of integration of the Latin American economies in the world market and the role which external financing could play in a development strategy designed to overcome poverty. This omission does not mean ignorance of the importance of this subject, which is vital to some countries. At this stage, it has been thought best to place the accent on domestic policies since they are considered to have priority in the objectives pursued by the Project.

I. POVERTY, BASIC NEEDS AND DEVELOPMENT

In the 1960s, both the United Nations system and the governments of the member countries converged in their aim of concentrating their efforts on raising productivity and eliminating the obstacles to economic growth in developing countries. This aim was based on the assumption that economic growth, independently of the type of development, would automatically solve the serious and widespread problems of poverty, excessive inequality and unemployment which characterized nearly all the developing countries.

Latin America was successful in its efforts to accelerate its economic growth. In the 1950s its gross domestic product grew at an average annual rate of 5.2%, which meant an increase of 2.3% annually in per capita income. In the following decade the rates were 5.6% and 2.6%, respectively, and finally in the period 1970-1977 they rose to 6.1% and 3.3%. In short, Latin America's rate of economic growth was not only satisfactory but it increased in the course of time with the result that the per capita domestic product more than doubled in the period between 1950 and 1977.

This notable evolution did not yield all the benefits expected of it, however, in terms of reducing the magnitude of poverty, diminishing the excessive inequalities and eliminating unemployment. If the period 1960-1970 is analysed it will be seen that the magnitude of poverty was only reduced from 51% in 1960 to 40% in 1970, while the absolute number of poor persons remained practically unaltered at 113 million.^{5/} The distribution of income underwent no major changes: the share of the poorest 20% in total income dropped from 3.1% in 1960 to 2.5% in 1970 and that of the poorest 50% rose from 13.4% in 1960 to 13.9% in 1970.^{6/} Finally, the scanty information available on the employment situation indicates that the problem of unemployment did not change much in the 1960s, and by 1970 the open unemployment rate was 5.8% and the total under-utilization of manpower was equivalent to 27.4%.^{7/}

^{5/} See, S. Piñera, "¿Se benefician los pobres del crecimiento económico?", op.cit.

^{6/} CEPAL estimates.

^{7/} Regional Employment Programme for Latin America and the Caribbean (PREALC), The Employment Problem in Latin America: Facts, Outlooks and Policies, Santiago, Chile, April 1976.

This experience of Latin America in particular and of the developing world in general gave rise to profound scepticism concerning the traditional belief that economic growth would bring about within a reasonable period both greater employment opportunities and improved living conditions for all. As a result of this questioning, which was accentuated in the mid-1960s, attention focused not only on the rate of growth but also, and with greater emphasis, on the type of growth and the distribution of its benefits among the various social groups.^{8/}

This concern induced certain international agencies, public institutions and academic establishments to prepare new development strategies incorporating other objectives in addition to economic growth. The following may be noted among the strategies which emerged as alternatives to that of raising the economic growth rate to the maximum:

(i) The development strategy aimed at promoting the creation of employment. It considers the attainment of full, productive and freely chosen employment as an end in itself which is different from and goes beyond the economic growth objective;^{9/}

(ii) The strategy of growth with distribution, which does not consider the traditional dilemma of growth first and redistribution later or redistribution first and growth later, and suggests that the development strategy adopted should deal simultaneously with the problems of growth and those involved in the distribution of its fruits. To that effect, special emphasis is placed on the task of reorienting public investment along such lines as to increase production capacity and the generation of income for the poorest groups;^{10/}

^{8/} CEPAL has always maintained a position in which emphasis is placed not only on economic growth but also on an equitable distribution of the fruits of such growth as central development objectives. See, for example, E. Iglesias, "Situation and prospects of the Latin American economy in 1975", CEPAL Review, first half of 1976, Santiago, Chile.

^{9/} See ILO, World Employment Programme, Research in Retrospect and Prospect, Geneva, 1976.

^{10/} See World Bank/University of Sussex, Redistribution with Growth, 1974.

(iii) The strategy for the satisfaction of basic needs. A distinction must be made here between the satisfaction of basic needs as an objective which can be achieved by means of different strategies, policies and instruments, and the satisfaction of basic needs as a strategy or means for achieving that purpose. The latter concept often means introducing radical changes in the prevailing political system and in the economic and social organization of the countries.

There is no approach involving generalized acceptance of the meaning and scope of what has been called the strategy for the satisfaction of basic needs.^{11/} Moreover, the various approaches commonly grouped together under this head present great similarities, but also marked divergencies. The main elements common to these strategies are: the satisfaction of basic needs as a central development objective; the explicit inclusion of certain non-material basic needs; the presentation of basic needs as a dynamic concept which evolves over time in accordance with economic growth and the evolution of the people's expectations, and the specification of material basic needs such as food, education, health, housing and sanitation; emphasis on the direct provision to the poorer groups of the necessary goods and services to satisfy their basic needs, rather than on the indirect course of attaining a level of income compatible with the satisfaction of those needs; the importance of structural changes, including the redistribution of assets as a prerequisite for a basic needs strategy; and recognition that the distribution of political power is a determining factor in the initiation and implementation of a basic needs strategy.^{12/}

^{11/} The best known approaches to this question are found in: the Dag Hammarskjöld Report, What Now? Another Development, prepared on the occasion of the Seventh Special Session of the United Nations General Assembly in September 1975; Employment, Growth and Basic Needs: A One-World Problem, Report of the Director-General of the International Labour Office to the Tripartite World Conference on Employment, Income Distribution and Social Progress and the International Division of Labour, Geneva, 1976; the report by the Bariloche Foundation, Catastrophe or New Society? A Latin American World Model, Ottawa, 1976; and Reshaping the International Order: A Report to the Club of Rome, New York, 1976.

^{12/} For a more detailed comparative analysis of the various approaches related to the basic needs strategy, see D.P. Ghai, A.R. Khan, E.L.H. Lee and T. Alfthan, The Basic Needs Approach to Development. Some Issues Regarding Concepts and Methodology, ILO, Geneva, 1977.

The main divergencies are: the repercussions of the magnitude and nature of the changes introduced in the economic and social structure and in the prevailing political system; the periods in which the objectives of the strategy must be achieved; the relative priorities assigned to other development policy objectives; the importance ascribed to satisfying the non-basic or less basic needs of the middle-income groups; the extent to which the interrelationship existing between productivity, income and consumption is recognized; the degree to which the machinery for the allocation of resources and the distribution of income find practical expression, etc.

These divergencies are sufficiently important to be able to group under the common head of basic needs strategy some approaches between which there are fundamental differences.

The real differences between these three strategies do not lie so much in the objectives pursued, but rather in the manner of achieving them, i.e., in the procedures, policies, instruments, time-limits and restrictions. As regards the procedures, the first two strategies focus on permanently improving productivity and employment conditions and, therefore, the capacity for generating income for the poorest groups; the third centres attention on the direct provision, generally by the State, of the necessary goods and services to satisfy basic needs. The first two strategies cover longer periods and to some extent are less drastic than the third.

Closely linked with this last point, the first two strategies, because of the gradual process involved, are more compatible with the restrictions imposed by the political and economic systems prevailing in most of the Latin American countries. The third strategy is not bound by such restrictions and its implementation presupposes drastic changes in the political systems in force and in the economic and social organization of the various countries.

They all, however, have in common the basic assumption that mere economic growth in the context of a mixed market economy will not enable the existing serious situations of poverty to be corrected within a reasonable period. This assumption is based on the fact that the unequal distribution of material and

/human capital

human capital is inherited from generation to generation, that the actual operation of the system often discriminates against the poorest sectors, and that in the best of cases State intervention has represented a weak palliative with minor effects, and those only of a transitory nature.

Accordingly, if the problem of poverty and excessive inequality is to be solved within a reasonable period, both economic growth and the systematic, efficient and leading role of the State are ineluctable requisites.

The purpose of this document is to enumerate and analyse, in the context of the Latin American situation, some components of a development strategy aimed at eradicating poverty; that is, to satisfy on a permanent and dynamic basis the material basic needs of the whole population. The emphasis placed on material needs in no way means ignoring or overlooking the existence of other basic needs which are not of a material nature. In fact, the satisfaction of some of these needs, such as social participation and organization, not only represents an aim in itself, but in many cases is an indispensable requisite in the satisfaction of material basic needs.

The basis of the present study is that the eradication of poverty cannot be analysed as an independent objective, but must be integrated in a development strategy. It is suggested in the study that in order to design such a strategy it is essential, first, to define its objectives clearly and specify the priority assigned to each and, secondly, to obtain a proper diagnosis of the situation in which action is to be taken. The task of defining the objectives and establishing an order of priority undoubtedly falls to each individual country. The analysis made here, however, is based on the assumption that the development strategy adopted by the countries of the region will have multiple objectives, and that the reduction or elimination of poverty will be one of the most important goals, though not the only one. To achieve stable and sustained growth, satisfy the needs of the middle-income groups, lessen the excessive inequalities, maintain certain internal and external equilibria, reduce the degree of dependence and introduce some structural changes will also be included as objectives of that strategy.

II. THE ELEMENTS OF A DIAGNOSTIC STUDY

For the preparation of a development strategy it is not only necessary to define its objectives clearly, but also to have a proper knowledge of the main political, economic, social, cultural and demographic characteristics of the countries in which it is to be implemented.

The purpose of the diagnostic study is to indicate the characteristics of each country which are most relevant for the preparation of the strategy. In view of the fact that the subject analysed in this document is the reduction or eradication of poverty, the diagnostic study must centre on the aspects most directly linked with that objective, which have been classified in three groups for the purpose:

(a) The first group comprises all the characteristics of poverty and the poor. Mention may be made among these of the extent and severity of poverty, the magnitude of the resources that would be used in the task of eradicating poverty, the size of the sectoral deficits, the main features of poor households and the members of those households in terms of geographical location, educational levels, employment characteristics, access to markets, access to public goods, ownership of factors, demographic behaviour, forms of organization and participation, etc.;

(b) The second group consists of the main characteristics of the structure and operation of the economy in general. Among these may be mentioned the structure of ownership, income distribution, relations with the external sector, the process of accumulation and growth, machinery for the allocation of resources, and the operation of the market for goods, services and factors;

(c) The third group covers the characteristics of the State. These include the political will and capacity of governments to perform the task of eradicating poverty, the relative size of the State, the structure of public expenditure, the characteristics of the administrative and bureaucratic apparatus, the machinery utilized by the State for the provision of goods and services and redistribution of income.

The characteristics classified in each group undeniably present marked differences between one country and another. It is proposed, therefore,

/not to

not to make an exhaustive diagnosis of the situation in each country, but rather to present the main features which are common to them all and to illustrate in part the most important areas of divergence between them.

1. The magnitude of poverty and the characteristics of the poor

This section contains the main results of the studies on poverty in some countries recently carried out by CEPAL. The definition of poverty adopted in these studies is that of an absolute concept of poverty according to which families spending all their income on food yet failing to satisfy their nutritional needs are considered to be indigent; and families which, given their income and the percentage they spend on food, fail to satisfy those needs are considered to be poor.^{13/}

The latest figures on income distribution for a group of Latin American countries were obtained from surveys and censuses carried out around 1970. The results given here are based on an analysis of nine countries.^{14/}

(a) Incidence of poverty

On the basis of this information it is estimated that around 1970 19% of the population of Latin America was living in conditions of indigence and 40% in conditions of poverty,^{15/} which expressed in absolute terms means that there were 54 million indigents and 113 million poor. These regional averages, however, conceal marked disparities between the countries with respect to the magnitude of poverty. Thus the proportion of the population living in poverty in that year was less than 10% in Argentina, 10 to 25% in

^{13/} See again the studies by S. Piñera, "Definición, medición y análisis de la pobreza: Aspectos conceptuales y metodológicos", "¿Se benefician los pobres del crecimiento económico?" and "Medición, análisis y descripción de la pobreza en algunos países latinoamericanos", working documents of the Project on Critical Poverty, CEPAL, 1978, and by O. Altamir, "La dimensión de la pobreza en América Latina".

^{14/} Argentina, Brazil, Chile, Colombia, Costa Rica, Honduras, Mexico, Peru and Venezuela.

^{15/} The percentage and number of poor include the indigent population.

Chile, Costa Rica and Venezuela, 25 to 40% in Mexico, 40 to 55% in Brazil, Colombia and Peru, and over 55% in Honduras.

These studies cover 84% of the population of Latin America, excluding Cuba; the remaining 16% live in countries on which no information is available and which were therefore not classified in these five groups.^{16/}

(b) Degrees of poverty ^{17/}

Poverty gaps are another factor which it is important to analyse. They may be defined in many different ways. One is the per capita poverty gap, which measures the severity of poverty and represents the difference between the value at the poverty line and the average per capita income of the poor. It is estimated that for the whole group of 19 Latin American countries (excluding Cuba and the countries of the Caribbean) this gap amounted in 1970 to an annual average of 74 dollars at that year's prices.^{16/} This gap multiplied by the absolute number of poor represents the absolute poverty gap and is equal to the resources which would have to be transferred on a permanent basis to the poorer groups if they are to emerge from their situation of poverty. For the group of 19 countries this gap amounted in 1970 to a value of 7,800 million dollars at 1970 prices.^{18/}

Depending on the purpose of the measurement, the absolute poverty gap may be expressed as a percentage of disposable personal income, of the national income, of the gross domestic product, of government expenditure, etc. Defined as a percentage of disposable personal income, in 1970 it averaged about 6% for the region. This means that it would be necessary to transfer to the poorer groups of the region 6% of total disposable personal income, or 12% of the disposable income of the richest 10% ^{19/} to

^{16/} The sources of the existing data on income distribution present serious difficulties, in both conceptual and measurement terms, for the preparation of this estimate, so some adjustments were necessary. See "¿Se beneficiaron los pobres del crecimiento económico?", op.cit., which describes the main difficulties and the adjustments that were necessary in order to estimate the magnitude of poverty in Latin America.

^{17/} For the conversion to dollars at 1970 prices a parity exchange rate was used.

^{18/} In 1970 the poor in those 19 countries numbered 106 million.

^{19/} CEPAL estimates the share of the richest 10% in personal income at 47.8%.

enable them to obtain, on average, an income equivalent to the poverty line. This poverty gap expressed as a percentage of national income and the gross domestic product averaged about 5% and 4.5%, respectively. Measured as a proportion of public expenditure, however, its average value was around 22%. As a percentage of the gross domestic product this gap clearly shows that in a region whose per capita income in 1970 almost quadrupled the poverty line, from the point of view of resources the eradication of poverty appears to be a feasible task. If it is calculated as a percentage of public expenditure, on the other hand, and considering that the State will necessarily bear the main responsibility for this task, it is noted that the State will have great difficulty in carrying it out.

The average values of the various poverty gaps for Latin America conceal even wider variations between the countries than those indicated in the estimates of the incidence of poverty. For example, the absolute poverty gap expressed as a percentage of disposable personal income in 1970 was less than 1% in Argentina, between 1 and 5% in Chile, Costa Rica, Mexico and Venezuela, between 5 and 12% in Brazil, Colombia and Peru, and over 15% in Honduras. The variation in the poverty gap expressed as a percentage of public expenditure was even greater.

These marked differences clearly show that the degree of feasibility as well as the difficulty of the task vary widely from country to country.

The gaps calculated above are only intended to provide an order of magnitude and their mechanical interpretation could lead to a false appraisal of the poverty problem. Obviously, the situation cannot be remedied merely by a transfer of income from the rich to the poor, but rather by altering the structure and operation of the economic, social and political systems so that without sacrificing growth the existing distributive and redistributive patterns and the distribution of the fruits of future growth will be permanently changed.

(c) Sectoral balances

The magnitude of poverty in a country may be measured by estimating the poverty gap in terms of income or directly estimating the shortfalls in the satisfaction of some of what are considered to be basic needs. In the following paragraphs, brief mention is made of four of them: nutrition, education, housing and health.

/As regards

As regards nutrition, it is estimated that between one-third and two-fifths of the population of Latin America suffer from nutritional deficiencies since their calorie consumption is lower than the minimum needs recommended by FAO. Taking as a reference the cost of the basket of foodstuffs used to determine the poverty lines, the cost of the nutritional gap in Latin America is estimated at between 1 and 2.5% of the gross domestic product.^{20/}

In education, the additional cost to the educational system of providing six years of primary education for future cohorts is estimated at one-third to one-half per cent of the region's gross domestic product.^{21/}

With regard to health, preliminary estimates for Brazil show that the expenditure on health necessary to finance an "adequate" health system would absorb 2.5% of the gross national product.^{22/} Since most of the countries spend between 1 and 1.5% of their gross national product on health, in order to finance an "adequate" health system such expenditure should be increased by the equivalent of 1 to 1.5% of the region's gross product.

With respect to housing, it is estimated that about 1% of the gross national product would have to be transferred to families affected by housing shortages to enable them all to spend on housing the equivalent of what is spent by families on the poverty line.^{23/}

To sum up, a first approximation indicates that the additional cost of covering the gaps existing in these four sectors ranges from 3.5 to 5.5% of the region's gross product. These figures are very similar to the estimated poverty gap expressed as a percentage of the region's domestic product.

^{20/} See preliminary estimates of the Project on Critical Poverty, CEPAL, 1979; S. Reutlinger and M. Selowsky, Malnutrition and Poverty: Magnitude and Policy Options, World Bank, 1976.

^{21/} Preliminary estimates of the Project on Critical Poverty. These estimates assume that the average cost per pupil remains constant and does not include the expenditure that would have to be incurred in attracting and retaining the students in the educational system.

^{22/} See P. Knight and D. Mahar, Brazil human resource special report, Annex III. "Health and nutrition", World Bank, 1978.

^{23/} See A. Churchill, Basic Needs in Shelter, World Bank, 1978.

(d) The evolution of poverty

It is important to determine not only the magnitude of regional poverty but also its evolution before and after 1970. With this end in view, the magnitude of poverty in 1970 is compared with that existing in 1960 and that which will probably exist in 1978.

It is estimated that around 1960 about 51% of the population of Latin America was living in poverty and approximately 26% in a state of indigence. Translated into absolute terms, there were 110 million poor and about 56 million indigents.^{24/} In 1970 a relative decrease is noted in the incidence of both poverty and indigence. The former dropped from 51% in 1960 to 40% in 1970, and the latter from 26% to 19% between those same years. In absolute terms, however, the number of poor and indigent persons remained practically unchanged over that period.

Furthermore, the poverty gap underwent considerable changes. As a proportion of personal disposable income, it averaged about 6% in 1970 compared with nearly 12% in 1960. The difference between these two figures clearly shows the considerable change in both the degree of feasibility and the difficulty of the task of eradicating poverty between those years.

The poverty gap thus expressed may vary in terms of three very different factors. The first is a change in the average severity of poverty, which is measured by the average poverty gap of each individual person, and defined as the difference between the poverty line and the average per capita income of the poor. Between 1960 and 1970 this gap was reduced by approximately 10%, from 82 to 74 dollars, owing to the fact that the per capita income of the poor increased during the period concerned.

It is important to note that two very different situations arise in the evolution of this group's income. On the one hand are found the poorest of the poor, that is the 19% of the population which remained in a state of

^{24/} This estimate of the evolution of poverty is based on S. Piñera, "¿Se beneficiaron los pobres del crecimiento económico?", op.cit., and on CEPAL's estimates concerning income distribution in Latin America in 1960 and 1970.

indigence in 1970, and on the other the 21% of the population which in that year were living in poverty but not in a state of indigence. The per capita income of the first group varied much less in the period 1960-1970 than the aggregate per capita income, while that of the second group experienced increases which in some countries exceeded the average rise in per capita national income.^{25/}

The second factor is the reduction in the magnitude of poverty measured by the percentage of poor in the population. This percentage, as already mentioned, decreased by about 22% in the period concerned.

