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### Notes and explanation of symbols

*The following symbols are used in tables in the Review:*

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(...)	Three dots indicate that data are not available or are not separately reported.
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(—)	A dash indicates that the amount is nil or negligible.
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	A blank space in a table means that the item in question is not applicable.
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(-)	A minus sign indicates a deficit or decrease, unless otherwise specified.
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(.)	A point is used to indicate decimals.
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(/)	A slash indicates a crop year or fiscal year, e.g., 1970/1971.
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(-)	Use of a hyphen between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.
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References to "tons", mean metric tons, and to "dollars", United States dollars, unless otherwise stated. Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates. Individual figures and percentages in tables do not necessarily add up to the corresponding totals, because of rounding.

## Guidelines for contributors to *CEPAL Review*

The editorial board of the Review are always interested in encouraging the publication of articles which analyse the economic and social development of Latin America and the Caribbean. With this in mind, and in order to facilitate the presentation, consideration and publication of papers, they have prepared the following information and suggestions to serve as a guide to future contributors.

—The submission of an article assumes an undertaking by the author not to submit it simultaneously to other periodical publications.

—Papers should be submitted in Spanish, English, French or Portuguese. They will be translated into the appropriate language by ECLAC.

—Papers should not be longer than 10 000 words, including notes and bibliography, if applicable, but shorter articles will also be considered. The original text should preferably be submitted on diskette (Word Perfect format). Otherwise, two printed or typed copies should be provided.

—All contributions should be accompanied by a note clearly indicating the title of the paper, the name of the author, the institution he belongs to, and his address. Authors are also requested to send in a short summary of the article (no more than 300 words) giving a brief description of its subject matter and main conclusions.

—Footnotes should be kept to the minimum, as should the number of tables and figures, which should not duplicate information given in the text.

—Special attention should be paid to the bibliography, which should not be excessively long. All the necessary information must be correctly stated in each case (name of the author or authors, complete title (including any subtitle), publisher, city, month and year of publication and, in the case of a series, the title and corresponding volume number or part, etc.).

—The editorial board of the Review reserve the right to make any necessary revision or editorial changes required by the articles.

—Authors will receive a one-year courtesy subscription to the Review, plus 30 offprints of the article, both in Spanish and in English, at the time of publication in each language.

## CONTENTS

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<b>The State, the community and society in social development</b>	<b>7</b>
<i>Fernando Henrique Cardoso</i>	
<hr/>	
<b>Neo-liberal structural reforms in Latin America: the current situation</b>	<b>15</b>
<i>Joseph Ramos</i>	
<hr/>	
<b>Indebtedness and fiscal stability: Is history repeating itself?</b>	<b>41</b>
<i>Guillermo E. Perry</i>	
<hr/>	
<b>Reforms in the oil industry: the available options</b>	<b>51</b>
<i>Fernando Sánchez Albavera</i>	
<hr/>	
<b>Indigenous organizations: rising actors in Latin America</b>	<b>63</b>
<i>Rodolfo Stavenhagen</i>	
<hr/>	
<b>Non-agricultural rural employment in Central America</b>	<b>77</b>
<i>Jürgen Weller</i>	
<hr/>	
<b>Marginality and social integration in Uruguay</b>	<b>93</b>
<i>Ruben Kaztman</i>	
<hr/>	
<b>Trade policy within the context of the World Trade Organization</b>	<b>121</b>
<i>Diana Tussie</i>	
<hr/>	
<b>Trade and environment: green light or red light?</b>	<b>139</b>
<i>Helga Hoffmann</i>	
<hr/>	
<b>Nominal anchors and macroeconomic coordination options in MERCOSUR</b>	<b>153</b>
<i>Gonzalo Rodríguez Prada</i>	
<hr/>	
<b>Export promotion policies in Central America</b>	<b>173</b>
<i>Larry Willmore</i>	
<hr/>	
<b>Recent ECLAC publications</b>	<b>188</b>

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# The State, the community *and society in* social development

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**Fernando Henrique Cardoso**

*President of the Federative  
Republic of Brazil.*

The World Summit for Social Development, held in Copenhagen on 11 and 12 March 1995, brought up once more the ideals which gave rise to the United Nations at the San Francisco Conference and which have since been reasserted in many forums of the Organization. The maintenance of peace and security, although an irreplaceable element in the peaceful coexistence of nations, was not the only objective of that Conference, however: it also sought to lay the foundations for a form of coexistence which would make possible more harmonious development. The United Nations Charter which emerged from that meeting was the clear expression of a humanistic spirit and of the quest for democratic ideals and values which made human beings the centre of governments' concern.

At Copenhagen, it became clear that social problems and the quest for a form of development which respects the environment, has democratic bases, and leads to greater equity are not the exclusive concern of the under-developed or developing countries, but also of many developed nations. Perhaps there is a renewed

awareness that this is not just a question of a duality, as was claimed in the past, but of something inherent in the very heart of the development styles of present-day societies.

Consequently, it is once again important to give continuity to the drive for reflection and action generated at Copenhagen, and in view of its great experience in Latin America and the Caribbean, ECLAC is amply endowed to help the countries of the region to reflect on these issues with renewed creativity.

Although many of the efforts made in the region have been frustrated, sharing our experiences can help us to redirect our development policies in a direction consonant with our ideals, which continue—and should continue—to be those proclaimed ever since 1945: ideals seeking a more equitable form of development, inspired in democratic and humanistic values.

The ten commitments assumed at Copenhagen came at a timely but complex moment.

It was timely, because after a long period in which we had almost unconsciously come to think of development solely in terms of economic development or development of the market forces, the Copenhagen Summit reminded us once again of the links between the economic and social dimensions.

It would be almost pathetic to think that, at the very moment when the Berlin Wall had fallen and the efforts to construct "real Socialism" were suffering the

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□ Translation of the revised text of President Cardoso's address at the First Regional Follow-up Conference on the World Social Development Summit Meeting (São Paulo, 6-9 April 1997).

outcome we have all witnessed, we should all begin to place our hopes in a kind of unbridled economic approach and to believe that the market was the road to the salvation of mankind.

Copenhagen showed us once again that we must return to our examination of such questions as the eradication of poverty, full employment, social integration and respect for human dignity, as well as the need to put an end to the economic illusion and acknowledge once again that in a social and historical process values are of fundamental importance.

When I say that values are of fundamental importance, I am not suggesting that we should replace the economic illusion with simplistic idealism, imagining that values are all we need. Obviously, this is not so. Values are not enough on their own, even with the best of intentions. In reality, a stable economic base and a stable currency are essential conditions for development.

Consequently, it is not a question of changing one simplistic approach for another—equally simplistic, but diametrically opposed—which claims that organized political will can take the place of the material conditions of production or the limitations imposed by the physical base and the form of organization of production.

Subject to this reservation, however, there can be no doubt that the time has come to concern ourselves once again with issues which, it may be noted, have always been major issues for ECLAC and for those whose conception of development was one which offers greater well-being to the vast majority of the population.

Although the time may be ripe, however, it is nevertheless a complex matter to put forward once again, in the most determined manner, the question of the best type of development and the challenge of attaining equality: i.e., the challenge of tackling social issues. This is because this question reflects a sort of paradox.

Just as it would be paradoxical to replace a socialist model—although severely distorted—with a purely market-based idea, so also it would be paradoxical that, precisely when we are beginning to talk about social issues once again, we should have to ask the State to apply a set of policies and take a series of measures when in some respects the State is neither effective nor efficient.

When I say, however, that we are demanding more from the State—because political will is organ-

ized and it is through public policies that the imbalances created by the market can be corrected to some extent—at a time when the State is suffering from limitations, what I really mean is that I do not wish to resign myself to the continued existence of the limitations which prevent it from acting effectively.

It is quite true that the State has limitations. To begin with—and I am not saying anything new when I make this assertion—we can see for ourselves that the regulatory capacity of the State has been greatly reduced. In order to show this, we need only refer to capital flows, which are now a source of concern even for those who normally sleep very soundly, i.e., the Presidents of Central Banks. Even they are now concerned, because they are unable to control these capital flows. This challenge can no longer be tackled from the exclusive sphere of competence of the State machinery.

It is not just a question of international capital flows, however: the world system of production has also been completely reorganized in such a way that production is now interlinked at the global level, which also helps to reduce the capacity of States to meet some of the challenges they have to face.

There are not many alternatives to this interdependence. This revolution—not only technological but also organizational—represents a further challenge to those who consider that we need a set of public policies which will ensure a better balance in the development process.

This means that the population expect from the organized political will of the State and from society a set of measures which are however limited by the realities of the current situation, which reduce the State's capacity for action in areas which were considered in the past to be inherent in the notion of a sovereign nation-State.

The foregoing is not designed to over-emphasize the paradoxical aspects or give rise to a feeling of perplexity: a psychological reaction which serves no theoretical nor practical purpose. The real aim is to seek mechanisms which will make it possible to reform public structures so that they can meet the challenge faced.

Social justice and social development will be impossible if we resign ourselves to the weakening of the State, both for the above-mentioned reasons and because of the incapacity, in many cases due to bureaucratic causes, to take decisions to cope with the increase in social demands so closely associated with democratization.

Democratization and an increase in social demands make themselves felt most rapidly and strongly precisely in those countries which have opened up to democracy but suffer from the greatest inequalities, so that the State is under pressure from both external and internal forces.

A major challenge is therefore to reconstruct the way political action is organized and, above all, to redefine the organs responsible for public policies. In this redefinition, it is necessary to decide what to do and what not to do. This is the present situation: it is necessary to define what the government should do, what it can do, and the best way to reshape the government machinery so that it can take effective action.

This issue needs to be given strong emphasis in order to enable the State to recover the strength it needs to channel the desires of society and meet the aspirations for social welfare. In other words, it is necessary to "de-privatize" the State.

Paradoxically, many of the forces which could help this de-privatization absolutely worship the State in its present form—ignoring the fact that it is a product of the previous phase, when there were close links between private sectors and the State—and impede the changes which could make the State more democratic and turn it into an effective instrument for spreading social welfare and giving members of the population greater access to all that they need for their social integration.

In Latin America, there has never been a "Welfare State". On the contrary, what has prevailed has been what we might call an "Ill-fare State": omnipresent, but tainted by private interests (whether good or bad) and also paralyzed by the corporative forces arising within it, by bureaucracy. Because of the perverse tendencies displayed by both of them, the State and society at large often coincide in the generation of corruption.

The State must therefore be the subject of courageous and far-reaching reforms if it is to be transformed democratically into a State capable of heeding the aspirations both of the marginalized and excluded sectors and of the sectors which, although integrated into society, demand a fairer form of income distribution.

Consequently, in our region there is no point in analysing the question of the crisis of the Welfare State, because we never managed to attain such a State. What has occurred here is a crisis in the "Ill-fare State". In reconstructing it, however, we must avoid the errors which led to the crisis in the Welfare State elsewhere, when, due to a variety of circumstances, it ceased to provide the welfare it promised.

By taking advantage of past experience, we could devise reforms of the State and forms of State action which would make it possible to overcome the paradox mentioned earlier. We should abandon the illusion that the market will automatically bring equity; what we want is more and more equality, not through the perpetuation of a privatized "Ill-fare State" but through a reform of the State apparatus which can transform it into an instrument of social progress.

This involves the renewed consideration of issues which were always important but are now assuming more vital significance every day. I am not referring solely to reform of the State. Education has become an essential element in the entire process, because in view of all the changes which have taken place in the system of production and all the challenges we will have to face, either citizens will be equipped to adapt to these requirements in constantly improved conditions, or else it will be sheer hypocrisy to talk about social inclusion, for there can be no social inclusion for those who are not properly prepared for these challenges.

Education will have a much broader meaning, for it will not be limited to literacy education or even formal training, but will involve the effective incorporation into the daily life of all citizens of techniques which will enable them to keep themselves informed and take decisions, because without information it is not possible to make rational choices and it is easy to be a victim of manipulation. Capacity for adaptation is necessary even for finding an occupation, to say nothing of a decent job.

As we all know, the present process of globalization may severely aggravate social exclusion. I am not saying, of course, that we should reject this process, because there is no other option. What alternative could there be? Autarky? Where? How? Production is increasingly dispersed, competitive, and dependent on technology, most of which is not in the hands of a single sector. There is no alternative to globalization, and this is an undeniable fact. What we should do, then, is to see what can be done, in the circumstances, to make sure that exclusion does not limit the possibility that the issues which concern us will leave the theoretical sphere and become concrete means of change.

Of course, education is not the only means of facing this challenge. Competitiveness is an essential requirement for inclusion, and it is yet another rule from which we cannot escape. All this has very well known consequences with regard to the supply of jobs. Indeed, we will have to change the very concept of employment.

Looking at the changes which have taken place in the employment structure and the effects they have had on employment in Europe, the United States and Japan, we can clearly see that globalization does not automatically translate into a given rate of unemployment. This rate varies, depending on public sector intervention, social conditions, the institutional and legal rules governing labour relations, and on the cultural and value-based capacity to understand that in a society like that which is taking shape, mobility –including geographical mobility– becomes a requisite for adaptation. There will be a rapid shift of production sectors from one region to another, like that which is taking place in Brazil, as for example in the case of São Paulo, and this will assuredly benefit the Northeast of the country. It will not benefit the worker who loses his job in a given place, however, unless we are capable of creating new jobs in that same place, shifting workers from the secondary to the tertiary sector or, as in the United States, giving workers great geographical mobility which enables them to seek work elsewhere. Such mobility is the antithesis of our existing values, which give preference to stability in the broad sense, opposing the displacement of workers and their families from one place to another.

All this calls for a new cultural outlook. This is why I have placed special stress on education, which is an instrument of socialization, of new values, of challenges and of preparation and motivation for facing up to these challenges.