The third factor relates to the changes in Latin America's aggregate per capita income which, during the period considered, increased by an average of 31%.

Accordingly, the factors contributing to the reduction of the poverty gap were the decline in the severity and magnitude of poverty (16 and 39%, respectively) and the increase in aggregate per capita income (45%). In other words, only half the reduction in the gap is attributable to those characteristics of poverty; the other half was due to the region's enrichment during that period. It may be inferred, therefore, that the objective which should be pursued is not only to reduce the poverty gap but to achieve this by reducing the magnitude and severity of poverty.

In order to estimate what happened after 1970 it must be borne in mind that as a rule several years go by from the time of a survey or census which collects information on income distribution until the time such information becomes available. Therefore, it is not possible to estimate the magnitude of poverty in 1977 by means of the same methodology as that used for the years 1960 and 1970. A preliminary estimate of the probable magnitude of poverty in 1977 may, however, be obtained on the basis of the distribution of income in Latin America estimated by CEPAL for 1970 and the rate of growth of both income and population between 1970 and 1977. Between those years, Latin America's gross domestic

^{25/} See S. Piñera, "¿Se benefician los pobres del crecimiento económico?", op.cit.

product grew by 51.1%, or at an average annual rate of 6.1%, while the population increased by 20.3%, or at an average annual rate of 2.7%, which means that, on average, the region's per capita income rose 25.9% during the period (3.3% annually). If it is assumed that the increase in the per capita income of the various population groups during the period 1970-1977 were equal to the growth of average per capita income,^{26/} it may be concluded that in 1977 about 33% of the population of Latin America received a per capita income below that of the poverty line, i.e., that the poor numbered around 112 million. In other words, in relative values the magnitude of poverty was reduced by 7%, but in absolute values it remained practically unchanged.

An estimate of the poverty gaps on the basis of the same assumptions indicates that their probable average values in 1978 had dropped by 40% compared with those of 1970. That is to say that the poverty gap represented about 3.5% and 7% of total disposable income and of the disposable income of the richest 10% of the population, respectively. Expressed as a percentage of the gross domestic product and of public expenditure, the gap would be around 2.7% and 13%, respectively.

(e) Characteristics of poor households

The information contained in surveys and censuses brings to light certain characteristics of poor households. This section centres on the characteristics which tend to occur systematically in the countries analysed, notably the following:

(i) It is important to note the reduction obtained in the urban-rural income differentials when the income declared in surveys is corrected taking into account the urban-rural price differentials, income in kind and self-supply, and under-declarations are eliminated. Nevertheless, the results show that poverty affects rural households to a greater extent than urban households; 62% of the former and 26% of the latter may be classified as poor households.

^{26/} According to CEPAL figures, the growth of per capita income of the poorest 40% of the population between 1960 and 1970 is almost identical to the growth of average per capita income during that period.

(ii) The lower the income level, the greater as a rule is the household's dependence on earned income. In indigent and poor households, work is practically the only source of income.

(iii) A close relationship exists between unemployment and poverty, but other factors are also involved. Although the great majority of indigent and poor heads of households have some form of employment, a high percentage of them are underemployed. This is borne out by the high percentage of workers from indigent and poor households who work for less than 39 hours a week and who expressly state their desire for additional work. This information obtained from analyses of households surveys coincides with the ILO estimates according to which unemployment in Latin America covers 5% of the labour force, while underemployment affects nearly 30%.^{27/} In short, the problem of poverty is not only a problem of unemployment, even more a problem of underemployment or the quality of employment.

(iv) The per capita income of households, which is the variable used to define poverty, may be broken down into four factors: size of income from different sources of labour, average level of income per person employed, rates of participation in the labour force and rates of dependence.^{28/}

An empirical analysis shows that the differentials of income per person employed account for more than half the disparities in per capita income between poor and other households. These differentials are the result of differences in both personal characteristics (education, age, sex, experience) and employment characteristics (urban and rural area, economic sector, size of enterprise and others).^{29/} The rest of the

^{27/} See ILO, Employment, Growth and Basic Needs: A One-World Problem, Geneva, 1976.

^{28/} See, S. Piñera, "Definición, medición y análisis de la pobreza: Aspectos conceptuales y metodológicos", op.cit.

^{29/} In this respect, see O. Altimir and S. Piñera, "Análisis de descomposición de las desigualdades de ingresos primarios en países de América Latina", Joint CEPAL/World Bank Project, 1977.

disparities are basically accounted for by differences in the rates of participation in the labour force and rates of dependence characterizing poor and other households.

To sum up, the level of income per employed person in the household appears as a variable determining whether or not the household is living in a state of poverty. Nevertheless, demographic variables such as the size of the household and rates of dependence, and others of a socio-economic and demographic nature such as rates of participation in the labour force and rates of unemployment, also show a close association with poverty. In relation to households which are not living in poverty, poor households are systematically characterized by their larger size, higher rates of dependence and lower rates of participation in the labour force. Empirical studies show a strong interaction between social and demographic variables and poverty, the difficulty being to determine whether these variables are the cause or the result of poverty. In other words, the foregoing analysis does not serve to determine whether poor households owe their condition to the fact that they are large, record low rates of participation and high rates of dependence, or whether on the contrary they present these characteristics because they are poor. In all probability there is a cause-and-effect relationship in both senses.

The following are some personal and employment characteristics of heads of households:

(i) The educational level is one of the variables showing the closest correlation with levels of poverty. The immense majority of indigent and poor heads of households have had three or less years of schooling. The incidence of poverty falls drastically when the head of household has completed his primary education. In this respect, education appears as an important condition for emerging from a state of poverty.^{30/}

^{30/} The fact that education may appear at the individual level as a means of escaping from poverty does not necessarily mean that it is so for all poor groups.

(ii) In the urban sector the heads of more than three-quarters of the poor households are private wage-earners, particularly manual workers, and self-employed workers. The relative importance of these two groups varies considerably between one country and another. In the rural sector, in addition to these two categories is that of agricultural smallholder.

In urban areas the poor are concentrated in the construction, commerce and services sectors; in rural areas the biggest concentration is in agriculture, and on a lesser scale in the three sectors mentioned. In the agricultural sector the percentage of poor is much higher than the proportion of the total population represented by this sector.

According to existing studies and the little information obtained from surveys, the degree of organization and participation of poor groups is inadequate or nil at the economic and social level, which prevents them from having any form of real participation in determining their living conditions.

Other results obtained from the country studies lack the regularity of those given above and have therefore been omitted from this document.^{31/}

^{31/} For a detailed analysis of the poverty profiles in the countries analysed, see S. Piñera, "Medición, análisis y descripción de la pobreza en algunos países latinoamericanos", op.cit.

2. Some structural and operational aspects of the economy

As mentioned in an earlier section, nearly all the Latin American countries have a mixed economy system. Under this system, private and public ownership of production factors exist side by side, and the combined action of the market and State intervention determines the allocation of resources. The degree of State intervention, the operational characteristics of the various markets, the level of concentration of ownership, etc., vary widely among the countries of the region. For this reason, it is not the intention to prepare a common diagnosis for them all, nor an exhaustive diagnosis of each, but merely to outline the most important aspects which should be considered in formulating a development strategy aimed at the alleviation or eradication of poverty.

(a) Income, growth, saving and investment

In 1977 the per capita gross domestic product of Latin America, expressed in dollars at 1970 prices, was 866 dollars.^{32/} This figure is nearly five times the value estimated for the poverty line in that year. Like all averages, however, this conceals marked disparities between the countries. At one end of the scale is Venezuela with a per capita income of 1,409 dollars, and at the other end is Haiti with a per capita income of only 137 dollars. This, together with the poverty gaps referred to, illustrates the great differences presented by the various countries in their capacity to deal with the poverty problem with their own resources.

This disparity occurs not only in their income levels but also in the rate of growth they have attained in the last few decades. On average, in the period 1950-1977, Latin America's per capita gross domestic product rose by 2.6% annually, the highest rate being recorded by Brazil (4.2%) and the lowest by Haiti (-0.1%). Of the 11 countries whose per capita income in 1950 was lower than the regional average, nine grew at rates equal to or lower

^{32/} Gross domestic product at market prices. A parity exchange rate was used for the conversion to dollars. (Source: CEPAL, Division of Statistics and Quantitative Analysis, National Accounts Section.)

/than the

than the average. Haiti and Honduras, the countries with the lowest per capita incomes in Latin America, also registered the lowest rates of increase in per capita income. In the period 1970-1977 the region's per capita gross domestic product grew at an average annual rate of 3.1%. In seven of the 11 countries whose per capita income was less than the regional average, it grew during this period at rates equal to or lower than that average.

As regards the saving-investment process, Latin America's national and external saving averaged 25.9% of national income in 1977. Of this proportion, national saving accounted for 24.5% and external saving for only 1.4%. It is inferred from this that, in terms of averages for Latin America, 94.5% of gross investment was financed in that year by domestic saving, and the remaining 5.5% by external saving.

Both the domestic saving effort and the percentage of the total absorbed by external saving varied widely from country to country. In the five years from 1971 to 1975 domestic saving expressed as a percentage of national income was less than 10% in Chile, Haiti and Uruguay; between 10 and 15% in El Salvador, Guatemala, Honduras, Nicaragua and Peru; between 15 and 20% in Argentina, Bolivia, Colombia, Costa Rica, Dominican Republic, Ecuador and Paraguay; and over 20% in Brazil, Mexico, Panama and Venezuela.^{33/}

Moreover, the national component of total saving fluctuated during those five years between 61% (Nicaragua) and 123% (Venezuela).^{34/}

This widely dissimilar situation presented by the countries in both their domestic saving effort and their capacity of access to external saving largely explains the notable differences observed in their rates of growth.

(b) Level and rate of population growth

In 1977 the population of Latin America was bordering on 340 million. The growth rate during the period 1950-1977 reached an annual average of 2.8%, which was only lower than that observed in the Middle East and was much higher than that of the developing world. The highest and lowest

^{33/} CEPAL figures on the basis of official statistics.

^{34/} Ibid.

annual rates were 3.3% for Mexico and 1% for Uruguay. In nine of the 11 countries whose per capita gross domestic product was lower than the regional average, the population growth rates were equal to or higher than that average.

In the period 1970-1977 the population of Latin America increased at an average annual rate of 2.7%. Once again, in nine of the 11 countries whose per capita gross domestic product was lower than the regional average, the population grew at rates that were equal to or higher than that average.

These figures show the existence of a negative relationship between the level of per capita income of these countries and the rate of population growth. However, in an econometric analysis of the relationship existing between the average growth rates of the population and the per capita product for 19 countries of Latin America in the period 1950-1977, a positive though insignificant relationship is found between the two.

In short, the higher the countries' per capita income the lower as a rule is their rate of population growth. The same relationship does not exist, however, between the growth rates of the per capita product and the population.

(c) The structure of ownership and income distribution

Two closely linked aspects whose analysis is an important part of the diagnostic study of poverty are the structure of ownership and the distribution of income prevailing in the various countries of Latin America.

From a conceptual point of view, it is useful to distinguish between the primary distribution of income, defined as the distribution resulting from the operation of the economic system before the redistributive action of the State, and the final distribution of income which is the result of the primary distribution corrected by the redistributive action of the State.

The usefulness of this classification lies in the fact that it distinguishes two major means by which the State can affect the final distribution of incomes. The first category includes State action of a distributive nature, in the sense that it affects the primary distribution of income and, as a result, tends to have a permanent effect on the final

/distribution of

distribution of income. The second category covers action of a redistributive nature, which, without altering the factors which determine primary income, affect the final distribution of income. The nature of the latter means that it usually has a more passing effect than the former.

The primary distribution of income basically depends on the structure of ownership of the factors of production and the prices or remuneration assigned to them by the economic system.

In analysing the structure of the ownership of the factors of production, it is useful to distinguish between physical or financial capital and human capital.

Information concerning the structure of ownership of the stock of physical and financial capital is surprisingly scarce in the vast majority of countries of the region. Nevertheless, the few studies and surveys which contain information on this subject show that income from capital makes up a progressively increasing proportion of income in the sectors at the highest levels of the distributive pyramid, and that these show a degree of concentration much higher than that prevailing in income from work.^{35/}

The ownership of the means of production is a decisive variable not only because of its direct effects on the concentration of income, but also because of the greater political power which frequently accompanies the concentration of ownership. When there exists this situation in which political power is identified with economic power, it is likely that the groups which have such power will exercise decisive influence in dictating the norms which regulate the operation of the system. In this way, inequality in the distribution of income, caused by the concentration of ownership, tends to be perpetuated and in many cases increased.^{36/}

^{35/} See, for example, R. Webb "La distribución del ingreso en Perú", in CIEPLAN, Distribución del ingreso, Fondo de Cultura Económica, Mexico, 1974; S. Piñera "The structure of income distribution in Bolivia", in Fiscal Reform in Bolivia, Law School, Harvard University, 1976; "Chile: Encuesta nacional sobre ingresos familiares, 1968", en CEPAL/World Bank, "Proyecto sobre medición y análisis de la distribución del ingreso en países de América Latina: Tabulados de trabajo", E/CEPAL/L.115/5, November 1974.

^{36/} See, for example, R. French-Davis "Mecanismos y objetivos de la redistribución del ingreso" and J. Graciarena "Estructura de poder y distribución de ingresos en América Latina", in Distribución del ingreso, op.cit.

CEPAL estimates of income distribution in Latin America indicate that in 1970 the richest 5% of the population received 30% of total income, while the poorest 20% received only 2.5% of the total income. In other words, on average the income of the first group is about 50 times that of the second. On the basis of this same estimate, it may be observed that half of the population obtained 86.1% of the income, amounting to an average per capita income equivalent to 6.2 times the average per capita income of the poorest half of the population.

The situation described for 1970 was not fundamentally different from the situation in 1960. In 1960, the richest 5% of the population received 33% of the income, while the poorest 20% received only 3.1%, with the result that the average income of the richest 5% was 43 times that of the average income of the poorest 20%. In the same year, half of the population received 86.6% of the total income, which means that, on average, the per capita income of that group was equivalent to 6.5 times that of the poorest half of the population.

In short, both in 1960 and in 1970 estimates of income distribution show major disparities between the various sectors of the population. Changes in income distribution observed during the decade reflected a decline in the share in total income of both the richest and the poorest sectors, and an increase for the middle-level groups.

(d) The structure of production

Doubts concerning the suitability of the structure of production in many countries of Latin America have increased in recent years. The basic argument is that the region's structure of production does not correspond to its resource endowment, thus hampering the full and efficient use of its productive potential.

However, this lack of correspondence is important not only because of the effect mentioned, but also because of the close relationship which exists between the structure of production adopted by an economy and its capacity to generate employment, and also the relationship between that capacity and poverty.

/The lack

The lack of correspondence between the productive structure and the resource endowment is reflected in over-large sectors which are capital-intensive and use modern foreign technology and which, as a result, have a very poor capacity to absorb labour, particularly the least skilled. Furthermore, it is asserted that, in view of the resource base of the economies of the region, these sectors tend not to be those which offer comparative advantages in the context of the world economy.

Such sectors use a high proportion of the stock of capital, but nevertheless provide employment only for a small percentage of the labour force. Within a dynamic approach, they absorb the major part of the investment resources available to the economies, but only a small proportion of the very large increases in the labour force which occur from year to year in various countries of Latin America.

The other side of the coin is that the remaining sectors - many of which, because of their technological features and the existing resources in the countries, enjoy comparative advantages - have seen a decline in their possibilities of growth, have received a meagre proportion of investment resources, but at the same time have had to absorb a major part of the increase in the labour force, operating at clearly unsatisfactory productivity levels.^{37/}

These disparities as regards technology, capital, employment and productivity have tended to worsen over time, increasingly restricting the capacity of the economies of the region to generate employment. According to empirical studies carried out in the region, if the present structures of production remain unchanged, the rate of growth necessary to maintain unemployment at its current levels amply exceeds the rates of growth achieved by the various countries of the region in the past two decades, which are the highest ever.^{38/}

^{37/} If the various production activities in the region are divided into three technological strata - modern, intermediate and primary - it may be observed that the first employs 12% of the labour force in the sectors involved, and generates more than half the product; the second employs 48% of the labour force and generates 42% of the product; the third occupies more than a third of the labour force and generates only 5% of the product. See, Aníbal Pinto, "Styles of development in Latin America", CEPAL Review, Santiago, Chile, first semester 1976.

^{38/} See, for example, R. Prebisch, Transformación y desarrollo, Santiago, Chile, 1970; OAS, Guidelines for Achieving Maximum Employment and Growth in Latin America, 1973; "Tendencias y proyecciones a largo plazo del desarrollo económico de América Latina" in United Nations, Cuadernos de la CEPAL, Santiago, Chile, 1978.

There are many causes of this situation. Some of them are related to the economic policies pursued in the various countries. There is no doubt that a very strong influence has been the structure of political and economic power prevailing at the time of their introduction. Nevertheless, this section will not analyse the characteristics of the structure of political and economic power and its relationship with the economic policies pursued, but the consequences of some of these policies for the structure of production and the question of whether or not this structure is suited to the existing factor availability. The aim is to contribute to identifying and analysing possible areas of intervention by the State as part of a strategy for the eradication of poverty.

The economic policies which affect the structure of production include:

(i) Protectionist policies, which have been maintained beyond desirable levels. There is no doubt that any policy should be analysed bearing in mind the circumstances in which it was formulated. The protectionist policy applied in many countries of the region, with the aim of initiating a process of import-substituting industrialization, originated in the major crisis of the 1930s.^{39/} This tendency became accentuated as from the Second World War, a period during which international trade offered no sure alternative either to meet internal consumption of certain industrial goods or to find an outlet for the export goods produced in the region. Furthermore, this strategy originated in a climate of pessimism concerning the evolution of the region's terms of trade, and one of optimism concerning the prospects of a rapid and effective process of integration of the economies of Latin America, which was a vitally important part of the strategies drawn up.

Nevertheless, with the passage of time many of the circumstances changed. The striking recovery of the developed world, together with the spectacular growth and liberalization of world trade, opened up new opportunities both to meet the region's internal consumption of many industrial goods and to find outlets for a greater volume of export products. Moreover, there was a halt

^{39/} The major Latin American countries initiated the process of import substitution after the 1930s crisis.

in the worsening of the terms of trade which had occurred in the five years between 1955 and 1960 compared with the previous five years.^{40/} Starting in 1960, the terms of trade recorded cyclical variations, but did not show a clear long-term trend.^{41/} Finally, the process of regional integration advanced very much more slowly than had been hoped, and even tended towards a halt at the end of the period.

All these changes pointed to the need to revise the protectionist strategy which was being pursued. Nevertheless, in many cases there was a continuation of the indiscriminate process of import substitution, to a degree which probably impaired the rate of growth in the countries in question.^{42/} The initial stage of easy substitution, in which domestic production replaced imports of non-capital-intensive and technologically simple goods, gave way to the substitution of imports of increasingly capital-intensive and technologically increasingly complex goods. Together with this change there was an increase in the average level and spread of tariff protection, and protection mechanisms were diversified, incorporating the use of quotas, bans, import deposits and so on. Faced with this situation, many foreign and transnational corporations suspended exports of some goods to the region, replacing them by national output, and this was of direct benefit to the captive markets which resulted from the high level of protection. Later, the smaller Latin American countries tended to replicate the import-substituting industrialization strategy pursued by the larger countries, and this, because of the size of their domestic markets, made it even more costly.

^{40/} It should be mentioned that, for various reasons, including the Korean War, the region's terms of trade reached the highest level of the century in the five years between 1950 and 1955. As a result, the fall in the terms of trade between 1955 and 1960 reflected a return to normality and not a permanent declining trend.

^{41/} See "América Latina: relación de precios del intercambio" in United Nations, Cuadernos Estadísticos de la CEPAL, Santiago, Chile, 1976.

^{42/} See, for example, B. Balassa, "Exports and economic growth. Further evidence", Journal of Development Economics, North-Holland Publishing Company, vol. 5, N°2, June 1978; A. Krueger, Foreign Trade Régimes and Economic Development: Liberalization Attempts and Consequences, Cambridge, Mass., 1978; M. Michaely, "Exports and growth: An empirical investigation", Journal of Development Economics, op.cit., vol. 4, N° 1, March 1977.

It is necessary to add that the lack of correspondence between the structure of production and the existing resource endowment is not solely related to the high average level of tariff protection and its consequent dampening influence on the exchange rate - which harms the exporting sectors and encourages the import-substituting sectors - but also, as has already been mentioned, to the wide spread of such protection. This spread frequently tends to be biased in favour of the industrial sectors which are most capital-intensive, use more complex technology and, as a result, have a smaller capacity to generate employment.^{43/} In other words, the problem does not lie solely in the fact that the process of import-substituting industrialization harmed the remaining sectors, particularly agriculture and the sectors making intensive use of labour and natural resources, but also in the fact that the type of industrialization promoted by the structure of protection ^{44/} is probably the least appropriate in view of the comparative advantages and resource endowment characteristic of many Latin American countries. In this regard, according to the empirical studies carried out in these countries, the exporting industries are much more labour-intensive, particularly in terms of unskilled labour, than the import-substituting industries. Furthermore, this characteristic is more marked in exports to the developed world than in those to the developing world.^{45/}

^{43/} See J. Carvalho and C. Haddad, "Foreign trade strategies and employment in Brazil" and V. Corbo and P. Meller, "Alternative trade strategies and employment implications: the Chilean case", in A.O. Krueger et al., eds., Alternative Trade Strategies and Employment Growth, NBER, University of Chicago Press, 1979.

^{44/} The structure of protection is the result of the joint action of tariffs, bans, quotas, import deposits, the exchange rate and so on.

^{45/} With regard to these latter points see: A.O. Krueger "Alternative trade strategies and employment in LDC's" in American Economic Review, May 1975; A.O. Krueger and N. Akkrassane, eds., Trade Strategies and Employment Growth, Cambridge, Mass., Ballinger Press, 1979. This work contains papers on Brazil (J. Carvalho and C. Haddad), Chile (V. Corbo and P. Meller), Colombia (F. Thoumi), Uruguay (A. Bension); see also V. Corbo and P. Meller "Trade and employment: Chile in the 1960s", American Economic Review, February 1978 and J. Sheahan, "Trade and employment: Industrial exports compared to import substitution in Mexico", Research Memorandum, No 43, Williams College, 1971.

/In this

In this regard, the pertinent question is not whether Latin America should industrialize or not, but rather whether it is advisable for the State, in protecting industry, and especially certain industrial sectors, should remove protection from the remaining economic activities and, most specifically, those which, because of their technological characteristics which are suited to the existing resource endowment, offer the greatest potential for export.

It is perfectly reasonable that, in the field of resource allocation, the State should not adopt a neutral position but, on the contrary, intervene by providing incentives for the sectors in which the benefits to society exceed the private benefits and discouraging those where the situation is the reverse. It is important to emphasize that the concept of comparative advantages is not a purely static concept, but also has a dynamic element, in the sense that such advantages may be absent or weak at the initial stage, but emerge or become strengthened once the process of production has been begun. This dynamic element may not be correctly appreciated by the private sector, and so temporary direct or indirect action by the State is justified.^{46/} Moreover, a country's comparative advantages considered from a private viewpoint may not coincide with those seen from the social point of view. Many factors may ensure that the private costs and benefits of a specific activity differ from their social costs and benefits. Such factors are related not only to the existence of exogenous factors and distortions in the economy,^{47/} but also the differences in the private and social discount rates,^{48/} political instability, irregularities in economic policies or the risks of expropriation, all of which affects private and social values in very different ways. This divergence between private and social values may mean that action by the market alone will not succeed in guiding the process of resource allocation in keeping with the country's genuine social comparative advantages, and thus corrective action by the State is justified.

^{46/} This consideration is closely related to the argument regarding embryonic industries.

^{47/} Analysis of the consequences of these distortions for the divergences between social and private values is one of the central topics of the social evaluation of projects.

^{48/} The private discount rate normally tends to exceed the social discount rate, and thus biases the allocation of resources in the private sector to the detriment of long-term projects.

In a mixed economy, the selective provision by the State of incentives for some sectors, directly or indirectly, is not only one of the principal tasks of economic planning, but also provides complete justification for it.

Nevertheless, two considerations apply to this task of the State. Firstly, tariff protection is only one of the many instruments available to the State to stimulate the selected sectors. Furthermore, the lack of flexibility and versatility of this instrument normally make it very inefficient compared with other incentives.^{49/} Secondly, it is not clear that the sectors which have historically been favoured under tariff protection are the same as those in which the social benefits exceed the private benefits, or as those others where protection was necessary solely as a temporary measure in order to acquire the dynamic component of comparative advantages. With regard to the first point, experience shows that the sectors which have not benefited from protectionist policy have been those which were most labour-intensive. In view of the major differences between the social and private prices of the factors characteristic of many countries of the region,^{50/} it is very probable that the sectors which have not been protected are precisely those where the social benefits exceed the private benefits and, as a result, those which should have received preferential treatment under public policies. As regards the second point, it is easy to observe that protection for the selected sectors, far from having been temporary, has in general been permanent and has increased over time.

Finally, it is important to mention that the policy of selective protection by the State is not incompatible with a process of integration. In fact, integration may be an effective instrument for a process of initiation in exports and imports and for the gradual transition towards

^{49/} If tariffs are used as an incentive instrument it is impossible to affect production without simultaneously affecting consumption; to guide protection specifically towards one or more production factors; to discriminate between geographical areas and so on. This restricts the ability of this instrument to achieve flexibility and versatility in affecting solely the factors it is necessary to stimulate.

^{50/} The differences will be analysed in the following section.

greater openness to the outside. For this purpose it is necessary to plan a genuine downward trend in the common external tariff. If this tariff is used by the State to provide discriminatory treatment in some production sectors, this treatment should be selective in nature, so as to favour the sectors in which the social benefits exceed the private benefits, regardless of whether these sectors are industrial, agricultural or mining sectors.

This process of opening up by means of integration, in addition to its clear political importance, offers at least two economic advantages compared with individual opening up. The first is that each country not only gains in well-being from its own tariff reduction, but also benefits from the reduction in tariffs by the remaining countries participating in the integration process. The second advantage is that the option of opening up plus integration reduces the vulnerability of the countries adopting it vis-à-vis outbreaks of protectionism in the rest of the world.

(ii) Domestic price policies. The price policies adopted by the governments of Latin American countries have frequently tended to discriminate against the prices of agricultural goods and in favour of the prices of industrial goods. This behaviour is partly due to the tendency of the governments to exercise greater control over food prices, because of the important role they play in determining the cost of living in urban sectors.

This situation has tended to bias the structure of production to the detriment of agriculture. Furthermore, the absence of external competition, together with the frequent practice of fixing the domestic prices of industrial goods in line with the costs of the least efficient producer, has contributed to the emergence of monopolistic or oligopolistic conditions in many industrial branches, where the existence of inefficient producers guaranteed excessive profits to the less inefficient producers.

(iii) Public investment policies. As was mentioned above, the protectionist and price policies followed in many countries in Latin America led to a price or incentive structure which channelled a major part of private investment to the industrial sector, and in particular to some of its subsectors. The investment policies followed in the public sector tended

/in some

in some way to reinforce this concentration, since in many of these countries they were oriented towards the creation of urban infrastructure and major industries in highly capital-intensive activities (metallurgy, iron and steel, petrochemicals, the motor industry and so on). This policy may have meant neglecting investment in rural and agricultural infrastructure and investment which tends to favour the sectors which make intensive use of labour and natural resources in general.^{51/}

(iv) Factor price policies. A fourth type of policy which has probably had an important effect on the structure of production is made up of policies which have introduced major differences between the private and social prices of the factors of production, by artificially increasing the cost of engaging labour compared with the cost of capital. This structure of relative factor prices has encouraged the expansion of the highly capital-intensive sectors, damaging growth in the labour-intensive sectors. This point will be dealt with in more detail below.

(e) The markets for goods

The operation of the markets for goods in a large number of Latin American countries is far from competitive. In particular, the markets related to the manufacturing sector are characterized by a monopolistic or oligopolistic structure. This type of structure is favourable to the owners, by enabling them to use their monopolistic or oligopolistic power to obtain higher than usual profits and, at the same time, harms those who have no share in the ownership of such enterprises. This occurs in at least three ways. It harms consumers, because they must pay prices for final goods and services which are higher than those which would apply if competition was greater; it harms producers and own-account workers, since they have to face prices for inputs and intermediate products which are higher than those which would prevail in a competitive market; and, finally, it harms wage earners because this monopolistic or oligopolistic structure tends to depress demand for labour.^{52/}

^{51/} There is no doubt that some sectors related to natural resources, particularly mineral and energy resources, are an exception to this trend.

^{52/} When a monopoly in the market for goods coexists with a degree of monopoly in the market for labour, workers in these enterprises or sectors can, through higher wages, share part of the excessive profits generated by the absence of competitiveness. In these cases the effect on employment is even more adverse.

Empirical studies on industrial concentration in the manufacturing sector show that the structure of this concentration is very similar in the different countries investigated. The sectors where the highest degrees of concentration appear tend to be the same in the various countries.^{53/}

Many factors have helped to create or worsen this monopolistic structure. They include the absence or inadequacy of effective external competition because of the prohibitive levels of protection existing in many sectors; the size of domestic markets, which, together with the specific technology of economies of scale, tends to concentrate domestic production on a small number of enterprises; the existence of legal provisions which restrict the entry of new producers to some markets, or which stimulate monopolistic behaviour, thus preventing a greater degree of competition; the concentration of ownership; the fragmentation of the capital markets and unequal access to them; and the passivity of the public sector.

(f) The factor markets

In order to carry out a diagnosis of the operation of the factor markets in Latin America, it is necessary to analyse both the degree of integration in the markets and the reasons for the intensity in the use of the factors.

Concerning the first aspect, it has been noted that the factor markets in Latin America do not operate in an integrated form; this has been referred to as "fragmentation of the market". This fragmentation occurs both in the labour market (particularly for unskilled labour) and in the capital markets.

In the urban and, to a lesser degree, the rural labour markets, the so-called modern or protected sectors frequently coexist with the so-called traditional or unprotected sectors.^{54/} The former are characterized by a high

^{53/} See, for example, P. Meller, "The pattern of industrial concentration in Latin America" in The Journal of Industrial Economics, vol. XXVI, N° 4, Basil Blackwell, Oxford, September 1978; P. Meller, S. Leniz, C. Swinburn, "Comparaciones internacionales de concentración industrial en América Latina", Ensayos ECIEL, N° 3, Rio de Janeiro, August 1976; P. Meller, "El patrón de concentración industrial de América Latina y su comparación con el de Europa occidental" in CIEPLAN, Notas técnicas N° 5, Santiago, Chile, February 1978.

^{54/} There is no doubt that this classification is a simplification of reality, since there are many kinds of market which appear at points intermediate between the two types mentioned.

level of trade union organization, the existence of collective bargaining and labour contracts, and the parties almost always comply with legal provisions concerning minimum wages, statutory readjustments and labour legislation in general. In the latter, trade union organization is weak or non-existent, and there is practically no collective bargaining. Many of the legal provisions in the labour field do not affect them, and wages basically remain determined by the unequal forces in these markets.

The modern or protected sector also tends to coincide with the high-productivity sector, while the reverse is true for the traditional or unprotected sector. According to estimates made for some countries of the region on the basis of census data,^{55/} employment in the modern sector represents only about a fifth of the country's labour force and about a third of the non-agricultural labour force.

This duality in the labour markets, particularly in urban labour markets, has important implications for the formulation of development strategies which are aimed at combating poverty, especially as regards employment and wage policies and traditional redistributive policies.

This phenomenon of fragmentation also occurs in the capital markets. It is well known that access to credit is different for different persons and different enterprises. Some enterprises, normally the largest, have access to the international credit market; others, to the institutionalized domestic credit market, whether this is public or private; and, finally, there are those who have access only to the informal credit market or have no access to credit. For many reasons which it is not appropriate to analyse in this document, these three types of enterprise obtain credit on very different terms as regards amount, interest and repayment periods. Furthermore, greater access to credit tends to correspond with foreign technology and higher capital intensity.

^{55/} See R. Webb, "Wage policy and income distribution in developing countries", Princeton University, 1974; and Sector informal; funcionamiento y politicas, PREALC, 1978.

/As regards

As regards intensity in the use of factors, that is to say, the number of units of labour which are used per unit of capital, it is necessary to examine at least three elements which determine it, which are very different in nature.

The first of these is related to the problem of shifts. Many studies have indicated the desirability of using the stock of capital on two or more shifts as a means of increasing employment.^{56/} Nevertheless, the factors which have prevented this arrangement from being adopted widely in Latin America are not entirely clear.

A second element is technological know-how proper - that is to say, the knowledge possessed by entrepreneurs who must take decisions concerning the various production processes or techniques which they may use. In this regard, they tend to prefer the most modern, highly capital-intensive technology, which is not necessarily the best if it is wished to reduce costs to a minimum. Furthermore, world technological research is concentrated in the developed countries; it is estimated that more than 98% of world expenditure on technological research is attributable to those countries.^{57/} In such countries the relative price of labour, and particularly the least skilled labour, is high compared with the developing world. Moreover, they are characterized by an abundance of capital and skilled personnel, so that it is natural that their technological progress should tend towards the development of production methods which are large-scale, increasingly capital-intensive and, as a result, use labour, especially unskilled labour, less intensively.

^{56/} See, for example, D. Schydrowsky, "Capital utilization, growth, employment, balance of payments and price stabilization", Discussion Paper N° 22; J. Ramos, "La ampliación de turnos en la industria chilena: la factibilidad de una política de empleo productivo", Discussion Paper N° 12; P. Millán, "Guidelines for policies to increase the use of capital through multiple shifts in industrial plants", Discussion Paper N° 13; R. Abusada-Salah, "A statistical shift-choice model of capital utilization", Discussion Paper N° 15. All these papers belong to the Discussion Paper Series of the Center for Latin American Studies, University of Boston.

^{57/} See C. Cooper et al., "Technology for the Second Development Decade", paper presented at the United Nations Conference on Technology, 1969.

A third element affecting the intensity of the use of factors is their relative price, or, more exactly, the cost of using them. The great importance attached to this element in economic publications indicates the need to go into this subject thoroughly in the diagnosis.

Many studies carried out in Latin America highlight the great difference between the private and social prices of factors.^{58/} The relationship between the cost of using labour and that of capital is, for entrepreneurs, particularly those in the modern or protected sector, much greater than that which occurs in the social area, where these costs are determined by the relative scarcity of both factors in each country. In general, it is recognized that in most of these countries the prevailing relative prices have meant not only that productive resources are allocated inefficiently, hindering the creation of new jobs, but also that inequality in income distribution is constantly increased, with the consequent adverse effects on poverty. One of the most deplorable aspects of this situation is that government policies have in many cases helped to aggravate the problem. This aspect has been the subject of a specific analysis in the reports of ILO.^{59/}

The importance and the impact of this distortion in relative factor prices on the allocation of resources, the generation of employment, the distribution of income and poverty in general depend crucially on the value of the elasticity of substitution of the factors which are characteristic of the various economic sectors. Rejecting the existence of a world of fixed proportions, the extent of the effect of this distortion, though not its existence, remains to be discussed.

^{58/} See, for example, OAS, Guidelines for Achieving Maximum Employment and Growth in Latin America, 1973; ILO, Towards Full Employment, 1970; S. Piñera y P. Meller "El problema del empleo en Chile", Chile 1940/1975: treinta y cinco años de discontinuidad económica, 1978.

^{59/} See, for example, ILO, Fiscal Policies for Employment Promotion, 1971

There are many factors resulting from economic policies and institutional circumstances which have led to this situation. These factors may be divided into two major groups, depending on whether they have tended to increase the cost of employing labour or to make it cheaper to use capital.

Among the factors in the first group, it is useful to distinguish two types: those which have tended to increase workers' wages, and those which have tended to raise the cost of employing labour without involving a rise in wages.

In the first type, mention may be made of the existence of protected sectors in the economy, in which the level of wages does not play a balancing role. Many reasons have been adduced to explain the existence of a wage level above the equilibrium level.^{60/} The most popular is of an institutional nature, and is related to the role played by trade unions, collective bargaining, labour legislation, minimum wage policy, job security legislation and the political pressures which organized labour exerts on the government. There is no doubt that these mechanisms have had an important positive effect on the level of wages on the so-called modern or protected sectors, and that they may have affected the distribution of the product generated in those sectors to the benefit of the workers. Nevertheless, it must be recognized that they are most likely to have had a negligible, nil or even negative effect on the wages or incomes of the poorest groups of the population. Most of these are in the rural sectors, in the traditional or unprotected sectors, or belong to the categories of own-account workers, the unemployed, pensioners and so on, whom these benefits do not reach. In fact, labour legislation itself, by banning or discriminating against trade union organization in the countryside or in smaller enterprises, has contributed to accentuating the duality in the labour markets.

^{60/} See, for example, ILO, Fiscal Policies for Employment Promotion, 1971; J. Stiglitz, The Structure of Labor Market and Shadow Prices in LDC's, Employment and Rural Development Division, World Bank, 1976; D. Mazumdar, The Theory of Urban Underemployment in Less Developed Countries, Employment and Rural Development Division, World Bank, 1974 and D. Turnham, The Employment Problem in LDC's, a Review of Evidence, OECD, 1970.

As can be seen from the empirical studies carried out,^{61/} to the extent that the elasticity of substitution among factors which characterizes the sectors where these mechanisms have prevailed is not zero, they may have restricted the creation of protected jobs, thus limiting the inclusion of workers from the traditional sector and own-account workers, who are normally included among the poor groups.

Among the factors of the second type, that is, those which have tended to increase the cost of employing labour without involving a rise in wages, one of the most important has been the tax on employment implicit in the machinery for financing social security.^{62/}

Both the magnitude and the coverage of the payroll tax on wages and salaries which is designed to finance social security vary widely between the different countries of the region. The tax rate is almost 20% in the Andean Group countries, and more than 40% in the countries of the Southern Cone.^{63/} Furthermore, in most of these countries the magnitude and

^{61/} In fact, the empirical studies show that the value of this elasticity is between 0.5 and 1.5, and that it is higher in agriculture than in industry. See, for example, J.R. Minasian, "Elasticities of substitution and constant-output demand curves for labor" in The Journal of Political Economy, vol. LXIX, N° 3, The University of Chicago Press, June 1961; A. Arellano, "La elasticidad de sustitución entre factores: una estimación de su orden de magnitud para el sector manufacturero chileno", Instituto de Economía, Universidad de Chile, 1968; J. Katz, Production Functions, Foreign Investment and Growth Based on the Argentine Manufacturing Sector, North-Holland, 1970; W. Thirsk, "Ease of factor substitution in agriculture", Colombia Programme of Development Studies, Paper N° 34, Rice University.