We cannot keep on presenting the situation in terms of a disjunctive: first the economy, and then social matters. Nor can we assert that social issues are what really matters, because human beings are above all else, and neither can we put forward an indiscriminate combination of both approaches, for that would have no sense. Instead, we must give attention to economic and social matters at one and the same time, although it is also necessary to clarify exactly what “at the same time” means, for sometimes issues do not all arise simultaneously: sometimes priority attention must be given to social aspects, and sometimes to economic considerations.

Nor must we take a static view of the situation. Sometimes social aspects come first because in certain circumstances the driving force behind the process of change is education and values. In other circumstances, however, the driving force is provided by technological development which comes from abroad

and is the result of foreign education and values which nevertheless influence our region.

We must therefore take an almost kaleidoscopic view: we must not let ourselves be guided by fixed rules on orders of precedence and we must seek at all times to establish links between the two aspects. If a process takes place on the economic level, then we must identify its links with the social sphere. If it takes place on the social level, then it must be linked up with the economic sphere: otherwise it will not have a solid basis or continuity.

Consequently, we must place limits on over-mechanical reasoning in terms of the establishment of disjunctives and must accept the challenge of thinking instead in terms of the actual situations.

With special reference to the case of Brazil, I would say that the efforts we have made to stabilize the economy and consolidate and strengthen democracy, as well as our deep interest in social development, are in line with the foregoing considerations. They are inspired by them, even if the desired results are not always achieved.

It goes without saying that when we formulated the stabilization plan known as the “Plano Real” we rejected recession as a means of stabilization. Indeed, from 1993 through 1997 the Brazilian economy will have grown by 25%, if growth in 1997 amounts to 4% or 5%. In an economy which now amounts to some 700 billion reals, 25% is a high growth rate to have been achieved over the same period as the application of the stabilization plan.

Since the Plano Real began to be applied in 1993, average remuneration has risen by 42%, although not uniformly in all sectors. In fact, it rose more in the informal sector than in the formal one, and it even rose more in the case of own-account workers than in the other categories. Although there have been some shortcomings, the truth is that it has been possible –at least so far– to reconcile stabilization of the currency with economic growth and improved income distribution.

For the first time, the statistics on income distribution –in which, as you know, it is by no means easy to secure changes– have shown signs that although those who earn most will continue to earn still more, the growth in their income will be smaller than in the case of the lowest-income sectors, although the latter will continue to be relatively poor. Thus, there are now signs of a change in functional income distribution,



which is very important and must be maintained, even though this will not be easy.

The statistics also show that, in the six biggest metropolitan areas, 13 million Brazilians managed to rise above the poverty line between 1993 and 1995: a good example of the social effects that an economic development plan can have. Without adhering to any fixed idea about what should come first and what should come after, it proved possible to make a significant effort in this direction, within the prevailing limitations.

With regard to employment, I cannot present such a uniformly positive picture, because global processes of change usually present economies with considerable challenges, and unemployment rates rise at certain times and in certain regions. If we use the indicator which allows us to make international comparisons—that of the Brazilian Geographical and Statistical Institute (IBGE)—we see that the rate of unemployment in Brazil was between 5% and 5.5% in the years in question. Using other types of indicators, the figures may be slightly higher. All the indicators coincide with regard to the upward or downward trend, however, although the actual levels depend on the way the questions are phrased (if the worker has been looking for work for a week, a month or three months; his age; etc.). Using the same technique consistently, however, what matters are the fluctuations observed, and the fact is that since the Plano Real began to be applied the fluctuations have been very slight, whatever the methodology used.

There has been a recovery which, although quite marked, does not give grounds for claiming that the unemployed will be fully absorbed. The continuity of the process cannot be guaranteed unless the reform of the State is further consolidated: a very thorny problem which gives rise to strong opposition, for different reasons, from both the Left and the Right.

Reform of the State adversely affects certain individual interests, and this naturally gives rise to opposition. We must therefore keep on striving to advance in this process. This reform does not only mean a struggle against the corporativism of public officials, however: it involves much more than this.

Above all, it means reforming the mechanisms linking the State and the members of society at large in the social areas. There are many concrete examples of this. Thus, the Ministry of Education, which has taken many measures for this purpose, has arranged among other things that part of the resources destined for

schools should be provided to them directly, without passing through other levels which are political in some cases and bureaucratic in others. In the area of health, where the biggest obstacle is to find ways of establishing a direct link between the demands of society and the State apparatus, there are also political problems, but these arise at the substantive policy level and not at the intermediate level of the transfer of resources.

Moreover, especially in the case of a federation like Brazil, the State can no longer be of a bureaucratic, unitary nature. There must be decentralization, which is already under way in the education and health sectors and which we hope will become more and more firmly established in the area of agrarian reform, for without this it will be impossible to establish the necessary conditions for the progress of a country the size of Brazil.

Firstly, and perhaps most importantly, there is the financial responsibility of the central government. Secondly, the government must have the capacity to define policies. Thirdly—and this is very important but not very frequent in the region—it must have the capacity to evaluate the effects of the policies by monitoring their results. Fourthly—and this is vitally necessary for exercising this control—it must have suitable links with society, the trade unions, and the opposition parties.

This is what happens at present in education and health. And in housing, for example, nothing is done without first passing through procedures which are not only subordinated to the legitimate political powers but also to a dialogue with society. This dialogue broadens the whole spectrum, and the decision-making process also includes minority sectors or opponents of the central government. The central government never raises obstacles of a party political nature to the distribution of resources, because it recognizes how important it is that resources should be received where they are needed and that there should be clear and open arrangements for controlling their transfer.

Consequently, reforming the State apparatus is not simply a question of “de-privatization” of the State, in the sense of making it independent of the private interests which have installed themselves in it. Nor does it simply mean changing bureaucratic relations. It is not just a question of the State’s withdrawal from certain areas of economic activity where there are capital resources in order to concentrate on others, but of making fundamental changes in the ethos of public

administration without which there can be no question of development with greater equity, because the market forces alone are incapable of generating such equity. The system of government must be open and democratic, and it must make the opposition sectors participate, whether they like it or not, in the decision-making process (I mean, of course, decisions on the distribution of resources, not on the general lines of the process, which are decided by the majority in a democratic system). This calls for extensive changes: the "de-privatization" of the State, its de-bureaucratization and its decentralization are essential conditions for progress.

Naturally, there are some situations in our countries—especially in Brazil, which is so huge and so full of inequalities—which call for more energetic measures. One of these situations concerns access to land. Traditionally, because of its economic and historical evolution, Brazil has been a country of latifundia. The latifundia have survived tenaciously, and even after big changes in the agricultural sector they still exist today, side by side with the entrepreneurial production sector, and remain a major presence in Brazilian life.

Meanwhile, however, broad sectors of the population are living in poverty: there is great rural and urban poverty, and a growing combination of the two. Increasingly, asking for land is an indirect, symbolic way of demanding greater equity. Although we can and must recognize the existence of this process, however, we have not given really serious, profound thought to the consequences of giving access to land or to the possibilities, costs and nature of the agrarian reform process we could carry out.