^{62/} For an estimate of the impact of the social security tax on employment, see, for example, PREALC, "Efectos sobre el empleo de un cambio en el modo de financiamiento de la seguridad social", 1975; E. Aninat, "La eliminación del sistema de cotizaciones previsionales: estimaciones de su impacto sobre el empleo", Estudios de Planificación CIEPLAN, 1971; J.E. Coeymans, "Efectos de la rebaja de cotizaciones previsionales y su financiamiento sobre la asignación de recursos y el empleo", trabajo presentado a la 4a. Reunión de Economistas, Jahuel, Chile, 1978.

^{63/} See "Efectos sobre el empleo de un cambio en el financiamiento de la seguridad social", in Acción de los ministerios del trabajo en la Política del empleo del Grupo Andino, PREALC, (mimeo), 1975.

coverage of the social security tax has shown a clear upward trend.^{64/} In 1960, about 21% of the economically active population of Latin America was covered by the social security systems; in 1970 the proportion was 30%. In 1960 expenditure by the social security systems represented 2.3% of the gross domestic product of Latin America at factor cost; in 1970, 3.3%.^{65/} It is important to highlight the fact that these considerations refer to the method of financing social security and not to the level or structure of such expenditure. The expenditure is a separate area, the diagnosis of which is of great importance for the redistributive policies designed to alleviate poverty.

Concerning the factors which have led to a drop in the cost of employing capital, mention may be made of the overvaluing of the national currency and the frequent tariffs exemptions or preferences on the import of capital goods, which have reduced the cost of imported capital; low real interest rates (which are often negative);^{66/} the frequent subsidies on the use of capital implicit in tax regulations, such as, for example, those which permit accelerated capital depreciation and tax rebates on the basis of the capital invested.

^{64/} See The Costs of Social Security, ILO; R. Reviglio, "The Social Security Sector and its Financing in Developing Countries", IMF, Staff Paper, 1969; "Guidelines for Achieving Maximum Employment and Growth in Latin America", OAS, 1973.

^{65/} See "Indicadores del desarrollo económico y social en América Latina", Cuadernos estadísticos de la CEPAL.

^{66/} These low rates of interest have an adverse effect on employment not only by penalizing saving, with its consequent effect on capital accumulation, but also because by generating excess demand for credit they make it necessary to resort to other machinery to ration the supply available. In such circumstances, it is natural that the banking sector should favour the large enterprises in each branch, not only because the risk is smaller, but also because of the pressures they exert and because of the desirability of administering few but substantial lines of credit. The result is that, in addition to stimulating enterprises which have access to credit towards excessive mechanization, scarce credit is channelled precisely to the enterprises which are most likely to be capital-intensive.

In sum, in the modern or protected sectors there is a great difference between the relative private and social prices of factors. The artificially higher cost of hiring labour in relation to the cost of capital has produced three simultaneous effects which tend to have a negative impact on employment.

First, there is an intersectoral effect. Labour-intensive activities, such as construction, agriculture, agribusiness and light industry, which are discriminated against by the tax on labour, have lost ground in total output, whereas the share of capital-intensive activities has increased.

Second, there is an intrasectoral effect, inasmuch as the small and large enterprises in each sector use factors with differing intensity, as is shown by empirical studies.^{67/} The result has been that the large scale enterprises, which are capital intensive, have increased their share of output in each sector, whereas the share of small-scale industry, which is labour intensive, has declined. A consequence of this decline has been that each level of output of the industry generates a smaller volume of employment.

Third, there is an effect within enterprises themselves. In any productive activity where a choice exists between technologies with a different mix of factors, the entrepreneur, seeking to minimize costs and maximize profits, usually chooses the technology which involves the least amount of labour and the greatest amount of the other factors.

(g) Demographic aspects

Rather than attempting an exhaustive analysis of demographic aspects, this section will give orders of magnitude for Latin America of a number of demographic variables.

It was mentioned earlier that the population growth rate of Latin America in the period 1950-1975 was one of the highest in the world, only surpassed by that of the Middle East.^{68/} Other demographic indicators, however, place

^{67/} Empirical studies carried out in Latin America show that within a given sector small enterprises use labour more intensively than large enterprises. See, for example, A. Berry "The relevance and prospects of small-scale industry in Colombia", Economic Growth Center, Discussion Paper, Yale University, 1972; P. Meller and M. Marfán "Pequeña y gran industria: Generación de empleos y sectores claves", Estudios de CIEPLAN, N° 20, Santiago, Chile.

^{68/} See D. Morawetz, Twenty-five Years of Economic Development 1950-1975, World Bank, 1978.

the region in an intermediate position. In the period 1970-1975, gross birth and death rates stood at 3.69 and 0.92% respectively, clearly midway between Africa and Asia on the one hand and the developed world on the other. In that same period life expectancy at birth was on average 61.4 years, again an intermediate position between Africa and Asia on the one hand (45 and 48.5 years respectively) and the developed world on the other (71.1 years). The same is true of the percentage of urban population, although in this respect Latin America's situation is closer to that of the developed world than to that of the rest of the developing world. In 1975 roughly 60% of the Latin American population lived in urban areas. The same proportion was 24.2% in Africa; 22.9% in Southern Asia; 67.6% in Europe; and 69.3% for the developed world as a whole. With regard to the age structure of the population, Latin America's situation resembles that of Africa and Asia more than that of the developed world. In the three regions mentioned first, about 54% of the population is under 15 years of age; in Europe and the rest of the developed world this percentage amounts to only 25%. The proportion of the population aged over 65 amounts to about 3% in the three developing continents, as against about 12% in Europe and the developed world as a whole.^{69/}

However, these Latin American averages hide great variations among countries and groups of countries. In the period 1970-1975, the population growth rate was 3.21% in Central America and Mexico; 2.9% in countries of South America excluding the Southern Cone;^{70/} 1.9% in the Caribbean countries, and 1.43% in the countries of the Southern Cone. In the same groups of countries the birth and death rates amounted respectively to 4.2% and 0.94%; 3.8 and 0.92%; 3.3 and 0.9%; and 2.3 and 0.9%. These figures clearly show that the great differences in the natural growth rates of the population are basically due to differences in birth rates and only to a lesser degree in death rates. Great differences also remain in life expectancy in the different

^{69/} For comparisons between continents and regions see, Selected World Demographic Indicators by Region and Country or Area, 1970-1975, United Nations, New York, 1978.

^{70/} The Southern Cone includes Argentina, Chile and Uruguay.

/subregions which

subregions which have been identified. In Central America and Mexico, life expectancy is 61.5 years; in South America excluding the Southern Cone, 60.5 years; and in the Caribbean and Southern Cone countries, 63.1 and 66.5 years, respectively. Much the same is true of the percentage of the population living in urban zones. In Central America and Mexico, about 57.1% of the population live in urban zones; in South America excluding the Southern Cone, this proportion is 58.9; in the Caribbean 48%, and in the Southern Cone 80.7%. These differences also hold for the structure of the population. The under-15 age group represents 45.7% of total population in Central America and Mexico; 43.1 of the population of South America excluding the Southern Cone; 40.7% of the population of the Caribbean; and 30.4 of the population of the Southern Cone.71/

This summary of demographic statistics shows the great differences which characterize the different countries and groups of countries of Latin America. In addition to these differences there are variations within each country both between urban and rural zones and between the different regions.72/

Turning again to global indicators, it would appear from the projections made by CELADE 73/ based on the "medium growth hypothesis" that the population growth rate will stay high for the remainder of the present century, and the decline, which will become steeper as of 1980, will only bring it down from the present 2.8% to 2.4% by 1995/2000. Thus over the next 25 years the Latin American population will almost double.

71/ See, for example, United Nations, Selected World Demographic Indicators by Region and Country or Area, 1970-1975, op.cit.

72/ See, for example, CEPAL-CELADE, "El desarrollo y la población en América Latina: Un diagnóstico sintético", 1975.

73/ See, CELADE, "Demographic Bulletin", N°18, Year IX, Santiago Chile, 1978.

/According to

According to the same projections, migration from rural to urban zones will continue, particularly in the countries where a high percentage of the population still live in the countryside. This movement will increase the pressure on urban services and physical space and accentuate the rural dispersion characteristic of the population distribution patterns in Latin America.^{74/}

In addition, the age structure of the population will change, with an appreciable rise in the number of inhabitants of active age. Over the period 1975-2000 the average annual growth rate of this group is estimated at 2.9%, higher than that of the total population (2.7%). This rise, together with higher rates of participation, particularly of women, will cause the labour force to grow at an average annual rate of nearly 3%, which represents a major challenge to the region's capacity of generating employment.

There can be no question that the demographic variables must have a major influence on the choice, orientation and application of policies aimed at eliminating poverty. Thus a thorough study of the demographic situation in each country, identifying its main characteristics and accurately projecting future trends, is certainly a valuable contribution to the efficient design of policies and instruments for the eradication of poverty.

^{74/} See, L. Herrera "La concentración urbana y la dispersión de la población rural en América Latina: Su incidencia en el deterioro del medio humano" CELADE, Series A, N° 136, 1976.

3. The characteristics of the state

There is no inherent force in the market mechanism which automatically directs resources towards the satisfaction of the basic needs of the poorest groups. Only an external factor acting through or outside the market can redirect resources towards those groups. In view of the complexity and magnitude of the problem, it is necessarily the state which must be responsible for this task, which involves designing, applying, encouraging, controlling and financing the various activities and policies needed for that purpose.

Consequently, an essential part of this study is to analyse the situation of the state and the means it possesses for action in the eradication of poverty. Its action to this end can be divided into two major categories, distributive or redistributive. The former affects the primary distribution of income resulting from the operation of the economic system and the structure of ownership, whereas the second sets out to correct that primary distribution by means of transfers. This section of our study concentrates mainly on the factors which determine or condition the size and nature of the redistributive action of the state. For this purpose a number of categories of conditioning factors should be distinguished.

In the first place, there is the will and political ability of governments to tackle the task of eradicating or alleviating poverty. The lack of real will has been and may continue to be one of the main obstacles to the attainment of this objective. There are many causes of this situation. The state's redistributive action may affect current income, or else the gains produced by growth. In either case, one group or another must give up some of its share of present or future income to the poorer groups. However, institutional arrangements and the operation of the power system are heavily biased in favour of the group of owners, professionals, bureaucrats and organized workers at the expense of the groups with low productivity and little organization, which include many of the agricultural workers,

/own-account workers

own-account workers and wage-earners in the so-called unprotected sectors.^{75/} In brief, the groups which have to give up some of their share are precisely those with the highest levels of organization and lobbying power with which to influence governments and hold up their redistributive action, whereas the groups which should benefit from that action are lacking in effective organization and lobbying power to encourage it.

Other factors which have contributed to the lack of will or political ability, or both, have been the fatalistic attitude that poverty is an inescapable evil and the belief that the elimination of poverty and economic growth are mutually incompatible objectives.^{76/} The result has been a tendency to neglect the problem of poverty at the expense of that of growth.

The second category of factors conditioning the extent and nature of the state's redistributive action concerns the size of the state, its bureaucratic and administrative structure, its knowledge of the main characteristics of poor households and their members, and of the activities of intervention, and the policies and instruments needed to undertake redistribution effectively.

The size of the state, not necessarily in terms of ownership of factors or levels of intervention but rather as regards its ability to mobilize resources, is a basic conditioning factor. In Latin America public expenditure as a percentage of the gross national product is, on average, below 20%. This proportion tends to be lower as the extent of poverty in a country is greater,^{77/} which means that on average the poverty gaps as a percentage of the gross national product rise almost five-fold when expressed as a percentage of public expenditure.

^{75/} See A. Pinto and A. Di Filippo, Notas sobre la estrategia de la distribución y redistribución del ingreso en América Latina; R. French-Davis, "Mecanismos y objetivos de la redistribución del ingreso"; G. Graciarena, "Estructura de poder y distribución del ingreso en América Latina", all in Distribución del ingreso, Fondo de Cultura Económica, Mexico, 1974.

^{76/} It is important to stress here that the degree of incompatibility does not depend so much on the nature of the objectives themselves than on the policies and instruments used to obtain them.

^{77/} See United Nations, 'Indicators of Economic and Social Development in Latin America', Cuadernos estadísticos de la CEPAL, Santiago, Chile, 1976.

The administrative structure of the state is another conditioning factor of vital importance. In the field of income redistribution, the administrative apparatus of most of the countries of the region is directed towards the middle and upper income groups, particularly in the urban sector, and does not take due account of the special situation of the lower income groups of society. This administrative structure is to some extent the result of deliberate action resulting from the abovementioned factors. However, it is also partly due to a certain degree of ignorance not only of the main characteristics of poor households and their members but also of the areas of intervention and the most efficient policies and instruments for eradicating or alleviating poverty.

Experience shows that in Latin America these political, social, economic, administrative and technical factors have together created a situation in which the state's redistributive action has not only been insufficient in terms of resources and inefficient in their use but has also failed to direct a significant proportion of its benefits to the poorest sectors, or to ensure that the burden of its financing falls on the richest sectors of the population.

The empirical studies carried out on the incidence of tax systems in Latin America has shown that, with some exceptions, these are proportional and even regressive.^{78/} The preference for indirect rather than direct taxes, very small or inexistent taxation of property and capital gains, the margins of evasion, preferential tax arrangements and exemptions are the main causes of this situation. In about 1970, on average in Latin America, tax income stemmed from taxes in the following proportion: on income, 27%; on property, 4.6%; on imports, 23%, on exports, 4.9%; on production, 34.4%; and other taxes, 2.6%. In sum, indirect taxes represented more than 68% of total tax income.^{79/}

The empirical studies of the incidence of public expenditure present a less clear-cut picture. Some studies suggest that public spending has a

^{78/} See R. Bird and L. De Wulf, "Taxation and income distribution in Latin America: A critical review of empirical studies", IMF, Staff Papers, vol. XX, N° 3, 1973.

^{79/} See R.J. Chelliah and others, "Tax ratios and tax effort in developing countries 1969-1971", IMF Staff Papers, vol. XXII, N° 1, March 1975.

certain redistributive effect,^{80/} whereas others suggest that this redistribution only transfers incomes from the top groups to the middle upper groups without effectively reaching the poor.^{81/} This situation is attributed to the fact that the poor groups are not incorporated in the machinery and channels through which the benefits of public spending are distributed. The high percentage of government expenditure in the field of education allocated to higher education is an illustrative indicator of this point. However, all the studies agree that the redistributive effect of public expenditure is inadequate and that there is a broad and promising field for increasing public sector redistributive activities both through financing and in the size and allocation of expenditure. What is usually called social expenditure is unquestionably the component of public expenditure which has the greatest potential for redistribution and the reduction of poverty. However, what is important from the standpoint of poverty is not merely the level of social expenditure but also its composition and allocation by income groups, and the degree of effectiveness with which it is administered. This final aspect, which is overlooked in studies of its incidence, is certainly an area of action of great importance.

This section concludes with a brief analysis of the features and limitations of the most frequently used redistributive instruments:

(i) Legal provisions, whose application is supposed to be generalized regarding wage adjustments, minimum wages and similar measures.

One of the limitations of this type of instrument has already been analyzed in the section on the structure of job markets. The segmented

^{80/} See, for example, R. Bird and L. De Wulf, "Taxation and income distribution in Latin America: A critical review of empirical studies", *op.cit.*; L. De Wulf, "Fiscal incidence studies in developing countries: Survey critique", International Monetary Fund, 1974; J. Meerman, "Fiscal incidence in empirical studies of income distribution in poor countries", IDA, Discussion paper, 1972; A. Foxley, E. Aninat, J. Arellano, "¿Quiénes se benefician de los gastos públicos?", Estudios de CIEPLAN, N° 10, Santiago de Chile, 1977; M. Urrutia and C. de Sandoval, "Política fiscal y distribución del ingreso en Colombia" in Distribución del ingreso, CIEPLAN, Santiago, Chile, 1974.

^{81/} See V. Tanzi, "Redistributing income through the budget in Latin America", mimeo, 1972.

nature of those markets has prevented legal wage adjustments and, inter alia, legislation on minimum wages, working days and job security from benefiting wage-earners in the informal urban sector, workers without steady jobs, the unemployed, seasonal agricultural workers, etc. Furthermore, since they are directed entirely to the wage-earning sector, such measures wholly neglect own-account workers, small businessmen and the agricultural smallholders. In other words, precisely the groups most affected by poverty are in general left out of the benefits from these types of measure, which have unquestionably played an important part in defending the purchasing power of part of the wage-earning sector against inflation and in tapping for them some or all of the increases in productivity in their sectors.

In summary, state action of this type can indeed play an important role in redistribution, but its limited coverage at present and its almost total lack of selectivity represent serious limitations in the task of eradicating poverty.

(ii) A second mechanism frequently used is that of social security benefits, major components of which are pensions, which transfer income towards the passive sector, and family allowances, which transfer resources to large families. In general, these social security benefits are characterized by the fact that they openly give preference to the highest income workers. The glaring disparities in the size of family allowances according to the different type of beneficiaries, the proliferation of preferential régimes, early retirement, heavily subsidized credit arrangements linked with the social security systems, etc., clearly bear out this assertion.

These forms of discrimination within the prevailing social security systems are compounded by the limited coverage of the latter. By failing to cover workers in the informal workers, own-account workers and smallholders, they exclude a large percentage of the poor sectors. In 1970, for example, only 30% of the economically active population of Latin America was covered by social security systems.^{82/}

^{82/} See CEPAL, "Indicators of economic and social development in Latin America", op.cit.

(iii) A third mechanism used by governments consists in intervening in the fixing of prices of goods and factors. Two types of interventions in the price mechanism can be distinguished. One uses taxes or subsidies to introduce differences between the price paid by the consumer and the price received by the producer; and the other is limited to establishing prices either below or above market levels. In general, price intervention policies have been used for redistributive purposes of both types. Basically they have led to a tax system which establishes different rates of tax (or subsidy) according to whether the goods concerned are necessities or luxuries,^{83/} or measures which fix prices of certain essential goods below market levels, or tariff franchises or preferential exchange rates for the import of staple goods.

All these actions are justified by the fact that the essential goods are consumed most by the poorest groups and therefore they would be the main beneficiaries of such policies. This warrants two comments. In the first place, instruments of this kind are not selective and therefore if the benefits are to reach the target groups they also have to reach the rest of the population. Secondly, fixing prices below equilibrium prices for essential goods stimulates their demand, but at the same time discourages supply. This contradiction in its effects on supply and demand means that price fixing often has results contrary to those desired.

(iv) Fiscal policy is a fourth mechanism of redistribution frequently used in Latin America. As pointed out above, given the lack of progressivity in the tax system and the limited redistributive effect of public expenditure, the joint result of these two components of fiscal action has not had major effects on income redistribution or the reduction of poverty.

4. Summary and conclusions

(a) Economic growth has been satisfactory in Latin America. However, broad sectors of the population (40% in 1970) continue to receive an income which is not sufficient to satisfy their basic material needs.

^{83/} In the case of factors, the discrimination in pricing has been based on the type of use made of inputs or in the characteristics of their users.

(b) Projections based on past trends show that if the current style of development continues the percentage of the population living in poverty will tend to decrease but the absolute size of the poor population will remain constant.

(c) Economic growth has made it possible to reduce substantially the poverty gap, i.e., the percentage of the product which would have to be transferred to the poor for them to rise to the poverty line.

(d) The decline in this gap suggests that in most Latin American countries the problem of poverty is connected increasingly with a lack of fairness in the distribution of national resources rather than with the limited size of the latter. This is not to overlook the significance of the difficulties in the way of eradicating poverty, but rather to stress that, from the standpoint of the availability of resources, the task is increasingly feasible.

(e) At the current stage of development of many Latin American countries, the eradication of extreme poverty is a moral imperative, is justified economically and is necessary for political stability in the medium term.