With regard to the rate of settlement of families on the land, the average in Brazil in the past was ludicrously low: ten thousand families per year. Under the present government, a little over a hundred thousand families have been settled in two years, and this year it is planned to settle another eighty thousand. Compared with what is needed, this is nothing, but compared with what was done in the past it is quite a lot, and compared with the resources available it is a great achievement. Each operation of settling a family on the land costs 25,000 reales just for a start, and what has happened in Brazil is that the families are not "emancipated" as soon as they are settled, but continue to receive State aid, so that the outflow of resources continues, and this must be taken into account.

Society must decide if it wants, or if it is able, to carry on with this process. If it decides to continue,

then it must provide the means—by paying taxes—for turning that decision into reality. In order to settle a million families on the land, we would need 25 billion reales just for a start.

After the settlement operation, attention has to be given to the family production unit. A recently established programme—PRONAF—has allocated some US\$ 600 million to the provision of support for small family units.

In Brazil, the resources are in fact available in many cases. There is political will at the top, but we lack the necessary machinery to ensure that those resources flow properly and reach those who need them. The State institutions—those of an "Ill-fare State" designed to suit the interests of big business, the big corporations, contractors and banks—have no channels for reaching the public. A new situation is now starting to take shape in which, thanks to stability and the resumption of growth, we are beginning to have more resources at our disposal, but we lack the means to use them properly by giving priority to the poorest sectors of the population.

The problem is both one of management and of political aspects, because in many cases proper management is impeded by clientage and local interests. Often, there are even problems in the bureaucratic structures themselves which prevent the smooth flow of the resources, for political reasons, through incompetence, or because of ideological differences.

Without reform of the State there can be no proper social policy, and without greater coordination and close contact with society, social policy will simply wither away in the throats of those who call for action and the pens of those who grant resources but know that they will have little practical effect because there is not sufficient social capacity to put the decisions into effect.

This issue is intimately related with that of equity, which is of fundamental importance, like the question of access to land. There are many unanswered questions, and there are a great many people who proffer answers or suggest solutions with the greatest abandon. When we really start to think about the problem in depth, however, it becomes clear that what is needed is to work together, for nothing is solved merely with goodwill gestures or protests, and that the finances must be reorganized so that the State can work better and interact with society at large.

Another issue related with equity that I would like to emphasize—in the spirit of Copenhagen, taking a

non-economistic view of the changes needed— is that of human rights, which is of fundamental importance in a country like Brazil, where we are setting up the National Human Rights Department, because concern for human rights cannot be limited to gestures of goodwill by the government or by those who feel concern with this issue. There must be a process of reeducation covering the whole scale of values, as well as continuity of action and unremitting insistence on this issue.

In exclusive societies like ours, which have become accustomed to such glaring inequality, violence is a natural sub-product. It soon ceases to be a product of poverty and becomes deeply rooted in the form of a kind of toleration of the intolerable, an acceptance of reprehensible practices against which it is the duty of governments to protest. But to protest against what, and against whom? There are clear culprits: all of us. This is a broad-ranging process which demands continuity of action.

In order for the process of reeducation to have the necessary continuity, we need a kind of beacon to light the way, to serve as the conscience of the country and constantly point out errors, even knowing that in many cases these errors cannot be corrected at a given moment, and knowing that although there are culprits it is not enough to blame them, for we must go much further: we must develop another kind of values, another kind of solidarity.

Those who have studied sociology are familiar with Fernando Tönnies and a classic expression in sociology: the distinction in German between the words *Gemeinschaft* and *Gesellschaft*, community and society. Through the expression *Gemeinschaft*, the supporters of this school of thought referred, almost a century ago, to the direct, face-to-face relations typical of a community, to the possibility of a shared experience: people are united because they

have a shared experience. In a situation of *Gesellschaft*, of society, in contrast, there is a contractual relationship which does not involve the solidarity arising from a shared experience. These two expressions were seen as opposites.

In the world of today, with the changes which have taken place, with the current communications media, with the instantaneous, “real time” nature of the processes that take place, societies are in some respects beginning to have shared experiences: violence, well-being, fear, economic challenges, material achievements. There is now a renewed possibility that this situation may occur in the relations within society.

Our challenge is how to transcend both *Gemeinschaft*, the community, and *Gesellschaft*, society and the relations within society: how to transcend them by combining them, in the specific sense of transcending them in dialectic terms.

We must transcend this opposition between economic and social and political issues, between public and private issues. That is the challenge. A new vision of the world means that we must seek a concept that will enable us to restructure our whole way of thinking, leaving aside that opposition between community and society which fascinated everyone so many years ago, and make us feel capable of a form of action in keeping with today’s challenges.

Such action must be based on a great advance in the field of technology which can be present in all areas. But this action can only be carried out, and the distinction between society and community can only be transcended, if we return to the question of ethics and values, not viewing it as something threatening or as an empty moral discourse, but as an effective means of motivating action to promote change.

(Original: Portuguese)



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# Neo-liberal structural *reforms in Latin America:* the current situation

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**Joseph Ramos**

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and Management, ECLAC.*

Latin America is currently undergoing a strategic turnaround with far-reaching implications: from an inward-oriented form of development with heavy State intervention in production and the system of prices, to an outward-oriented development strategy in the context of a free market, with the private sector playing the leading role. This study analyses the seven main reforms associated with this neo-liberal strategy. It concludes that all these reforms could have positive effects if properly implemented, but in fact the most successful of them have been tax reform, the opening-up of trade, reform of the pension system and, to a lesser extent, privatization processes. The most unsuccessful and costly policies have been those associated with macroeconomic stabilization programmes and financial liberalization, for the idealistic views of the neo-liberal school regarding the presumed automatic virtues of the market mechanisms blinded them to some vital shortcomings which hinder the possibility of smooth and rapid movements towards an equilibrium situation.

# I

## Introduction

It is a well known fact that since the mid-1980s, and even earlier in some countries, Latin America has been undergoing a strategic turnaround of a magnitude which has no precedent at least since the 1930s. This has been reflected in measures such as the following (Williamson, 1990; Fanelli, Frenkel and Rosenwurcel, 1992): i) liberalization of almost all prices; ii) a tendency to deregulate the main markets (above all those of capital and foreign exchange, and to a lesser extent the labour market); iii) elimination of most subsidies; iv) efforts to secure fiscal balance; v) generalized elimination of almost all non-tariff barriers; vi) radical and rapid reduction of customs tariffs, which have gone down from effective rates of protection of around 100% in the mid-1980s to current average tariffs of less than 20%; vii) reduction of the number of tariff brackets from an average of over 60 to only three at the present time; viii) privatization of public enterprises in competitive sectors (except for some strategic natural resource-based enterprises) and in natural monopolies (such as electricity and telecommunications) for amounts totalling between 5% and 10% of GDP; and ix) privatization of many functions previously considered as being exclusive responsibilities of the State, such as social security and part of health and education.

The initiation of this new development model was due to a combination of various factors (Ramos, 1993): first, the external debt crisis gave rise to heavy macroeconomic imbalances and the subsequent stagnation which was characteristic of the 1980s, the "lost decade"; second, although the progress which accompanied the import substitution industrialization (ISI) strategy was on a scale without precedent in the region, in the mid-1970s this model began to give sharply decreasing yields which were reflected in the stagnation of total factor productivity; and third, theoretical and empirical criticisms of State interventionism began to be levelled in the North and were taken up by Latin American neoliberal circles, which attacked such interventionism not only because of its alleged inefficiency but also for trying to create a modern Welfare State on the basis of a weak economic structure.

The principles which inspired this turnaround—the market economy, private ownership, fiscal prudence and the leading role of the private sector—are of course shared by both the main currents of present economic thinking: neoliberalism on the one hand, and

neostructuralism on the other. Neoliberalism, however, must take the credit for having speeded up that turnaround by its merciless criticism of the previous strategy, its insistence on the importance of trade openness, and its unswerving defence of the virtues of the market.

Nevertheless, the real distinction between neoliberalism and the social democratic regimes of Europe and the neostructural currents in Latin America is that neo-liberals are firmly convinced that, with few exceptions, the set of measures referred to above is both a necessary and a sufficient condition for growth and, basically, also for equity. They maintain that if this model fails to give the desired results, this is due to rigidities derived from the interventions of the economic policy and institutions. Neostructuralists (Sunkel, 1991), in contrast, attribute many of the most important rigidities to critical flaws, segmentation and gaps in those same factor markets, so that they question whether that set of measures will automatically result in growth, and still less in equity. They therefore call for State intervention to correct these critical flaws and claim that the notable success of the newly-industrialized Asian countries, in terms of both growth and equity, is due precisely to such intervention.

There are two typical attitudes to the neoliberal reforms. One attitude considers the structural reforms inspired by neoliberalism to be the quintessence of good economic policy, while the other considers that this model involves excessively high costs, especially as regards its impact on distribution. In the following sections, I shall develop two theses. One is that although in general terms the reforms make sense in the long run, there have been serious technical errors in their application, because the local neoliberals idealize the market and seem to attribute to it the capacity to adjust rapidly, automatically and effectively to any kind of disturbance or policy change. The other is that, while recognizing that there have been costs in terms of distribution due to the neoliberal approach, I nevertheless maintain that most of the reforms could be effected without regressive costs if applied judiciously and accompanied by additional measures to avoid or relieve distributive problems. If my views are correct, then the proposed economic reforms could be useful for other countries, provided they eschew the prejudices so typical of the local brand of neoliberalism.

## II

### A global appraisal of the structural reforms

Perhaps the most striking aspect of the major turnarounds that have taken place in almost all the countries of the region is that it is not the success of this new development model which has sparked off the reforms, because the signs of success are still quite few in number and feeble. Thus, the growth rate of the region since the inception of the trade openness process (which generally began towards the end of the 1980s, except in Chile) has not even reached 3% per year, compared with the rate of 5.6% per year registered in 1945-1980: a period when import substitution industrialization (ISI) prevailed (table 1).

Even if we calculate the annual growth rate as from the entry into effect of trade openness, and only after inflation had been brought down (so as to eliminate the effects of recessions possibly attribut-

able to stabilization policies), we see that it is still below that of the ISI period (an average of 4.4% compared with 5.6%). In the region, only Chile, Ecuador and Panama have recovered levels of investment similar to those registered before the 1980s (of the order of 20% of GDP). In reality, the only general indication that these new measures are bearing fruit is the rise in industrial productivity (by around 6% per year), but this has been registered for too short a period (1990-1994) to allow firm conclusions to be drawn from it (table 2). Consequently, nearly ten years after the initiation of the reforms, we are still living off the promise rather than the reality of good results.<sup>1</sup>

Furthermore, the limited progress which has accompanied the reforms has tended to be concentrated.

TABLE 1

Latin America: Annual average growth rates of gross domestic product and exports

	Gross domestic product				Volume of exports		
	1925-1945	1945-1980	1980-1990	1990-1995	1950-1980	1980-1990	1990-1995
Latin America	3.5	5.6	1.2	2.6	4.3	5.3	7.7
Argentina		3.1	-1.5	5.3	3.1	7.1	6.3
Colombia		5.2	3.5	3.6	3.7	6.4	7.4
Costa Rica		6.7	2.1	4.0	6.2	4.3	11.5
Chile		3.6	2.7	7.2	4.4	6.6	11.4
Ecuador		6.8	2.1	3.5	6.9	6.2	9.5
Mexico		6.7	1.2	0.9	5.8	8.8	9.2
Peru		5.1	-1.0	5.5	4.9	-2.3	7.1
Uruguay		2.6	-0.4	3.4	1.7	5.0	3.7
Venezuela		6.7	-0.2	2.8	1.5	1.6	5.8

Source: ECLAC, Division of Production, Productivity and Management.

<sup>1</sup> This rough conclusion coincides with other appraisals which are beginning to be made. They include in particular those made by the Inter-American Development Bank (IDB), which, although already in circulation, are currently only for purposes of discussion. Although these studies find that the reforms improved the situation compared with the 1980s, they coincide in finding that there is still a long way to go in order to equal the growth rates achieved through ISI between 1945 and 1980, and they note that the reforms—especially those in the capital and labour markets—could give bigger dividends if they were intensified. If these findings are true, then it may be wondered why, under ISI and with the same weaknesses of

the factor markets, growth was so much faster then than now. For this reason, I think that these studies have not taken sufficient account of the needlessly high costs of many macroeconomic policies which have been badly designed or badly implemented, as well as their delayed effects. If we accept this point, this means admitting that, for an effective stabilization policy, the orthodox policy of balancing the fiscal accounts is not enough: much more important factors are the way deficits are reduced—by slashing expenditure, or by increasing income—and the implementation of successful efforts to coordinate the inflationary expectations of the economic agents. These are the Achilles' heel of orthodox macroeconomic policies.

TABLE 2

**Latin America: Annual average growth rates  
of industrial productivity**

	1970-1980	1980-1983	1983-1990	1990-1994
Argentina	3.1	2.7	2.0	8.8
Brazil	2.4	2.3	-0.3	9.7
Chile	2.8	4.5	-3.4	2.8
Mexico	1.7	0.8	4.3	2.3
Rest of Latin America <sup>a</sup>	1.0	1.0	-0.2	0.9
Latin America as a whole	2.0	2.0	0.8	5.9

Source: ECLAC, on the basis of official figures.