(f) The free play of the different economic and social forces in the market is not enough to overcome the present situation of poverty. For this purpose conscious and permanent action is required on the part of governments. Using the distributive and redistributive instruments available to public administration, governments must change the factors which condition the final distribution of real personal income.

(g) The eradication of extreme poverty must therefore be one of the top priority objectives of the development strategies prepared by the countries of the region. In order to attain it, more material and human resources must be allocated and an effort must be made to encourage the organization of the most underprivileged groups and adjust the administrative apparatus to the requirements involved in satisfying the basic needs of the whole population.

(h) In the following chapter, some policy guidelines are suggested for consideration in the corresponding strategies.

III. GUIDELINES FOR A DEVELOPMENT STRATEGY TO REDUCE OR ERADICATE POVERTY IN LATIN AMERICA

Introduction

In preparing a development strategy it is essential, first, to define clearly the objectives pursued and specify the priorities assigned to each objective, and, secondly, to possess an appropriate diagnosis of the circumstances in which the strategy is to be applied.

As regards the definition of objectives and the establishment of priorities, there is no doubt that the reduction or eradication of poverty may not be the sole objective of a development strategy, and accordingly it is necessary to ask: What are the other objectives? What conflicts may there be between them? What priority should be assigned to the pursuit of the various objectives? When the reduction or eradication of poverty is a priority objective, new questions arise, such as: Within what period should the strategy achieve its objective? Is this an objective which can be achieved by means of transfers, in which the effects of State intervention last as long as the intervention itself, or is it, in contrast, an objective which calls for interventions which introduce permanent changes in the productivity of poor groups and in their capacity to generate and retain income?

It is not our intention to give definite answers to these questions. Nevertheless, this discussion starts from the assumption that the development strategies adopted by the countries will have multiple objectives, among which the reduction or eradication of poverty will be one of the most important, but not the only one.

In the light of the general diagnosis of the situation in Latin America set out in the previous section, it is necessary to identify and analyse briefly some areas of intervention and some policies and instruments which governments may be able to use within the broader context of their own development strategies.

/It is

It is clear from the analysis above that the task of eradicating poverty necessarily requires substantial and systematic intervention by the State. The form of this intervention, but not the need for it, is a matter for discussion. The final objective of this intervention is the permanent improvement of the quality of life or real income (monetary and non-monetary) of the poor groups. These interventions may be described in various ways; in this paper they have been grouped into two major categories.

On the one hand stand interventions or policies of a distributive nature, which are those which have an effect on the primary distribution of income resulting from the structure of ownership and the operation of the economic system. This type of intervention is normally linked to the number and quality of jobs generated by the economy, and of the production factors possessed by the poor groups; to the productivity of these factors; and to the prices assigned to them under the operation of the economic system. These interventions are, in the final analysis, aimed at increasing the capacity of the poor groups to generate income.

On the other hand stand interventions or policies of a redistributive nature, which instead of affecting the primary distribution of income correct this distribution by means of transfers of income and of goods or services between the various sectors of the population. This type of intervention is basically linked to the form in which the State obtains public resources (impact of taxation) and spends them (impact of public expenditure and investment, particularly social expenditure on the direct, free or subsidized, provision of goods and services deemed basic).

There is no doubt that many public actions or policies contain both a distributive and a redistributive component. This is particularly true the longer the period over which the effects are considered. This fact necessarily introduces a degree of arbitrariness in any attempt at classification under the two categories mentioned above.

From the point of view of resources, interventions of these two types are substitutive, in the sense that an increase in expenditure on one of them implies, other things being equal, a reduction in expenditure on the other. Nevertheless, from the viewpoint of results, the two types complement each other, for at least three reasons. Firstly, failure to meet basic

/needs is

needs is in itself an important cause of the meagre capacity of the poor groups to generate income. Secondly, given the consumption habits of these groups and the availability of some basic goods and services, increases in real income do not necessarily guarantee that their basic needs will be met. Finally, there is no doubt that, for some groups, distributive actions are ineffective or require periods of gestation whose length is incompatible with the urgency of the situation to be resolved. In such cases, action in the field of assistance and redistribution is an indispensable accompaniment.^{84/}

In sum, in its development strategy each country will have to seek vigorously the best possible combination of distributive and redistributive interventions, bearing in mind specific characteristics and taking into account the conflicts which may arise between the different objectives.

A. DISTRIBUTIVE INTERVENTIONS AND POLICIES

This category comprises a great variety of policies, which may be classified into two major groups: policies designed to increase, jointly or separately, the number and productivity of the jobs generated by the economy, and to extend the benefits of these increases to the poorest sectors of the labour force; and policies designed to increase, jointly or separately, the number and productivity of the assets possessed by the poorest groups.^{85/}

The sections below indicate the principal areas of intervention, giving some examples of policies and instruments. Since this is a summary document, and since the policy proposals do not refer to a specific situation, the treatment of the various issues is necessarily very general. Nevertheless,

^{84/} Ernesto Tiróni, "Políticas gubernamentales contra la pobreza: El acceso a bienes y servicios básicos", working document of the Inter-agency Project on Critical Poverty, CEPAL, 1978 (unpublished).

^{85/} The provision by the State of basic goods and services, such as nutrition, education, health and so on, undoubtedly has a positive effect on the beneficiaries and thus includes a distributive component. Nevertheless, as it also involves a consumption component, this type of intervention has been included under redistributive interventions.

it has been deemed useful to set out as wide as possible an outline of analysis to serve as a reference both for further study of some aspects, of which empirical knowledge is meagre, and for the devising of specific policies within an overall frame of reference.

1. Policies designed to increase the number and productivity of jobs generated by the economy and to extend the benefits of these increases to the poor groups

(a) Principal areas of intervention which have an effect on the rate of growth of the economy

Since the main and almost the sole source of income for the poor groups is their work, increases in the number and quality of the jobs generated by economic growth constitute the principal automatic mechanism through which such growth reaches the poor groups (trickle-down effect).

As has already been mentioned, economic growth is a necessary but not a sufficient condition of success in the eradication of poverty. It is necessary not only because it has an influence on the number of jobs and on levels of wages, but also because it facilitates redistribution.^{86/}

Economic growth may accelerate, and lead to an increase both in domestic and in external saving - with the consequent effect on the volume of investment - or to an improvement in the quality of the latter. Both alternatives offer wide possibilities of intervention by the State.

The diagnosis pointed out that rates of domestic saving are inadequate in many Latin American countries. For this reason, the following paragraphs will refer only to this type of saving, which does not imply neglect of the important role played by external saving, which in some cases is vital.

Possibilities of increasing domestic saving are linked to the increase in public and private saving.

^{86/} The implicit assumption shared by the study on "Redistribución con crecimiento", op. cit., is that it is easier to redistribute increases in resources arising from growth than currently existing resources.

Information available in most Latin American countries indicates that there are clear possibilities of increasing public saving, thus contributing to raising the total rate of saving.

As far as the tax systems are concerned, in many cases the apparent progressivity laid down by the law does not correspond to what happens in practice; this can be seen in the relative share of direct and indirect taxes in total current income, and in the shortcomings in the application of standards in the tax field.

Among the reasons for the effective regressivity of the tax systems are tax evasion - and especially evasion of taxes on consumption, some income from capital and earned income of independent professionals; the existence of a variety of exemptions; the inadequate progressivity of taxes on income; and the fact that, in some cases, certain income arising from property and capital gains is not taxed.

Furthermore, an examination of the level and composition of expenditure by the public sector and the financing of State enterprises also shows that there is a possibility of substantially increasing the current surplus of the public sector or altering the composition of expenditure, either by rationalizing it, or by increasing income derived from the operations of State enterprises.

Simultaneous action on current income and expenditure of the public sector would increase the surplus on current account and, accordingly, the overall rate of domestic saving.

As for private saving, both the absence or instability of the capital market and the distortions which are a feature of it have had an adverse effect on the private sector's saving effort. This instability is reflected in the absence or inadequacy of medium-term and long-term readjustable savings and loan instruments to correct the effects of the chronic inflation which is characteristic of most of the countries of the region; the distortions are reflected in innumerable legal norms which discriminate between institutions or between instruments in the financial sector, and in the establishment of maximum limits on rates of interest, which has frequently given rise to negative real rates of interest, discouraging saving and preventing it from

/playing its

playing its role of balancing and guaranteeing resources for saving and investment.^{87/} Furthermore, in general the saver sees no link between his saving effort and the meeting of certain basic needs, such as housing, education, health attention and so on. For these purposes the State might provide a certain volume of financial resources, in the form of credits, with a subsidy element, as a function of the total of personal saving. On the one hand, this would stimulate saving, while on the other it would be channelled towards meeting basic needs.

Finally, the case might be cited where the objective of the redistribution process was not only to benefit certain groups but also to increase levels of saving. In such circumstances arrangements for forced saving, linked with increases in real income, might be proposed. The redistribution would then have a deferred effect, since it would result not in greater immediately available income, but in the ownership of securities signifying increases in real income in the future. These savings instruments should produce positive real interest, and might be added to other funds from voluntary saving held by individuals, destined to meet some basic need.

The improvement of the quality of investment, particularly in the public sector, is another huge and promising field of action. This would require some changes in procedures for the allocation of resources for public investment. In most of the countries of the region, the investment budget of the government sector is allocated by ministry. This procedure should be altered so that the allocation of the investment budget in the public sector is effected on the basis of a social assessment of the various projects. Although the final decision in the selection of projects is a political one, the technical contribution, which should become of greater importance, involves a strict assessment designed to identify and accurately quantify the social benefits and costs associated with each project. The

^{87/} In such cases it is necessary to resort to other machinery to ration saving-investment resources, which normally introduces distortions in the allocation of resources and has an adverse effect on the distribution of income. This latter result occurs because in most of these countries credit is more concentrated than saving, so that the establishment of the rate of interest below its equilibrium value has an adverse impact on the distribution of income.

absence of, or shortcomings in, the systems and machinery for social assessment of projects has prevented more appropriate use of the meagre resources channelled to investment.

In addition, in mixed-economy systems, the set of government policies which stimulate and guide investment by the private sector is of special importance. In this regard, one of the important tasks of planning in this type of economy is to apply taxes, subsidies or other policy instruments in order to guide investment in the socially most desirable way in the sectors where the costs or benefits to society differ from the private costs or benefits. In view of the distortions, exogenous factors and rigidities which characterize developing economies, and in view of the periods required for their removal, the task of guiding private investment in the socially most desirable way is a priority responsibility for planners.

(b) Areas of intervention which directly affect the structure of production

In the diagnosis mention was made of the fact that the structure of production is to some degree inappropriate to the existing resources in the region. The importance of this inappropriateness for the problem of poverty basically lies in the fact that, since the factors are used with widely varying intensity between one sector and another, the composition of supply, or production structure, significantly affects the volume of employment and levels of wages generated by a given level of production or volume of capital. The lack of correspondence between the structure of production and the existing resources, mentioned above, is an indication of the fact that the present structure of production, in many countries of the region, restricts the creation of jobs and depresses the levels of wages.

The specific characteristics of each country make it difficult to propose concrete policies in this field. Nevertheless, in the light of the principle that State intervention should tend to stimulate the sectors where the benefits to society are greater than the private benefits, regardless of whether the sectors are industrial, agricultural, mining or service sectors, and also regardless of whether they are aimed at the domestic or the external market, certain lines of action may be derived. In this regard, action by the State should be aimed at eliminating the differentiations which favour the

/sectors or

sectors or subsectors that are more capital-intensive, thus eliminating the discrimination usually suffered by the agricultural sector and other sectors which are labour-intensive, particularly in terms of the least skilled labour.

The diagnosis referred to various policies and instruments used by governments which have aggravated the lack of correspondence between the structure of production and the existing resources. This section briefly analyses a few criteria which may be adopted with a view to reducing or eliminating this lack of correspondence.

A first field of action is trade policy, which basically comprises exchange and protectionist policies,^{88/} which are closely related to each other, and to the countries' development strategies.

The advantages and disadvantages of the import substitution strategy, applied using a large variety of controls on external trade, and the strategy of opening up to the outside, have been fully analysed in various publications.^{89/} These argue that the former strategy had positive effects on growth and employment in its initial stages, which tended to disappear as the application of the process was intensified. They add that the intensification of this strategy not only failed to check the rate of growth of imports, but also led to stagnation in exports; to greater dependence, as imports were concentrated on raw materials and capital goods; to the emergence of inefficient and ever-growing bureaucracies to apply and monitor the innumerable restrictions on external trade; to a lack of competition in the industrial sector, since the size of domestic markets permits only a few enterprises in each industrial branch; to poor allocation of resources

^{88/} This policy is determined by the joint action of tariffs, quotas and import deposits, export draw-backs, other non-tariff barriers and so on.

^{89/} See I. Little, T. Scitovsky and M. Scott, Industry and Trade in Some Developing Countries: A Comparative Study; B. Balassa et. al., The Structure of Protection in Developing Countries; J. Bhagwati, Foreign Trade Régimes and Economic Development. Anatomy and Consequences of Exchange Control Régimes; A. Krueger, Foreign Trade Régimes and Economic Development, Liberalization Attempts and Consequences; V. Corbo, "Comercio exterior y empleo, algunas experiencias de países en desarrollo", CIEPLAN-Institute of Applied Economic Research, Concordia University, Montreal, 1978.

between the different industries and sectors, giving rise to a structure of production out of line with existing resources; and to distortions in relative factor prices. The same publications also analyse some advantages brought to the developing countries by greater openness to the outside. These advantages basically lie in the elimination of the distortions introduced by the strategy of import-substituting industrialization, the exploitation of economies of scale and the advantages of specialization, and greater competitiveness.

For these reasons, and those analysed in the diagnosis, it is felt that trade policy should tend towards greater openness in the economies towards external markets, which would reduce or eliminate discrimination in favour of import-substituting sectors, particularly those characterized by high capital intensity, and discrimination against the exporting sectors, especially those which are more labour-intensive, thus permitting better use to be made of the comparative advantages of each country.^{90/}

To this end, trade policy should aim at a simultaneous reduction in the average level of protection (with the consequent increase in the equilibrium rate of exchange) and of its degree of dispersion.

The equilibrium rate of exchange is closely linked to the evolution of protection, to the relationship between domestic and world inflation,^{91/} and to the evolution of the terms of trade. These interrelationships mean that it is necessary to co-ordinate exchange and protectionist policies within the context of an open trade policy.

Firstly, given certain levels of inflation and terms of trade, the greater the reduction in protection, the greater will be the increase in the equilibrium rate of exchange. Secondly, and given certain remaining variables, the greater the difference between domestic and world inflation, the greater will be the rate of increase in the equilibrium rate of exchange.

^{90/} It should be noted that this does not mean a return to discriminatory action under trade policy in favour of production for export and to the detriment of production for domestic consumption.

^{91/} Strictly speaking, it is world inflation which affects each country and which depends on the structure of its external trade.

Accordingly, within the context of an open trade policy, two viable options for exchange policy emerge: the free rate of exchange and the programmed rate of exchange.^{92/} The advantages and disadvantages of the two options are closely linked to the degree of competitiveness in the exchange market; the degree of stability of the terms of trade; the capacity of the market to distinguish between real long-term trends and temporary short-term fluctuations; and so on.^{93/}

In sum, a policy aimed at greater openness, and a reduction or elimination of discrimination in favour of the sectors which are highly capital-intensive and against those which are labour-intensive, would promote economic growth ^{94/} and would better align the structure of production with the resource endowment of the countries of the region.

Furthermore, both economic theory and some empirical evidence show that exports to the developed countries can make more intensive use of the labour factor than exports to the developing countries.^{95/} Accordingly, the structure of production and the resource endowment will be better aligned to the extent that the opening up of trade is extended to developed and developing countries, and not solely restricted to a subgroup of developing countries. In this regard, regional or subregional economic integration,

^{92/} The option of the fixed nominal rate of exchange is excluded because the very process of tariff reductions and opening up of trade, together with the differences in the levels of domestic and world inflation, generates upward pressures on the rate of exchange which make the fixed exchange rate option impracticable in the medium and long term. In other words, for countries with levels of domestic inflation which are higher than world levels the choice is not between devaluing or not devaluing, but between devaluing drastically and infrequently, or moderately and more frequently.

^{93/} For a more detailed analysis of the advantages and disadvantages of each of these options in some Latin American countries, and an argument in favour of one of them, see R. French-Davis, "Alternativas de política cambiaria", Estudios de CIEPLAN, N° 21, Santiago, Chile, 1978.

^{94/} In this regard see M. Michaely, "Exports and growth: an empirical investigation", Journal of Development Economics, March 1977; B. Balassa, "Export and economic growth: Further evidence", Journal of Development Economics, June 1978.

^{95/} See, for example, V. Corbo, "Comercio exterior y empleo: algunas experiencias en países en desarrollo", op. cit.

/together with

together with a declining common external tariff, is a necessary step and an effective instrument in the move towards a more general situation of openness.

But more appropriate economic growth and a greater correspondence between the structure of production and existing resources would have an important beneficial effect on demand for labour, which in turn would have favourable repercussions on the capacity to generate employment and on the levels of wages in the economy. Since labour is the main and almost the sole source of income of the poor, this increase in the number and quality of jobs which require fewer skills would make a substantial contribution to alleviating poverty.

The changes in the structure of production introduced by a policy of openness alter the level and structure of employment and wages and the value of the stock of capital in the various sectors, which in turn modifies the distribution of income and capital. In order to avoid undesired changes in the distribution of these two variables, or to limit them, there are at least two mechanisms and combinations of them. The first is related to the gradualness of the process of opening up. If this process occurs in a gradual and planned form, the various economic agents progressively adjust to it, and this avoids sharp undesired changes in the distribution of income and capital. The second mechanism involves total or partial compensation by the State for those harmed by the process of opening up. It may, for example, facilitate and finance the mobility of the labour factor and training and retraining of some labour sectors, and compensate for capital losses caused by the opening up. In short the greater or lesser acceleration of the process of opening up is related more to a problem of fairness than one of efficiency. The better the existing compensation machinery, the greater will be the optimum acceleration of the process of opening up.

Finally, it is important to point out that these reflections on exchange and protectionist policies tend to guide the trade policies of the Latin American countries towards greater external openness, but in no case represent rigid norms which can be generally applied. There are many economic and non-economic arguments which, in specific circumstances, and together with restrictions on the use of other instruments, justify permanent or temporary deviations from the basic line set out above.

/The existence

The existence of strategic goods, sectors or regions, the presence of distortions, rigidities or exogenous factors which cause private and social values to diverge, and the recognition of dynamic components in the acquisition of comparative advantages - in special situations, these justify discretionary intervention by the State to stimulate or discourage certain sectors or activities. In most cases the instruments of protection outlined above are not the best possible instrument, in the sense of achieving their objective while introducing the fewest possible undesired distortions. Nevertheless, in many situations the use of the best possible instruments is not feasible because of financial, administrative or political limitations. In such circumstances there may be justification for the application of protectionist measures which involve temporary or permanent deviations from the basic line mentioned above.

In addition to trade policy, there is a wide range of policy instruments which have a direct effect on the structure of production. Among these mention should be made of price and investment policies.

Price policy needs to be revised in order to identify and eliminate the frequent discrimination against the agricultural sector and in favour of the industrial sector contained in the price policies applied by many countries in the region. This discrimination has taken many forms, including the fixing of prices for agricultural products, bans, quotas or taxes on their export, and subsidies and preferential treatment for imports of agricultural products. The final objective of all these actions has been to keep the price of foodstuffs low for reasons of income distribution (in view of the large share of foodstuffs in consumption by the poor) and because of its importance in determining the cost of living in urban sectors. The revision of these policies should take into account not only their direct repercussions, but also their effect on the structure of production, the generation of employment and the distribution of income between agriculture and other sectors. In so far as controls of agricultural prices are justified for redistributive and nutritional reasons, it seems advisable to replace generalized price controls, which affect not only demand but also supply, by selective actions which subsidize specific foodstuffs or specific groups of people. This point will be analysed in greater detail in a subsequent section of this paper.