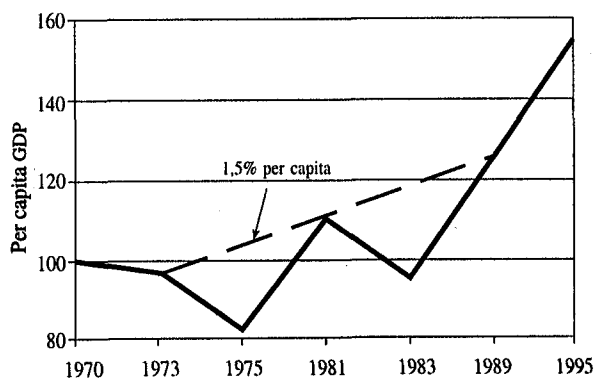
<sup>a</sup> Barbados, Bolivia, Colombia, Costa Rica, Ecuador, Guatemala, Jamaica, Panama, Peru, Uruguay and Venezuela.

rather than benefitting the bulk of the population, for in most countries real wages have grown less than the per capita GDP, or have even fallen, while poverty has increased in absolute terms. Although much, if not all, of the greater concentration in income distribution is due to the macroeconomic imbalances deriving from the debt crisis and the subsequent stabilization attempts, the fruits of the reforms have still not reached the bulk of the population.

These mediocre results are true even in the much-vaunted and longest-standing example of application of the neoliberal model: that of Chile, where per capita growth between 1973 and 1990 amounted to barely 1.5% per year (figure 1) and, because of the high rates of unemployment marking this neoliberal period, the percentage of poor families rose from around 30% to over 40% (Bosworth, Dornbusch and Labán, eds., 1994; Corbo, Lüders and Spiller, 1996).

FIGURE 1

**The Chilean miracle**  
(Evolution of per capita GDP)



In fact, the Chilean results are impressive if we only take the period in which the fruits of the neoliberal model were being reaped and exclude the period in which the costs of installing this model had to be paid (1973-1983). Thus, in the twelve years between 1983 and 1995 Chile did indeed register steady and significant growth of nearly 6.5% per year, its export volumes grew by almost 11% per year, and unemployment went down from 30% in 1983 to 7.2% in 1989 and 5.6% in 1995.

Obviously, recording the benefits without including the costs would be a most unscientific expedient, and furthermore I am convinced that many of the economic and social costs of establishing the neoliberal model in Chile could have been avoided if the authorities had taken a less dogmatic stance than that favoured by the local neoliberal supporters.

It is also important to note that even in Chile there were substantial deviations from the pure neoliberal model. Thus, between 1984 and 1989 non-traditional exports were promoted through the "simplified drawback" procedure, which was really an elegant way of disguising a subsidy: 10% of the total gross value of their production was returned to exporters, and this more than offset the customs duties on their imported inputs. At the same time, in the agricultural sector efforts were made to offset the generalized effects of the external debt crisis which was severely affecting both the tradeable and non-tradeable sectors, by establishing "price ranges" which, although movable, fixed a minimum producer price higher than international levels, when the latter fell below domestic prices.

These deviations naturally became even more pronounced after 1990, with the coming of democ-



Although still based on the neoliberal model, the democratic development strategy was modified to give the State a more active role in the simultaneous pursuit of both growth and equity (not one after the other, as prescribed in neoliberal theory). The economic and social results improved in this second period (1990-1995): GDP grew by 6.5% per year, exports increased by 11% annually, and both the investment coefficient and national saving reached record levels of close to 27% of GDP. Moreover, productivity, which had risen by less than 1% per year in the period 1983-1988, began to grow by nearly 4% per year, while annual inflation went down from 21% to 8% (the first single-digit inflation in 50 years) and unemployment sank to 7%. Furthermore, thanks to the increased productivity, the stronger trade union movement, the aggressive but consensus-based increase in the se-

verely depressed minimum wage, and the substantial increase in taxation (rather more than 2% of GDP), real wages rose by almost 4.5% per year and it was possible to make significant increases in long-neglected investments in human capital (in health, education and housing) and in minimum pensions and family allowances. As a result, the percentage of poor people went down markedly to less than 30% of the population and there was an improvement in income distribution. Finally, the inflow of very short-term capital was checked in order to minimize cyclical fluctuations and avoid sudden falls in the real exchange rate. The fact that a neoliberal model could be modified in this way shows that what really determine the true nature of the model are not the specific measures in themselves, but the approach, priorities and values of those responsible for implementing economic policy.

### III

## An appraisal of the seven main neoliberal structural reforms

Although the costs of the set of reforms inspired by neoliberalism have been high, while the benefits (with only a few exceptions) have so far been quite meagre, it would be interesting to determine: i) if all the reforms were equally costly or most of the costs were due to only a few of them; ii) which costs were due to errors of implementation and should therefore be avoidable, and which were due to intrinsic flaws in the neoliberal approach, and iii) if the reforms comprise a single unitary package, or if they can be separated from one another.

The following sections will draw up a balance-sheet of the seven main structural reforms, focussing on their essential features and showing their differences of instrumentation or approach compared with neostructuralism. These reforms are: i) anti-inflation and adjustment policies; ii) tax reform; iii) trade openness; iv) financial liberalization; v) privatization; vi) pension system reform, and vii) measures to deregulate the labour market and make it more flexible (Annexes 1 and 2 give details of what happened in respect of these reforms in 11 countries of Latin America and the Caribbean).

#### 1. Anti-inflation and adjustment policies

##### a) *Anti-inflation policies*

A necessary condition for lowering inflation is to reduce expansion of the money supply, which normally makes it necessary to reduce or if possible completely eliminate the fiscal deficit. Orthodox neoliberal theory, however, tends to argue that this condition is not only necessary but also sufficient in itself (accompanied, at the most, by wage controls to ensure that wages are readjusted not only according to past inflation but also in line with the target inflation) (Ahamed, 1986; Kiguel and Liviatan, 1988). Experience shows, however, that in all too many cases neoliberal-type anti-inflation programmes give rise to serious recessions: for example, falls in GDP of 15% in Chile in 1974-1975,<sup>2</sup> 8% in Venezuela in 1989, and 6% in Peru

<sup>2</sup> It is only fair to acknowledge that this Chilean recession was aggravated by a sharp fall in the terms of trade. Even so, it may be noted that Bolivia suffered a much bigger fall in 1985-1986 yet was able to put an end to its hyperinflation (of the order of 20,000% per year) with a much smaller recession (a drop of "only" 3% of GDP).

in 1990. This usually takes place because the authorities fail to adopt additional measures to assure producers that if they adjust their prices according to the targetted inflation, the suppliers of their inputs will do the same. It is essential to coordinate monetary control and fiscal policies with measures designed to guide expectations and the behaviour of the economic agents in line with the targetted inflation, and not only past inflation (Frenkel, 1995; Kiguel and Liviatan, 1992).

It is precisely the adoption of combinations of measures of this type that explain the successful anti-inflation programmes of Argentina in 1990 (without any fall in the product), Mexico in 1988 (with a slight expansion in the product), and Brazil in 1994 (with growth of nearly 5% in the product).<sup>3</sup> Among these coordination measures are the very sophisticated measures taken in Brazil, which gradually converted the main prices of the economy (public service charges, rents, wages) into a new unit of account, the Real, with constant purchasing power and pegged to the U.S. dollar through the exchange rate; explicit coordination measures, like the Economic Solidarity Pact established between producers, workers and the Mexican Government in order to secure a joint and simultaneous slow-down in rises in prices, wages, the exchange rate and public service charges; and the Convertibility Act in Argentina, which anchored the New Peso to a value of one U.S. dollar, limited expansion of the money supply in pesos to the inflow of dollars, de-indexed contracts, and restructured the entire public debt with a maturity of over seven days into ten-year bonds, payable in dollars but with an interest rate only equal to LIBOR (which brought down fiscal expenditure in respect of interest payments by almost 5% of GDP!). Naturally, these coordination measures were accompanied by monetary and fiscal policies to control aggregate demand.