/As far

As far as public investment policy is concerned, the lines of action should aim at a rigorous assessment of public projects using social criteria so as to reverse the governments' trend towards bias in concentrating public investment resources on urban and industrial infrastructure and in highly capital-intensive sectors. This trend or bias has led to neglect of the remaining economic sectors, particularly the agricultural, traditional and small enterprise sectors, which are the most labour-intensive.

(c) Areas of intervention and policies in the factor markets

The diagnosis referred to the effects of the fragmentation of the factor markets, and the intensity with which these markets are used, on the economy's capacity to generate jobs.

(i) Fragmentation of the Labour market. Some empirical studies have analysed, for various Latin American countries, the effects which the reduction or elimination of this fragmentation would have on income distribution, the wages of unskilled workers and efficiency in the assignment of labour.^{96/} They conclude that if the fragmentation of the labour market is reduced or eliminated, there will be a substantial positive change in the real level of wages and the number of jobs for less skilled workers, in the distribution of earned income and in efficiency in the allocation of labour. Furthermore, changes in the degree of fragmentation of the labour markets will contribute to determining to what extent a rise in demand for labour generated by economic growth or by the realignment of the structure of production will be reflected in wage rises for the present workers in the beneficiary sectors or in improved levels of employment in those sectors, favouring the new workers who join them.

^{96/} See, for example, C. Dougherty and M. Selowsky, "Measuring the effects of misallocation of labor", The Review of Economics and Statistics, vol. LV, N° 3, Harvard University Press, August 1973; J.A.P. de Melo, "Distortions in the factor market: Some general equilibrium estimates", Ibidem., vol. LXI, N° 4, November 1977.

The higher the proportion of the increase in demand for less skilled labour which takes the form of greater job opportunities, the greater will be the share of the poor groups in the benefits of growth or the realignment of the structure of production. In this regard there is a clear conflict or trade-off between higher wages and more jobs.^{97/}

Accordingly, interventions or policies designed to integrate the labour markets, enhance their degrees of competitiveness and ensure equal access to them for all workers with the same skills, are consistent with the objective of overcoming poverty. Among these actions, mention should be made of those which tend to improve existing information in the labour market and develop the systems for the placement of unemployed workers, those who are entering the labour force or those who wish to change jobs;^{98/} those designed to increase the geographical mobility of the labour force within and between sectors; to even out the degree of trade union organization and social pressure of the various sectors of the labour force; to eliminate the obstacles or exclusions hampering access to the various labour markets, whether legal, institutional or union-based; those which tend to eliminate obstacles and rigidities in the labour markets; and so on.^{99/}

Some of these factors and mechanisms which it is proposed to replace have played an important social and redistributive role in favour of some groups of workers. Nevertheless, by their very nature they cannot be extended to the entire labour force, and currently they affect the poorest groups in the labour force minimally, not at all or even negatively. As a result, the argument aims not only at the elimination of these factors or mechanisms, but also at their replacement by others which do not discriminate against the poor groups.

^{97/} The estimated average value of employment-wage elasticity for the manufacturing sector in Latin America is -0.5. This means that a rise of 1% in wages, if the volume of output is constant, reduces employment by 0.5%. See P. Meller, "Empleo, producto y remuneraciones en el sector manufacturero latinoamericano", CIEPLAN, Santiago, Chile, 1978.

^{98/} An improved system of placement helps to reduce frictional unemployment.

^{99/} The fixing of working hours in commerce, and restrictions on night work, are examples of obstacles and rigidities.

(ii) The phenomenon of fragmentation in the labour market also extends to the capital markets, and is reflected in major differences in the terms on which the various groups or sectors in the economy have access to credit. In many countries in the region a substantial proportion of total credit is assigned on an institutional basis to certain sectors, so that capital is undervalued in the modern highly capital-intensive sector, and overvalued in the traditional, labour-intensive sector. In order to deal with this phenomenon, State intervention should be designed not only to eliminate this discrimination in the allocation of credit, but also to create the institutions and machinery necessary to ensure access to credit for enterprises in the informal sector, own-account workers and small farm owners, among others. In this regard it is important to recognize that the absence of access to credit for these groups is not only a problem of price distortion - which might be resolved using taxes or subsidies - but is closely linked to the inability of the formal credit institutions and machinery to meet the needs of these groups. Consequently, elimination of the problem of fragmentation mentioned above requires in many cases the establishment of institutions and machinery which, at least temporarily, are designed for and specialize in meeting the credit needs of these groups. In addition, it is necessary to improve information systems, provide technical assistance and modify the legal and administrative norms which impose unattainable requirements on small property owners.

In short, there is a need to remove the obstacles which currently hamper access to credit for persons and enterprises that are de facto or de jure excluded from it.

(iii) Another field of intervention and formulation of policies in the factor markets is related to the intensity of the use of factors, which depends on the technological know-how available and the relative prices of factors.

/The reflections

The reflections set out in the diagnosis made it clear how inappropriate it is for the countries of the region to have to depend on technology originating from the most developed countries, where relative prices and availability of factors are very different. Nevertheless, it is not justifiable for each country to channel its meagre investment resources to developing its own technology in each production sector. It would be more advisable, firstly, to concentrate scarce resources on adapting foreign technology to the factor prices and resource endowment of the country and, secondly, to seek and select technologies developed and used by countries in a similar situation as regards relative prices and availability of factors. Finally, some of the actions in technological research can be channelled towards the selective development of indigenous technology in sectors where, given their specific characteristics, the above-mentioned solutions are not feasible.

In this regard, one potentially fertile field is the introduction of technological changes in the traditional sectors of the economy. This is an area where co-operation among the various countries of the region would appear to be highly desirable.

(iv) The elimination of the difference existing between the social and private relative prices of factors is another wide and promising field of intervention. The diagnosis drew a distinction between factors which have caused a rise in the cost of engaging labour in relation to its social price and those which have led to a decline in the cost of engaging capital compared with its social price. Among the former, a distinction was drawn between those which increase the real wage received by the workers and those which increase the cost of labour without involving equivalent increases in the real wage. This distinction is very useful in classifying and grouping interventions and policies with the purpose of reducing the difference between the social cost and the cost of using the factors.

The mechanisms of an institutional type (such as legislation on minimum wages, statutory readjustments, security of tenure and obstacles to access to certain labour markets imposed by the trade union structure or by legal or institutional factors, and so on), under which wages have increased in the so-called modern or protected sectors over and above the levels which would

/prevail in

prevail in their absence, and the tax on the use of labour implicit in the financing of social security by means of a payroll tax, cannot - or should not - be extended to the whole economy, particularly to its poorest sectors.

The obstacles to entry to certain sectors or enterprises are aimed at permitting and maintaining preferential treatment in terms of wages and working conditions and, as a result, hinder access to them by workers from other less favoured sectors. Accordingly, they operate only in the favoured sectors, and cannot be extended throughout the economy.

The remainder of the mechanisms of a legal, institutional or trade union nature set out above, and social security financed through payroll taxes, can theoretically be extended to all sectors of the economy. At present they operate only in the modern or protected sectors, which are characterized by lower inter-factor substitution and employment-wage elasticity and, consequently, their dampening effect on employment generation has probably been moderate, though not non-existent. In this regard it is important to mention that the benefits provided by these mechanisms for workers in the protected sector - through restriction of the ability to generate employment in this sector and, as a result, opportunities for the remaining workers to gain access to it - have depressed wages or incomes in the unprotected sector, which has harmed wage earners in the latter sector, own-account workers, the unemployed and those who are entering the work force for the first time, all of whom go to make up the poorest sectors of the labour force.

This does not mean that the mechanisms which have safeguarded the interests of workers in the protected sectors should be eliminated, but is designed to illustrate the undesirability of intensified use of these mechanisms.

A different situation prevails in the traditional or unprotected sectors, where these mechanisms operate to a lesser extent or not at all. These sectors are characterized by greater elasticity of substitution among factors and greater employment-wage elasticity than the so-called modern or protected sectors. As a result, extending such mechanisms to them, and increasing the levels of wages over and above their equilibrium levels, would have a greater dampening effect on the generation of jobs. In view of the chronic problem

/of unemployment

of unemployment and underemployment affecting most of the countries of the region, and particularly the poorest sectors, these mechanisms would aggravate rather than improve the situation of poverty which affects large numbers of their members.

It is clear, then, that in the protected sectors, and even more so in the unprotected sectors, it would be advisable to orient policies designed to improve the living conditions of workers in such a way that they do not result in artificial increases in wages (beyond increases in productivity), which are compatible only with high unemployment.

With respect to wage policy, it is essential in order to avoid conflicts between the objectives of redistribution and employment to draw a clear distinction between the concept of income - which constitutes an objective of economic policy, and for which it is legitimate for the community to impose a lower limit in the form of a minimum family income - and the concept of wages or, more broadly, the cost of employing labour.

Consequently, policies in this field should not tend to increase artificially the cost of employing labour, but to supplement up to minimum levels the incomes of all families in which the sum of their partial incomes, whether from remuneration, unearned income or any other source, is lower than the minimum family income established by the community as a standard.

This redistribution strategy has various advantages compared with that based on artificial increases in wages or social security benefits financed with taxes on work. In the first place, it does not raise the cost of labour, which means that it does not detract from the employment objective; secondly, it focuses attention on income and not on wages and, as a result, incorporates in the redistributive process the sectors not affected by wage policies. These sectors include the unemployed, small property owners and own-account workers, who normally represent the poorest groups of the population.

The policy for the financing of social security is another area of intervention. It is of vital importance to replace the present financing machinery, based on taxes on work, by another which does not discriminate between the various factors of production. Financing based on the overall

/incomes of

incomes of the nation or on taxes on output, consumption or value added would accomplish this end by eliminating discrimination against enterprises which are labour-intensive and in favour of those which are capital-intensive.^{100/}

Finally, laws and policies on security of employment and restrictions on dismissal offer another field of intervention. Although this type of legislation tends to protect the worker from arbitrary dismissal, by representing an additional increase in the cost of employment it protects persons who are employed at the expense of unemployed workers, those who enter the labour force each year and workers in the informal sector, for whom it will be more difficult to find work in the modern sector.

This does not in any way mean ignoring the need to protect workers from arbitrary dismissal, nor denying their right to compensation in cases of dismissal or involuntary unemployment. Nevertheless, interventions and policies should seek a way of achieving this object without discouraging the employment of labour.

One possibility is to transform the present system of security of employment into one of stability of income, replacing the compensation which the enterprise has to pay when dismissing the worker by compensation or a subsidy for unemployment paid through a special fund. This fund might be financed by the enterprises, but as a cost independent of that which they incur when employing labour (example: a value-added or other tax). In this way, in the case of non-arbitrary dismissals the employer would not incur greater costs in engaging (or dismissing) labour, and there would thus be no incentive to reduce the engagement of new staff. However, since it is necessary to protect workers from arbitrary dismissal, it would be advisable for a special tribunal to consider the matter. If the dismissal

^{100/} For various countries of the region a large number of studies have estimated the effects of a reform of this type on the level of employment, and concluded that these effects are significant. See, for example, "Efectos sobre el empleo de un cambio en el modo de financiamiento de la seguridad social", PREALC, 1975; E. Aninat, "La eliminación del sistema de cotizaciones previsionales: Estimaciones de su impacto sobre el empleo", Estudios de planificación, CIEPLAN, Santiago, Chile, 1971; J.E. Coeymans, "Efectos de la rebaja de cotizaciones previsionales y su financiamiento sobre la asignación de recursos y el empleo", trabajo presentado a la 4a Reunión de Economistas, Jajuel, Chile, 1978.

is deemed to be arbitrary, the cost should fall to the enterprise concerned. The unemployment subsidies might represent a declining proportion of the wage, and both their duration and the rate of decline might depend on the number of years worked.

Another possibility, which would replace or complement the above, would be to develop public employment programmes to which workers unable to find jobs would have automatic access for a given period. The implementation of these programmes would require constant efforts to identify a group of useful projects (public works, community projects, repairs, agricultural infrastructure work) which were labour-intensive.

Both the system of unemployment compensation or subsidies and public employment programmes can be co-ordinated with training programmes which improve the skills and productivity of the workers involved,^{101/} and with programmes of information and placement of workers in various labour markets to assist them to find productive employment.^{102/}

The analysis carried out of wage policies, policies for the financing of social security and policies of protection from dismissal provides a frame of reference for short-term, medium-term and long-term public policies in this field.

Obviously, the transition from the present systems to the proposed systems creates serious political, administrative and financial problems. Accordingly it is advisable to plan their application in a gradual manner and to make provision for the active participation of workers in order to ensure that the advantages of the new systems are correctly evaluated.

The diagnosis has already identified the principal factors which have reduced the price of capital compared with its cost to society. Interventions in this field should be designed to eliminate the subsidies on the use of capital which are implicit in the tariff exemptions and preferences enjoyed by imports of capital goods, in the overvaluing of the national currency, in preferential tax treatment and in the establishment of very low or negative real interest rates.

^{101/} In this regard see R. Morán, "Reseña y análisis crítico sobre el estudio de Pablo Humeus, 'El problema del empleo y recursos humanos: ideas para una política'", Cuadernos de economía, Universidad Católica de Chile, April 1974.

^{102/} See "Políticas de empleo al alcance del Ministerio del Trabajo", PREALC, 1975.

(d) Policies relating to markets for goods

This subject has already been analysed in part under the examination of policies which directly affect the structure of production. The purpose of this section is to identify and analyse very briefly interventions aimed at improving competitiveness in the markets for goods.

The diagnosis analysed the causes of the lack of competitiveness of some sectors and the possible effects of this situation on the poor groups. In view of the monopolistic or oligopolistic structure characteristic of many sectors of Latin American economies, interventions in this field can have a substantial effect on poverty.

As has already been mentioned, the opening up of trade, by introducing external competition, helps to improve competitiveness in the monopolistic or oligopolistic sectors protected by tariff or non-tariff barriers. There are other mechanisms available to the State which help avoid or reduce monopolistic or oligopolistic practices. One is the nationalization of such enterprises and the transfer of their ownership to the State, whereby they are made to behave as if they were competitive. Nevertheless, the State has available to it instruments which can achieve the same purpose without the need to resort to nationalization. These include the fixing of prices for such enterprises at the same levels as those which would apply in competitive situations; the establishment of levels of output equivalent to those which would apply in conditions of competition; and the application of a system of penalties for monopolistic or oligopolistic practices. With these instruments it is possible to ensure that monopolistic or oligopolistic enterprises behave as if they were competitive enterprises as far as output and prices are concerned.

The measures and instruments adopted to avoid or reduce such practices basically depend on political considerations and on the economic system adopted.

2. Policies designed to increase the number and productivity of the assets possessed by the poor groups 103/

The concentration of ownership of land and physical capital, and differentials in the productivity of these assets, account for a good part of the inequalities which may be observed in the personal incomes of the various groups of the population.

As a result, interventions designed to increase the number and productivity of the assets possessed by the poor groups are of fundamental importance, and are in some cases indispensable, in reducing or eradicating poverty.

A rise in the number of assets possessed by the poor groups may be achieved through a redistribution of existing assets in their favour, or of future increases in assets by means of a reorientation of new investment in favour of such groups. Among the justifications of this type of intervention is the fact that they have a lasting effect on the capacity to generate income of the groups which benefit, and that it is considered less paternalistic than others of the assistance type.

The opponents of this type of intervention argue that in general it clashes with the objective of growth and is ultimately more harmful than beneficial for the groups it aims to favour. From a purely economic point of view, in order for this not to occur it is necessary, firstly, to select or identify the sectors in which productivity is least likely to be adversely affected by the transfer of ownership and, secondly, to select those investment projects of benefit to the poor groups whose rates of return are not lower than the opportunity cost of capital.

It is probable that in decisions on this subject the economic criterion will be one of the factors taken into account, and that it will sometimes be the most important one; however, at all events it is necessary to ascertain the economic implications of the political decision.

103/ Interventions in the field of education, health, nutrition and so on, though they have a positive effect on the beneficiaries, contain an important consumption element and have been classified among redistributive interventions or policies.

It is also possible that considerations of a temporary nature will arise, in the sense that a measure modifying the structure of ownership may not immediately comply with the economic requirements, but that the situation will evolve favourably over time.

This is a complex and politically very sensitive subject; for that reason the observations made in the paragraphs below refer to some economic criteria which must be borne in mind when considering the redistribution of existing assets and future increases in them as a means of advancement of the poorest groups of the population.

(a) Redistribution of existing assets

The redistribution of existing assets is the most direct route for increasing the assets of the poor, but also the one which involves most conflict.^{104/} This redistribution may take two forms. One is the direct transfer of assets to benefit poor families;^{105/} another is the socialization of assets through their transfer to the State or to a workers' collective.^{106/}

In general, in the industrial sector, redistributions of assets by means of direct transfers to poor families present serious difficulties because of the indivisibility of capital in this sector. Hence one of the most widely used mechanisms for redistributing ownership in the urban sector is the nationalization of industrial enterprises, through their transfer to the public sector, or the establishment of workers' enterprises with collective ownership of capital.

The nationalization of enterprises in the industrial sector or the establishment of workers' enterprises do not necessarily bring about a redistribution in favour of the poor groups. This will depend on the magnitude of the compensation received by the former owners, efficiency in the management of the nationalized or workers' enterprises - which will affect

^{104/} There is no doubt that the redistribution of existing assets encounters greater resistance in the affected groups than the redistribution of future increases in assets.

^{105/} Agrarian reform with individual allocations of land is a classical example of this form.

^{106/} Agrarian reform with the allocation of land to collectives or to the State, the nationalization of enterprises and the formation of workers' enterprises are classical examples of this form.

the amount of surplus generated by these enterprises - and the purposes for which the State or the workers use the surpluses generated.^{107/}

In the case of nationalized enterprises, the magnitude of the net transfer at the moment of nationalization depends on the appraised value of assets (commercial value, book value and so on), the amount of the compensation compared with the appraised value and the terms on which the compensation is paid (including periods of time, rates of interest and so on). Obviously, both the decision to pay compensation and the amount and terms of such compensation will depend on largely political considerations.

Determining levels of efficiency in the management of nationalized enterprises and the real magnitude of the surpluses they generate is an area of controversy, both because of the value judgements involved and because of the insufficient empirical information available. There are various reasons for which the efficiency of public enterprises, measured in traditional financial terms, may not reflect the true degree of efficiency of the enterprise. These factors are closely related to the redistributive effect of nationalized enterprises. In other words, the fact that, according to empirical studies, many State enterprises in developing countries show a tendency towards deficit ^{108/} or insufficient surpluses does not necessarily mean that they are inefficient. The deficit or smaller surplus may be partially or totally due to the fact that the public enterprises undertake activities not carried out by the private sector because they are not very economic, but which play an important social role that is not reflected in the monetary income received by the enterprise.^{109/} The deficit or smaller surplus may also be partially or totally due to the fact that the public enterprises subsidize those who purchase the goods they produce or the users

^{107/} For a formal model which incorporates the principal parameters which determine the redistributive effect of nationalizations, see J. Cauas and M. Selowsky, "Potential distributive effects of nationalization policies: The economic aspects". Working document No. 178, World Bank, 1974.

^{108/} See, for example, A. Gantt and G. Dutto, "Financial performance of government owned corporations in less developed countries", IMF Staff Papers, vol. XV, 1968.