#### b) *Policies to adjust to external imbalances*

In order to adjust to a permanent external imbalance, two sets of policies are needed: on the one hand, policies to control expenditure (higher interest rates, higher taxes, lower public expenditure) in order to

reduce imports and reorient production towards exports, and on the other hand, policies (such as devaluation) designed to reallocate resources to tradeable activities and to shift expenditure towards non-tradeables. In practice, however, reduction of expenditure takes place much more quickly than reallocation of resources (since the latter requires time to move factors from a declining activity to a growing one), so that the orthodox neoliberal programme tends to generate unnecessarily severe recessions (Arellano, 1988). It is therefore hardly surprising that the most serious recessions in the region in 1981-1983 took place in the three countries applying neoliberal policies at that time: Chile, with a 15% drop in GDP; Uruguay, with a 14% drop, and Argentina, with a decline of 12%, compared with an average decline in GDP of only around 5% in the other countries of the region.

In view of this slower action of reallocation policies, neostructuralists propose that strong (although transitory and selective) additional incentives should be given to non-traditional exports (which are the most elastic in the short term), while temporarily raising the import duties on importable goods for which there is unused production capacity within the country. An example which bears out this approach is the fact that although Brazil was one of the countries hardest hit by the external upsets of 1981-1983, its GDP only went down by 3%, thanks largely to its very active policy to promote non-traditional exports. Another noteworthy point is that, after a 15% contraction in 1982-1983, the Chilean economy recovered by 6% in 1984 after a non-neoliberal minister temporarily raised customs tariffs to 35%, and this recovery was subsequently consolidated when a minister who followed neoliberal theories but was more pragmatic than many neoliberals established support price ranges for agricultural producers (many of whom were not cultivating their land because of their high level of indebtedness) and introduced a subsidy for new non-traditional exports.

## 2. Tax reform

A necessary condition for keeping macroeconomic imbalances within manageable bounds is to reduce or even if possible eliminate the fiscal deficit. From the macroeconomic point of view, it makes no difference whether this is achieved by reducing expenditure or by increasing taxes. It does make a difference from the point of view of growth and equity, however. Because of their urge to minimize the size of the State, neoliberals

<sup>3</sup> It is essential, of course, to combine policies designed to coordinate expectations with real reductions in the fiscal deficit. If this is not done, the anti-inflationary results will be only transitory, as they were in the 1980s in the case of the Plan Austral in Argentina, the Plano Cruzado in Brazil, and the Inti Plan in Peru.

erals systematically prefer to reduce expenditure. Neostructuralists, however, prefer to raise the tax burden, because on average its incidence on the private sector is much lower in Latin America than in the OECD countries (16% versus 25% of GDP; see ECLAC, 1992), and it is important to keep up a certain minimum level of investment in human resources and physical and scientific infrastructure, as well as ensuring that the population has at least a minimum of income and services. It may be noted, by the way, that if this burden were a serious discouragement to saving, then it would be difficult to explain how the most successful country in the region, Chile, not only had the highest private sector tax burden in 1989 (around 20% of GDP) but actually raised this to nearly 22% with the increase in taxes approved by the democratic government in 1990 in order to use the increased revenue to increase long-postponed social expenditure. In spite of this tax increase, in 1995 saving reached an all-time peak of the order of 27% of GDP and the product grew by nearly 7% per year between 1990 and 1995.

Both schools of thought agree, however, that except in a very few cases the rates of taxation, which already seem high on paper, should not be raised further. Instead, i) most of the wide range of tax exemptions or preferences for regions, sectors, State enterprises, etc. should be abolished; ii) a systematic effort should be made to stamp out tax evasion, and iii) the tax base should be expanded. Thus, for example, in Chile before the 1975 tax reform, the "general" tax rate was 7%, 12%, 17%, 35% or 40% depending on the source of income; the list of exemptions occupied 164 pages, and the sales tax varied from 8% to 24% according to the product in question, with nearly 130 exemptions. Simplification of this complex tax structure was essential both for expanding the tax base and for reducing tax evasion.

Indeed, the 1975 Chilean tax reform was one of the neoliberal successes that has attracted least attention. It introduced the Value Added Tax (IVA) in place of the sales tax, because the latter led to the inefficient verticalization of production in order to minimize the cumulative effect of the sales tax; taxes were indexed in order to maintain the level of revenue in real terms in times of inflation; tax rates were made uniform for all taxpayers of similar types, and almost all the existing exemptions were abolished. The reform not only corrected inefficient and inequitable distortions but also rationalized and simplified the tax legislation, significantly broadening the tax base. Moreover, this simplification, greater uniformity and rationalization made it

possible to initiate a systematic campaign against tax evasion which raised fiscal revenue by four percentage points of GDP in four years ... without increasing any tax rates!

Once the tax legislation had been simplified, it was possible to carry out the campaign against tax evasion (Eyzaguirre, 1985; Fuentealba and Marshall, 1990) by: i) dismissing and drastically punishing the most senior corrupt officials in the internal revenue service, especially if they were supporters of the government, in order to give greater credibility to the fight against corruption in the civil service; ii) making the tax inspectors take technical examinations, dismissing the most poorly qualified 50% of them, and considerably raising the salaries of those who were kept on; iii) drastically punishing tax evaders, beginning with the most notorious cases in order to show that there would be no exceptions, with temporary closure of businesses on the first offence and permanent closure on the second, and iv) computerized control of tax information, with cross-references by source, and impersonal and automatic computerized selection of taxpayers to be subjected to exhaustive spot checks, thus guaranteeing equal and non-discretionary treatment.