^{109/} In this regard see L. Whitehead, "Public sector activities" in K. Griffin (ed.) Financing Development in Latin America, MacMillan, 1971, and A. Nove, Efficiency Criteria for Nationalized Industries, Allen and Unwin, 1973.

of their services, by selling them at prices below production costs; or they may subsidize the sellers of their inputs by paying them prices which are higher than the equilibrium prices. In such cases the nationalization of enterprises involves a redistribution of income in favour of the buyers or users of the goods and services they produce or those who supply them with inputs.

Finally, the deficit or smaller surplus may also be totally or partially due to the fact that the nationalized enterprises pay their workers more than the equilibrium wage, or that they engage more workers than would be ideal from the point of view of maximizing the surplus. In such cases the nationalization of enterprises implies a redistribution in favour of those workers initially working in them, or unemployed workers, own-account workers or workers in less favoured sectors who join the nationalized enterprises because of the greater use such enterprises make of the labour force.

None of the redistributive mechanisms of the nationalized enterprises mentioned above necessarily involves a redistribution in favour of the poorest groups. Because of the nature of the goods and services they produce and the occupational structure characteristic of them, it is probable that it will be the middle-level groups which benefit most from these redistributive mechanisms.

Finally, the redistributive effect of the nationalization of enterprises also depends on the use made of the surpluses and the form in which the deficits they generate are financed.

If there are surpluses, they do not in their entirety constitute additional resources. Firstly, the enterprises affected used to pay taxes before nationalization, so that the increase in resources available to the State is equivalent to the profits of the enterprises less the payment of compensation and less the taxes they previously paid. In addition, it is possible that the policy of nationalizing enterprises will have repercussions on the behaviour of the private sector as regards levels of output, investment, and so on, thus affecting tax revenues. If there is a deficit, the redistributive effect of the nationalization will also depend on the

impact of taxes (including the inflation tax) which are necessary to finance the deficit.110/

In short, if it is wished to make use of nationalization as a means of improving the situation of the poorest groups, it is necessary, firstly, for the nationalized enterprises to generate surpluses, and, secondly, for the State to appropriate the surpluses and allocate them directly to benefit the poorest groups.

In the rural sector, agrarian reform is the principal mechanism for redistributing assets. Moreover, in view of the high concentration of the structure of ownership of land in Latin America,111/ and in view of the emphasis on rural development which is essential for any strategy for the eradication of poverty,112/ changes in the structure of land ownership are in many countries essential requirements to ensure that the benefits of rural development policies reach the great mass of the rural poor and not only the present owners of land.

There are various options of agrarian reform depending on the means adopted to allocate the land transferred.113/

The land transferred may be allocated on an individual basis to the beneficiary families; on a collective basis, by transferring the land to the State or to a workers' collective;114/ or by a combination of both forms,

110/ Concerning the effects of the nationalization processes in Chile and Peru, see the empirical studies of A. Foxley, E. Aninat, G. Arellano, "Redistribución del patrimonio y erradicación de la pobreza", Estudios CIEPLAN N° 3, Santiago, Chile, 1976; A. Figueroa, "El impacto de las reformas actuales sobre la distribución de los ingresos en el Perú", in A. Foxley (ed.) Distribución del ingreso.

111/ In this regard see S. Eckstein, G. Donald, D. Horton and T. Carrol, "Land reform in Latin America: Bolivia, Chile, Mexico, Peru and Venezuela", World Bank Staff Working Paper N° 275, 1978; and S. Huntington, Political order in changing societies, Yale University Press, 1968.

112/ About 60% of the poor in Latin America live in rural areas.

113/ In this regard see M. Lipton, "Towards a theory of land reform" in D. Lehman (ed.) Agrarian Reform and Agrarian Reformism, Faber and Faber, London, 1974.

114/ The first form was that adopted by the agrarian reform in countries such as Bolivia and Venezuela. The second form was adopted in others, such as Mexico, Peru and Cuba. Collective ownership may be accompanied by the individual allocation of land for the purposes of working, as is the case for the majority of Mexican ejidos.

/through allocation

through allocation on a collective basis for a transitional period and, later, on an individual basis;115/ or, finally, through the coexistence of family farms and collective farms.116/

There are many factors which must be taken into account in determining the best method of agrarian reform. Mention should be made of the ideological and political factors relating to the existing structure or advocated by the government for the remaining sectors of the economy. Secondly, another influence is the characteristics of the sector which is to be reformed, and the type of ownership under which the peasants which it is hoped to favour have worked and the levels of skills reached by them.

The experience of countries such as Mexico and Bolivia shows that, when the reformed sector is initially made up of large farms based on traditional technology using a large quantity of labour, and where there exist tenant farmers and small landowners who are familiar with the various aspects of agricultural work, the subdivision of land into small plots and subsequent allocation on an individual basis has made it possible to increase not only the incomes of the beneficiary families, but also agricultural output. Nevertheless, this type of reform means that a wide group of the rural population is left aside from the direct benefits of the process.117/ The way in which this type of reform affects the peasants who remain landless is unclear, and largely depends on the effect it has on demand for the labour offered by these peasants. If this effect is negative, it is possible that this type of reform will worsen instead of improving the distribution of income in the agricultural sector.118/

115/ The settlements under the Chilean agrarian reform constitute an example of this mixed form. In this regard see A. Foxley, E. Aninat and G. Arellano: "Distribución del patrimonio y erradicación de la pobreza", Estudios CIEPLAN, op. cit.

116/ The agrarian reforms in the countries of Eastern Europe are examples of this form.

117/ The minimum area of land allocated which will maintain a family fluctuates between 30 and 40 hectares, which in Mexico and Bolivia has meant that between half and two-thirds of the rural population has been excluded from the direct benefits of the agrarian reform. See S. Eckstein et al., op. cit.

118/ In this regard see A. Berry, "Land reform and agricultural income distribution", Pakistan Development Review 11, N° 1, 1971.

In general, it is known from experience that small farms absorb more labour and have higher output per unit area than large farms.^{119/} Consequently, the subdivision of the land increases the demand for labour, and the beneficiaries of the greater generation of employment are, firstly, the families which receive the land, and only secondly the landless peasants, whose numbers tend to rise over time because of the rapid growth in the rural population.

The situation is different when the sector which it is sought to reform is made up of large agricultural, forestry or livestock enterprises, based on modern, highly capital-intensive technologies and benefiting from substantial economies of scale. The subdivision of this type of enterprise into small units can have a considerable adverse effect on output from the sector, and on the distribution of income. In such cases, agrarian reform, instead of attempting to subdivide these enterprises and subsequently to assign them on an individual basis to the beneficiary families, should aim at forming production co-operatives or workers' enterprises based on collective land ownership. In such enterprises each worker would receive a wage and a share in the surplus. With the application of these arrangements, continued benefit would be drawn from the economies of scale, the senior skilled staff would be retained and better marketing conditions and access to credit would be achieved.^{120/}

In order to prevent agricultural output from being affected by agrarian reform - particularly the method of subdividing the land and allocating it on an individual basis - it is important that the State, at least on a transitional basis, should either directly or indirectly provide training and advisory services, improve the marketing of the inputs and products and facilitate access to credit for the new owners.^{121/}

^{119/} In this regard see P. Dorner, Land Reform and Economic Development, Penguin, 1972, and W. Cline, Economic Consequences of a Land Reform in Brazil, North-Holland, 1970.

^{120/} In this regard see S. Barraclough, "Alternative land tenure system resulting from agrarian reform in Latin America", Land Economics, vol. XLVI, 1970.

^{121/} In this regard see C. Bell and J. Duloy, "Rural target groups", in Redistribution with Growth, World Bank, 1974.

When the social viability of the agrarian reform is being assessed, account should be taken of the costs associated with these tasks.

(b) Reorientation of public investment.

Another form of ensuring a dynamic distribution of assets involves reorienting public investment, using it as means to raise the number and productivity of the assets possessed by the poor groups. As in the redistribution of existing assets, and subject to the same advantages and limitations, public investment can be used as an instrument for gradual socialization, increasing the total assets owned by the State or by a workers' collective; or it can also serve as an instrument for directly increasing the number and productivity of the assets of the poor. In this case it will be necessary to identify investment projects which are viable and at the same time concentrate their benefits on the poor groups, reducing to a minimum leakages to the remainder of the community.

In urban areas, public investment may be used to provide own-account workers and small entrepreneurs, either free or in a subsidized manner, with working tools, technical and commercial advice, credit, and so on. This can be done individually or collectively through the producers' co-operatives or workers' enterprises in existence, or through the creation by the State of so-called industrial workshops. Such workshops would possess tools, machinery, equipment and skilled technical staff, thus enabling them to carry out the dual task of hiring out the tools, machinery and equipment to the selected workers and at the same time training and providing assistance in the technical and commercial fields.

In the rural areas, investment can be channelled to the construction of infrastructure, such as roads and irrigation projects, or its improvement; to the free or subsidized provision of tools, machinery and agricultural inputs; and to the improvement of marketing channels and access to credit, and so on. The impact of this type of investment on poverty will depend on its economic return and on the percentage of the rural poor who own land. The wide geographical dispersal of poor rural families, and the fact that landless families make up more than two-thirds of all rural poor families in Latin America, seriously limit the effectiveness of this instrument. In addition, these two factors clearly show that in order to ensure that the reorientation of investment benefits a broad group of the rural poor, it must in many such countries be complemented by land redistribution.

/B. REDISTRIBUTIVE

B. REDISTRIBUTIVE INTERVENTIONS AND POLICIES

Interventions and policies of this type are basically linked with the tax burden and the distribution of the benefits of public expenditure - particularly what is known as social expenditure and expenditure related to social security - among the various groups of the population.

Certainly there also exist other interventions and policies with redistributive effects which are available to the public sector. The most widely used in Latin America have been price policy, including exchange and tariff policies, and employment and wage policy.

1. The tax burden

According to the empirical studies carried out on the impact of taxes in Latin America, the national tax systems are generally not progressive.^{122/} Taxes in themselves do not help to improve the situation of the poor groups (at least they should not worsen it) but, in contrast, represent the principal source of financing of expenditure and transfers by the public sector, which make up the main government instruments for the eradication of poverty. Although the studies do not tackle the question of determining the optimum degree of progressivity in the tax system,^{123/}

^{122/} See, for example, Estudio sobre política fiscal en Argentina, Consejo Nacional de Desarrollo, 1967; L. Bobrowski y S. Goldberg, "Presión tributaria por niveles de ingreso: un análisis comparativo", Finanzas Públicas: Segundas jornadas, Córdoba, 1970; C. Mc Lure "Patterns of Bolivian tax incidence", in Fiscal Reform in Bolivia, Harvard University, 1977; H. Aaron, "Estimates of the distributional impact of Brazilian taxes and expenditures", Council for International Progress in Management. United States, 1968; G. Sahota, "The distribution of tax burden in Brazil" (mimeo), 1968; C. Mc Lure, "The incidence of taxation in Colombia", in Fiscal Reform for Colombia, Harvard University, 1971; M. Urrutia y C. Sandoval, "Política fiscal y distribución del ingreso en Colombia", in A. Foxley (ed.), Distribución del ingreso, 1974; R. Webb, "Tax policy and incidence of taxation in Peru", Woodrow Wilson School of Public and International Affairs, Discussion Paper N° 27, Princeton University, 1972.

^{123/} An exception is the work by G. Sahota, "The distribution of tax burden in Brazil" (mimeo), 1968.

they all agree that the present degree of progressivity is insufficient. There is even evidence that in some countries it is decreasing over time.^{124/}

There are many areas in which the State can intervene to increase the degree of progressivity of taxation, so as to secure the additional resources required to finance the greater expenditure it must incur in embarking on the application of a strategy to eradicate poverty.

The extension of direct taxation on income to sectors which at present evade it (enterprises and individuals), and the revision of the rates of this taxation, are areas of intervention which are promising, though not free of difficulties, if it is wished to increase the progressivity of the taxation system as a whole.

The introduction of taxes on wealth and on property, including death duties, represents another field of intervention by the government to increase the progressivity of the tax system. In view of the high degree of concentration of ownership, and the low or non-existent taxation to which property is subject in most Latin American countries,^{125/} the introduction of taxes on wealth (immovable property, land, physical assets, financial assets and so on) is an instrument of great potential for that purpose.^{126/} There is no doubt that there are serious administrative and operational obstacles to the effective application of this type of tax; nevertheless, the fact that the range of existing assets is small, and their high degree of concentration, facilitates the introduction and verification of taxation on wealth which is not of general application, but affects only a small proportion of the population. In this regard, wealth taxes can be regarded

^{124/} See the empirical studies on the impact of taxation in Argentina cited above.

^{125/} Taxes on property represent only between 2 and 5% of total tax revenue in the various countries of the region. See R. Chelliah, "Trends in taxation in developing countries", IMF Staff Papers, No 18, 1971.

^{126/} In this regard, see J. Linn, "The incidence of property taxation in developing countries: a theoretical and empirical analysis applied to Colombia", World Bank Staff Working Paper No. 264, 1977.

as a complement to income taxes, with the dual objective of improving supervision of the latter and increasing the general progressivity of the tax system. Other aspects which should be taken into account when considering the introduction of more progressive direct taxes are related to the adverse effect they may have on the rate of saving and investment and on the supply of labour by the groups affected, and the flight of capital which they may cause.

Even if greater emphasis is placed on direct taxes, indirect taxes will continue to be the principal source of finance for the public sector. There has been a trend towards a constant increase in the relative importance of indirect taxes, and at present they make up more than 60% of total taxes in the various countries of the region.^{127/} Accordingly, the degree of progressivity in indirect taxes is of great importance in determining the degree of progressivity of the system as a whole. In most Latin American countries the structure of indirect taxes is regressive because it has been formed in an unco-ordinated manner, in response to the authorities' needs for additional income. Systematic reform of the structure of indirect taxes, with a view to making them genuinely distributive, is an important field of intervention by the State. In this regard, the assumption that the ideal structure of indirect taxes is that which, because it does not introduce distortions in relative prices, applies to all groups at the same rate, is not necessarily correct, because it does not take into account the distributive aspects. The introduction of distributive considerations in determining the ideal structure of direct taxes leads to the conclusion that such taxes need not necessarily be the same for various goods, but rather should be greater as income elasticity (luxury groups) is greater and lower as price elasticity is lower.^{128/} It is important to recognize that the redistributive effect of a given structure of indirect taxes depends not only on the relationship prevailing between the rate of the tax and the question of whether the good or service taxed has luxury or basic status, but also on

^{127/} See R. Chelliah, op.cit.

^{128/} In this regard see R. Musgrave and P. Musgrave, Public Finance in Theory and Practice, Mc Graw-Hill, 1973.

the characteristics of the process of production. The imposition of a tax reduces the price received by the producer, and accordingly alters the prices of and demand for factors, thus affecting the distribution of income. As a result, other things being equal, the greater the intensity with which the output of a good uses the factors possessed by the poor (unskilled labour), the lower will be the ideal tax rate.

Nevertheless, it is necessary to bear in mind that the use of indirect taxes differentiated by the type of good as a mechanism for redistributing income is justified only in so far as there exist factors which prevent the mechanisms based on direct taxes from fulfilling this function satisfactorily. This practice suffers from two major defects. Firstly, differentiated indirect taxes tend to introduce greater distortions in the allocation of resources and in the structure of consumption than direct taxes;^{129/} secondly, this redistributive machinery lacks selectivity in the sense that it does not make it possible to liberate the poor groups from the tax burden.

2. Public expenditure as an instrument for overcoming extreme poverty

As has already been mentioned, public expenditure is the most important governmental instrument to combat poverty. It can be used to increase the income levels of the poor groups, or to provide these groups directly or indirectly with certain goods and services which are regarded as basic.

(a) Public expenditure as an instrument for redistributing monetary incomes

The instruments for redistributing monetary incomes most widely used in the countries of the region are statutory readjustments of remuneration, the fixing of minimum wages and the payment of family allowances.

Previous sections analysed the drawbacks and limitations of the use of wage policies as an instrument for redistributing income in favour of the poor groups. These are related to their possible negative effects on

^{129/} This assertion is correct in so far as the supply of labour is inelastic, and is false when the supply of labour is elastic. See in this regard I. Little, "Direct vs indirect taxes", Readings in Welfare Economics.

unemployment, and the poor coverage of such instruments, which means that the poor groups are practically excluded from their benefits.^{130/}

In view of the present coverage of social security machinery in the countries of Latin America,^{131/} family allowances as a redistributive instrument also suffer from the drawback of excluding a high proportion of the poor groups from their benefits.

In the light of these considerations, it may be concluded that if a mechanism for the redistribution of monetary income is to contribute efficiently to alleviating poverty, it must not only not raise the cost of employing labour to levels which artificially limit the demand for labour, but in addition must meet at least three conditions. Firstly, its coverage must extend to the poor groups; secondly, the criterion used to determine the beneficiaries of the transfers must be based on the degree of poverty of the families, or on another variable correlated to the maximum with this one; and thirdly, the machinery for the redistribution of incomes must not discourage work or encourage idleness. To these conditions must be added simplicity in operation and efficiency in terms of administrative costs. At present, neither the wage mechanism nor the family allowance mechanism meets these conditions, since both cover only a third of the labour force and tend to exclude the poor groups.

One possibility in this regard is to use the family allowance machinery in the social security systems, and to broaden its coverage to the entire population, including wage earners in the non-traditional sectors, agricultural workers, own-account workers, the unemployed, and so on. Two possibilities arise: the first is that redistribution by means of family allowances should be limited exclusively to guaranteeing all families a minimum family income. To this end it is necessary to lay down a minimum standard family income, by adding up the minimum incomes attributed to each member of the family,

^{130/} Only about 30% of the urban labour force belongs to the modern sectors where these mechanisms operate. See R. Webb, "Wage policy and income distribution in developing countries", Princeton Brookings Income Distribution Study, 1974.

^{131/} In 1970 only about 30% of the economically active population of Latin America was covered by the social security systems. See "Indicadores del desarrollo económico y social de América Latina", Cuadernos Estadísticos de la CEPAL.

which are calculated on the basis of characteristics such as age, sex and so on. Every family whose total income was lower than the minimum family income previously established would receive from the State a subsidy equivalent to the difference between the minimum family income and the actual family income. The second possibility is to pay family allowances identical in absolute terms to all families, regardless of their level of income or up to a maximum level of income. In relative terms, these transfers would be progressive, although to a lesser extent than in the above case, and would have the administrative and operational advantage of not involving the difficult task of identifying the poor families which should receive this benefit.^{132/} No doubt many combinations of these two possibilities exist. The arrangement adopted will depend, among other factors, on administrative and operational considerations, the availability of resources and the size of the social groups which it is wished to benefit with the redistributive policies.

(b) Public expenditure as an instrument for the direct provision of goods and services to the poor groups: the basic needs approach

The redistributive action of the State can be effected not only by increasing the incomes of the poor groups, leaving it to them to establish their structure of consumption, but also by means of the free or subsidized public provision of collectively consumed goods and services and individual consumer goods. These latter two mechanisms have been the most widely used in Latin America.

There are two principal arguments in favour of the use of machinery for the direct provision of goods, and not merely of increases in income with the final use left to the consumer. Firstly, in view of the degree of poverty and poor education which are by definition a characteristic of the families which it is aimed to benefit, and in view of the high degree of complementarity of the benefits which characterize the consumption of essential goods at low levels of consumption,^{133/} it is highly likely that decisions

^{132/} One way of increasing the progressivity of this transfer arrangement would be to include family allowances in taxable income.

^{133/} For example, a higher degree of education may have a substantial positive effect on health, even if health inputs proper are not increased.

regarding the structure of consumption in these families will be very different from those they would take if they enjoyed better objective conditions of information, education and so on. This applies particularly in relation to the allocation of consumption of food within the family. The tendency to give preference to feeding adults at the expense of children would probably change if poor families became aware of the irreversible physical and intellectual damage malnutrition in the first months of life may cause in them.^{134/} The second argument relates to the characteristics of supply of certain basic goods and services. Some of them, for technological and institutional reasons, can be provided only by the public sector,^{135/} and accordingly the increases in incomes are not reflected in increases in consumption of these basic goods and services. For these two reasons, which are of greater relative importance the higher the degree of poverty, redistributive action by the State in favour of the poor groups must combine the redistribution of income with the redistribution of consumption. This does not mean that the pattern of consumption by these groups should be imposed entirely by the State, but it does justify interventions by the State designed to increase selectively consumption of certain basic goods and services by the poor groups, such as education, health, nutrition, housing, electricity, drinking water and sewerage. The central problem lies in finding instruments of redistribution which are administratively viable, efficient from the cost viewpoint and selective as regards the beneficiary groups or individuals.

Below appear a number of considerations of a general nature concerning the four traditional basic sectors: nutrition, health, education and housing.

(i) Nutrition. In Latin America two main factors have a strong influence on the State's policies and interventions in the field of nutrition: on the one hand, the high percentage of children in the total number of persons suffering from some degree of malnutrition, and on the other the small size of the calorie deficit when measured overall, comparing Latin America's

^{134/} In this regard see M. Selowsky, "The economic dimension of malnutrition of young children", World Bank, 1978.

^{135/} Examples are services providing drinking water, sewerage, electricity, health, education and so on.

average needs and availabilities. Of the approximately 112 million persons with calorie deficiencies, 52 million are children aged 9 or less. Malnutrition affects 55% of children and only 27% of adults. Moreover, the calorie deficit represents only 2.9% of total consumption of cereals. It is clear from this that, considered as a whole, the problem of malnutrition in Latin America basically affects children and arises from the unequal distribution of income and not from insufficient availability of foodstuffs. As one writer put it well, the problem of malnutrition is a problem of poverty and not one of a shortage of food.^{136/}

The economic justifications for State intervention in this field have been classified into three groups:^{137/} those based on the status of nutrition as a public good and its positive features; those based on the future savings of resources channelled to the health, education and other sectors as a result of better nutrition; and, finally, those based on the qualitative changes in human resources produced by better nutrition. The three above justifications have greatest force in the case of children.^{138/}

This section will analyse areas of intervention rather than elaborating on the justifications. One essential aspect which must be elucidated is the extent to which the fight against malnutrition can be based on increases in the incomes of the affected groups, and how far specific programmes or interventions are required. Without ignoring the positive repercussions that a rise in incomes has on malnutrition, both because of the direct effect of the marginal propensity to spend on food, and because of the improvement in health and education this increase brings with it, there is no doubt that

^{136/} See S. Reutlinger, "A poverty or a food problem", World Development, Vol. 5, 1977.

^{137/} Undoubtedly, as with any intervention to reduce poverty, the main justification is of an ethical, and not an economic nature. Nevertheless, the economic arguments make a substantial contribution to promoting the consensus and generating the political will whereby the State intervenes.

^{138/} In this regard see "The economic dimensions of malnutrition in young children", World Bank Staff Working Paper No. 294, 1978.

the extreme urgency of the problem makes direct intervention by the State essential.^{139/}

These direct interventions to increase calorie consumption include general measures such as subsidies for the production or import of foodstuffs, taxes and bans on the export of foodstuffs and specific measures aimed at focal groups such as food stamp programmes, special shops, the distribution of food to selected households and specific programmes for poor children and nursing or pregnant mothers.^{140/ 141/} In order to ensure benefits to poor children, subsidies must be provided in the first type of intervention to all consumers, whether they are rich, poor, children or adults, with substantial leakages occurring as a result. These may be reduced if the subsidies are concentrated on foodstuffs consumed by the poor and by children. The second type of programme gives rise to fewer leakages, but can be administratively very costly. The relative efficiency of the programmes, both general and specific, depends in the final analysis on a series of characteristics and variables which must be evaluated for each country. They include calorie consumption/income elasticity, cases of replacement of one foodstuff by another caused by the various interventions, the quantity of foodstuffs provided by the specific programmes in relation to existing consumption before their commencement, the administrative and institutional characteristics of the State and the economy in general.^{142/}

^{139/} This is particularly true if it is remembered that the process of urbanization, by incorporating women in the labour force and reducing breast feeding, introducing new needs (transport, clothing, and so on) and offering new goods, especially for adults (entertainment, fashion and so on), can adversely affect the nutritional status of children.

^{140/} Interventions designed to increase the nutritional value of specific foods (milk, bread, salt and so on) also fall into this category.

^{141/} For an analysis of current experience in this field in various developing countries, see S. Maxweel, "Food aid and supplementary feeding: impact and policy implications", IDS, Sussex University, 1977.

^{142/} For a systematic analysis of the factors influencing the efficiency of the two types of intervention, see S. Reutlinger and M. Selowsky, Malnutrition and Poverty: Magnitudes and Policy Options, World Bank Occasional Paper No. 23, 1976 and M. Selowsky, The economic dimensions of malnutrition in young children, World Bank Staff Working Paper No. 294, 1978.

/Finally, interventions

Finally, interventions designed to improve health, education, water supply and personal hygiene can have an important effect on nutrition, by reducing the harm done by gastro-intestinal diseases. In addition, the increase in popular awareness of the nutritional and affective needs of the various members of the family, particularly children, can also have important positive effects on the nutritional status of this group.^{143/}

(ii) Health. Although the increase in average life expectancy and the reduction in the incidence of specific diseases indicate an improvement in the average state of health in Latin America, there is no doubt that poor health continues to be an important problem, particularly for the poor groups. The principal causes of the health problem are precisely the extent and severity of poverty in the region, and its consequences - high fertility rates, malnutrition, overcrowding, the absence of drinking water and sewerage, and unhealthy housing and life in general. All these factors act upon one another, and hinder action designed to improve levels of health in isolation.^{144/} But this does not mean that the State should refrain from intervening in a specific manner in the health field or subordinate the solution of this problem to the elimination of poverty. On the contrary, the State must and in fact does intervene directly in this field in all the countries of the region. The economic justification for this action is equivalent to that mentioned with regard to nutrition, and, accordingly, no reference will be made to it in this section, which instead will concentrate on analysing policies and interventions in this field.

There is a degree of consensus that the size and structure of the health sector in the developing countries are inadequate for reasonably meeting the needs of the population. This is partly due to the fact that the health systems in many of these countries have followed the model of some industrialized countries, based on highly specialized medical staff,

^{143/} Some empirical studies carried out in the medical field have confirmed the positive relationship prevailing between affective variables and the capacity to absorb and benefit from food.

^{144/} For a detailed analysis of the subject, see World Bank, Health. Sector Policy Paper, 1975.

are oriented towards curative medicine and are highly capital-intensive. Most of the limited government expenditure on health is channelled towards maintaining expensive and well equipped hospitals, attended by highly trained medical staff.^{145/} Expenditure on health services basically covers curative treatment of an occasional nature. There is a tendency to ignore preventive measures and early diagnoses, and the health services are turned to only when crises arise. The result has been that in most of the countries only a small proportion of the population is served by the public health services, and those most affected by this exclusion are the rural groups and the urban poor.^{146/} In short, the health policies prevailing in many of these countries are not only ineffective but also unfair.

From this background it is clear that State intervention in this field should be directed towards creating a health system which places greater emphasis on preventive medicine and environmental conditions. This would lead to greater use of paramedical personnel, greater participation by the community and better geographical distribution of the health services, all of which would make it possible to extend such services to the rural areas and poor groups.

An interesting example in this regard is the plan for the rural sector being carried out in Brazil.^{147/} The plan is based on the premise that a large proportion of health problems can be prevented or treated successfully in the community itself, without the need to resort to costly hospitalization in urban sectors, and that preventive medicine services and simple curative

^{145/} On average, 50% of the health budget is earmarked for the operation of a few teaching hospitals, 20% for the operation of district or regional hospitals and clinics equipped with beds and only 10% for basic health services. See World Bank, World Development Report 1978.

^{146/} The concentration of medical, human and material resources in urban areas has been analysed in various empirical studies. See, for example, R. Beltrán, "El problema de la salud en el Perú" in Socialismo y participación, No. 2, 1978; Agency for International Development (AID), "Colombia health sector analysis", USAID Report 1974; A. Ugalde and R. Emery, "Political and organizational issues in assessing health and nutrition interventions", paper presented to the Conference on Measurement of the Impact of Nutrition and Health Programmes in Latin America, Panama, 1977.

^{147/} PIASS Plan.

medicine services should be integrated with more complex services by means of a pyramid-shaped administrative and institutional structure.^{148/} The plan proposes a system based on three levels of increasing complexity. The first level is composed of health units in small rural communities administered by local health auxiliaries. The main function of these units is to treat infectious diseases and detect more complex diseases. A second level is made up of health centres, which cover three units and have a nurse, an auxiliary and periodic visits from a hospital doctor. The function of these centres is to provide all health services which do not require hospitalization. The third level is made up of regional hospitals which cover four health centres and also the urban population.

Finally, the provision of drinking water and sewerage by the State can be an important instrument of intervention in improving the state of health of the population, particularly in the poor sectors, almost all of which have no access to such services.^{149/} It is vitally important to seek design and technological standards which make it possible to expand these services at low unit costs.^{150/}

(iii) Education. Education is one of the most effective fields of public intervention for the eradication of poverty. Various factors justify this assertion. Firstly, this is a sector in which action by the State is warmly welcomed, and in which political restrictions to greater participation are minimal. Secondly, despite the marked expansion in educational systems in the Latin American countries in the past two decades, between half and two-thirds of the present cohorts of children do not complete the primary cycle, equivalent to six years of basic education. Thirdly, as was mentioned in the diagnosis,

^{148/} See in this regard P. Knight and D. Mahar, "Brazil human resources, special report", Annex III, Health and Nutrition, World Bank, 1978.

^{149/} In this regard see World Bank, Health Sector Policy Paper, 1975 and R. Saunders and J. Warford, Village Water Supply: Economics and Policy in the Developing World, Johns Hopkins University Press, Baltimore, 1976.

^{150/} One possibility is to install public water taps rather than private connexions.

the problem of insufficient education affects the poor first and foremost. The vast majority of heads of indigent and poor households are persons with three years of education or less. Fourthly, according to empirical studies, education in Latin America continues to be an effective tool for raising the levels of productivity and income of the poor groups. Evidence of this is provided by the high rates of return on investment in education in many of these countries.^{151/ 152/} Fifthly, education is a task which complements action by the State in other fields (nutrition and health), and which produces many positive results for the community.

In short, the central problem is not to determine whether education is desirable or not, but rather to specify the appropriate type of education and machinery to spread it to the entire population, including the poor groups.

The need to realign the education systems with the real needs of the countries, eliminating the serious discrepancies between abilities and skills which they produce, and with the genuine needs of the economy, has been a widely discussed issue in the region. The central idea is that a major objective of education and training systems must be to ensure that the groups which benefit from them participate more productively in the development process. In order to achieve this, the educational system must be adapted to the characteristics and needs of the economic structure within which its products will work. This realignment will involve profound curricular reform to eliminate the academic bias inherited from the educational systems of the developed countries, and to design each cycle in the educational system as a preparation for the subsequent cycle, placing greater emphasis on vocational and technical education and training, and giving primary and secondary

^{151/} In this regard, see G. Psacharopoulos, Returns to Education, Jossey-Bass, San Francisco, 1973.

^{152/} Some studies deny the efficacy of education as an instrument for increasing productivity and income, and maintain that it serves only to provide credentials or to act as a screen for securing good jobs (screening hypothesis). However, this pessimistic view concerning the role of education does not apply to the developing countries, since the research on which it is based was carried out in developed countries, where conditions in the labour markets are very different and where there is a relative abundance of skilled manpower.

education meaning and usefulness in themselves.^{153/ 154/} Such curricular reforms are of particular importance in the rural areas, both because of the greater gap between the content of traditional education and the needs of the rural economy, and because of the high percentage of pupils for whom the primary cycle, which is normally incomplete, represents the only formal education to which they have access. Ruralization of educational systems can introduce curricular changes to ensure that education is more functional in these areas; modify teaching methods; incorporate non-formal educational programmes ^{155/} and intensive literacy programmes; integrate education programmes with other development activities; and so on.

Although the educational systems have expanded considerably in recent decades, a high percentage of the new cohorts of children, particularly in the rural sectors, still do not succeed in completing the cycle of primary education. In this regard, action by the State should modify the tendency observed in recent decades to concentrate a major part of the increase in expenditure on education in the urban sectors, with special emphasis on higher education. The State should direct its action, with priority to primary education, especially to the rural areas, in order not only to expand it in numbers, but also to bring its quality into line in the two areas.^{156/}

^{153/} This point is of great importance since in the countries of Latin America with per capita incomes of less than US\$ 400, only one in every eight children who enter the primary education cycle will succeed in reaching the cycle of secondary education. In the countries with higher incomes this proportion rises only to one in four schoolchildren. See S. Piñera, "The economics of education in developing countries", doctorate thesis, Department of Economics, Harvard University.

^{154/} For a fuller discussion of the directions which should be considered in curricular reforms, see World Bank, "Education: Sector working paper", 1974.

^{155/} In this regard see P. Coombs and A. Manzoor, Attacking Rural Poverty: How non Formal Education Can Help, The Johns Hopkins University Press, Baltimore, 1974.

^{156/} Primary teachers in the most backward rural areas tend to have insufficient skills for their tasks. For example, in the north-east of Brazil, 77% of primary teachers had received only primary education, and 31% had not completed primary education. See I. Tecalla, "Brazil education sector memorandum", World Bank.

An important source of finance for improving the quantity and quality of primary education can be obtained through the elimination, with due gradualness, of all or part of the subsidy currently provided by the State for university education.^{157/} In this regard, for reasons both of equity and of efficiency, the free or subsidized system of education should be replaced by another system financed by the pupils and complemented with a mechanism of scholarships or loans to permit pupils with meagre resources to have access to higher education. Finally, it is important to recognize that low school enrolment among poor children is due both to causes affecting demand for education by these groups and to the lack or shortage of schools. The former causes include low levels of parental education and the direct and opportunity costs of the educational process. As a result, the State must take special care to increase incentives for poor children to enter and remain in the educational systems. Free breakfasts and lunches in selected schools, the free provision of school texts, food, medical attention, transport, clothing and so on are some of the instruments which might be used selectively for this purpose.^{158/}

(iv) Housing. Many factors should be taken into account, in formulating a housing policy oriented towards the poor groups. They include the characteristics and rate of growth of the locality, the availability and cost of transport services, the location of sources of work for the poor groups, the costs of land and the provision of urban and basic services, levels of income and sources of finance of the poor groups and, finally, the size and quality standards of public housing.

Concerning the latter points, there is a widespread tendency in the countries of the region to establish quality standards for public housing which are incompatible with income levels of the poor groups whom it is intended to benefit, and with the amount of the total subsidy which the State provides for the housing sector. In this way the value of the cheapest public housing

^{157/} Public expenditure on higher education in Latin America averages more than half of public expenditure on primary education.

^{158/} Food programmes have had a marked positive effect on assistance provided to rural schools in the State of Goias in Brazil (see Federal University of Goias-INEP-SEC-CNAE Project, 1976).

substantially exceeds the capacity of these groups to pay. As a result, the State subsidy contained in the allocation of housing which favours the poor groups attains high unit values, so that only a very small proportion of the families with housing problems benefit. A recent study indicates that in Bogota and Mexico City the cheapest available house is beyond the means of 47 and 55% of the inhabitants of those cities, respectively.^{159/} These percentages fall to less than a quarter and a tenth, respectively, when the cost of low-cost housing is lessened through reductions in standards. standards.^{160/} In short, there is a clear conflict between the quality of public housing and the percentage of the poor groups who can have access to it, and this leads to the dilemma of whether to give a lot to a few or little to many. However, the costs can be lessened by reducing the size and quality standards of the dwellings and plots, by means of the shared use of certain basic services, use of labour from the beneficiary groups themselves, the widespread introduction of low-cost technologies, and so on.

There are other ways of widening the coverage of State action in this field so as to benefit a larger number of poor families. One way is to provide sites with basic services of access, water, drainage, sewerage and electricity, leaving the construction of the dwelling in the hands of the beneficiary groups; another would be not to build new housing, but to improve existing marginal settlements, by providing basic services of water, sewerage, electricity and drainage, and also improving the dwelling itself (roofing, waterproofing, extensions and so on).

The approach of seeking final, high-quality solutions to the housing problem of the poor groups, together with insufficient allocation of public funds for this purpose, inevitably leads to the exclusion of the vast majority of these groups from the benefits of State action.

In view of their cultural, social and economic characteristics, the poor groups do not normally have access to formal savings and borrowing markets. As a result, it is the responsibility of the State to set up the institutions

^{159/} See O. Grimes, Housing for low income urban families, Johns Hopkins University Press, 1976.

^{160/} Wee World Bank, Housing: sector policy paper, 1975.

and machinery required to channel the savings of these groups and to grant to them credit, which, together with previous savings and State subsidies, will enable them to finance the purchase of their dwellings.

C. FINAL CONSIDERATIONS

It is clear from the analysis in the preceding sections that, under a mixed economy - the system in most Latin American countries - there are many areas of intervention and many policies and instruments which governments could use in order to reduce or eradicate poverty.

In view of the present extent of poverty in most of these countries, its eradication cannot be conceived as an isolated objective, but as part of the wider problem of income distribution, and as a priority objective. Accordingly, it is necessary to include in national development strategies policies which are aimed at altering the structure of ownership, by reducing the present extent of concentration, improving the operation of the economic system, enhancing efficiency in the allocation of resources, raising the growth rate in the economy and achieving greater correspondence between the structure of production and the availability of resources; and, finally, transfer policies designed to meet the most urgent needs of the poor groups. The relative importance which should be assigned to these three types of intervention will depend on political considerations and the specific characteristics of each country.

Under a development strategy which pursues various objectives, among which economic growth and the eradication of poverty may have priority, the possibility exists that conflicts will arise between them. The seriousness of this possible conflict depends more on the instruments selected to achieve the objectives than on the nature of the objectives themselves.

The fact that governments have an opportunity to alleviate the poverty situation substantially does not necessarily mean that they wish to do so or can do so. At present the social groups which receive most of the benefits of growth are the sectors which are best organized, those which have the greatest capacity to exert pressure and the greatest political power. A development strategy which gives preference to the poorest groups would reduce

/the share

the share of the currently favoured groups in the benefits of future growth, so that the introduction of this type of strategy would necessarily lead to conflict.

One way of helping to ensure greater awareness of the problem of poverty and of strengthening determination to tackle it is to promote an open debate on the magnitude and characteristics of poverty, to demonstrate the feasibility of solving it from the viewpoint of resources and to identify areas of intervention and policies and instruments which efficiently pursue this task without necessarily jeopardizing the objective of growth.

A fundamental requirement for success in a strategy to eradicate poverty is the effective organization and participation of the poor groups. This is due to two reasons - the exercise of such rights confers on the poor groups the political power which they lack today, and also facilitates the application of many of the policies and instruments analysed above and makes it possible for their benefits to be effectively enjoyed by these groups.

The eradication of poverty is a dynamic process. Accordingly, any action which actually improves the situation of the poor groups, however inadequate it may be, can contribute to creating favourable conditions for successive actions leading to a comprehensive solution of the problem of poverty.