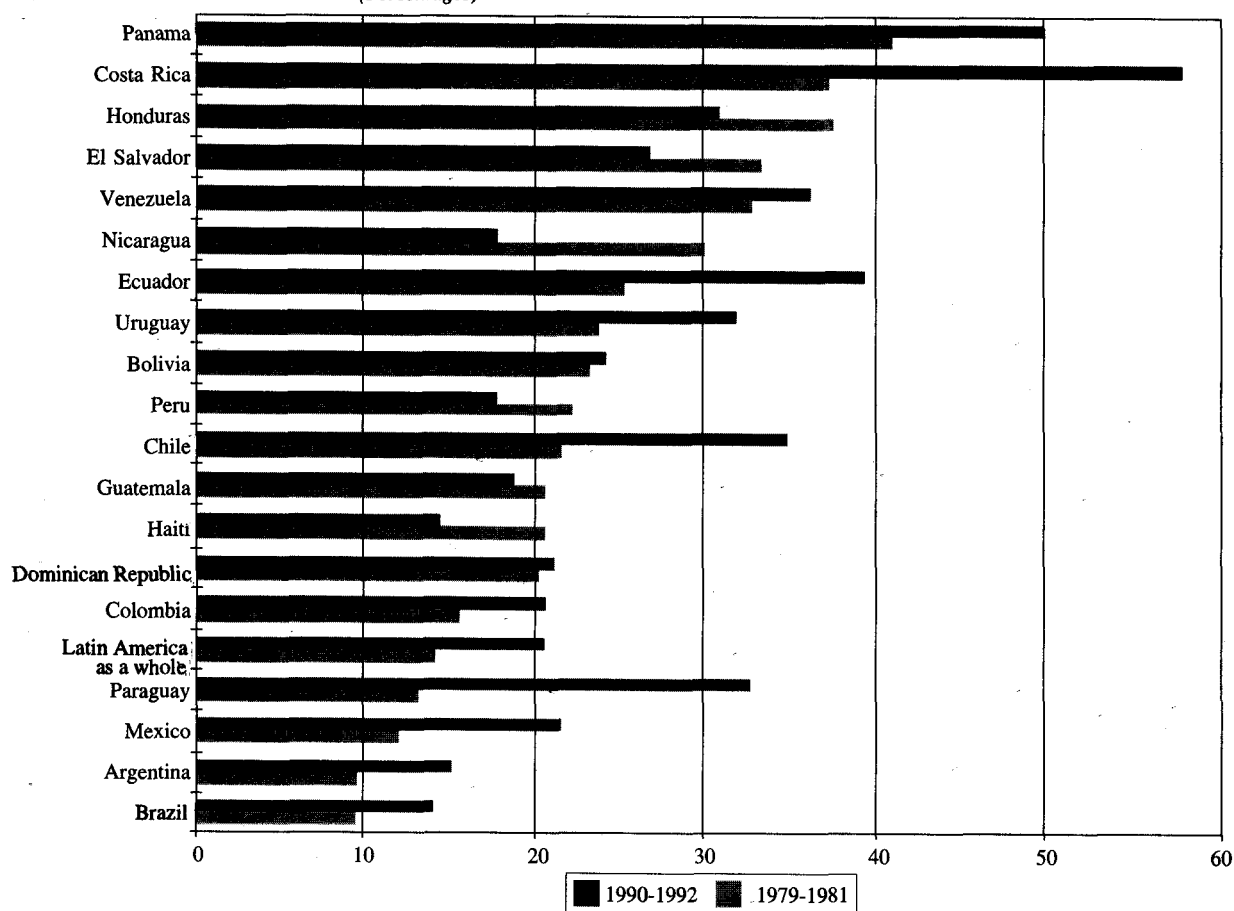
What was lacking in the 1975 Chilean tax reform was an attempt to seek more progressive distribution of the tax burden by changing the tax structure to include more direct taxes (which are generally more progressive than indirect taxes) instead of increasing existing taxes. The 1978 Mexican tax reform, for example, increased the share of direct taxes in the tax burden, broadening the taxable direct income base to include not only labour income but also capital gains, rents, dividends and non-financial income. In this way, it was possible to reduce the tax burden on the five lowest-income deciles by two percentage points of GDP, while the burden on the richest two deciles was increased by two percentage points (Carciofi, Cetrángolo and Barris, 1994; Gil Díaz, 1987).

### 3. Trade openness

Although neoliberals and neostructuralists disagree as to whether tariff protection was beneficial or not at the time for promoting the industrialization and growth of the region, both schools of thought agree that the increasing reorientation of the region's production platform from the narrow confines of the domestic market to the broader and more dynamic markets available abroad has long been overdue (Krueger, 1978; ECLAC, 1995a;

FIGURE 2

**Latin America and the Caribbean: Ratio of exports of goods and services to GDP  
(Percentages)**



World Bank, 1993). Indeed, as tariffs are an indirect tax on non-traditional exports (a point which neoliberals justifiably stress), it is necessary both to reduce them and to raise the exchange rate if it is desired to promote such exports.

In general, the results of the process of greater trade openness confirm the arguments in its favour: the share of exports in the regional GDP has risen from 14% before the trade openness exercise to a current level of over 20% (figure 2); exports of manufactures (many of them non-traditional for the region) have doubled their share in total exports to 50%, and since 1990 manufacturing productivity has risen by some 6% per year, indicating that greater openness has led to greater specialization (figure 2).

The only negative aspect is that the share of manufactures in GDP has gone down from 26% to 24%. Many analysts perceive a kind of "de-industrialization" in the slow growth of industrial output since

1980 (a little over 1% per year, compared with almost 6% per year in the 1970s), which they attribute to the over-rapid external openness of the region. However, the figures suggest that this "de-industrialization" was not due to the increased trade openness and the assumed consequent loss of competitiveness of local industry,<sup>4</sup> but to the serious macroeconomic imbal-

<sup>4</sup> It must be emphasized that the effect of the greater trade openness cannot be evaluated without taking into account the level and evolution of the real effective exchange rate, for a reduction of tariffs in the mid-1980s, when the real exchange rate was high as a result of the debt crisis, would have a very different effect (generally speaking, positive and expansionary) from a reduction carried out when the exchange rate was low or there was a heavy inflow of capital, with a consequent tendency towards appreciation of the exchange rate (as occurred in the region in the late 1970s and has occurred once again from 1991 onwards).

TABLE 3

**Latin America: Annual average growth rates  
of industrial value added**

	1970-1980	1980-1983	1983-1990	1990-1994
Argentina	1.6	-2.8	-0.8	6.9
Brazil	9.0	-5.6	2.2	2.8
Chile	1.1	-5.8	6.4	6.3
Mexico	6.3	-1.6	3.5	2.3
Rest of Latin America <sup>a</sup>	5.0	-1.9	2.4	3.1
Latin America as a whole	5.8	-3.5	2.1	3.4

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Barbados, Bolivia, Colombia, Costa Rica, Ecuador, Guatemala, Jamaica, Panama, Peru, Uruguay and Venezuela.

ances which affected the region in the 1980s. Thus, as we saw earlier, the belated and subsequently abrupt adjustment policies in 1981-1983 sharply reduced aggregate demand and especially industrial production (which fell by 10%), while the slow industrial recovery as from 1983 (around 2½% per year) was due to inflationary pressures or to poorly designed or poorly applied anti-inflation policies in that period (table 3).

Furthermore, greater trade openness is seen to be a poor explanation of the slow industrial growth of the 1980s—when the real effective exchange rate registered at the time of the greater openness was generally high—because imports of manufactures in 1989 were lower, even at current dollar prices, than in 1980 (table 4), whereas national manufacturing output was 6% higher. In fact, it was the region's exports of manufactures which grew most in this period (80%), converting the region's manufacturing trade deficit of US\$ 25 billion in 1980 into a surplus of US\$ 8 billion in 1989. Consequently, in general terms there was no replacement of local manufactures by imports in the 1980s.

In the manufacturing sector, the greatest effect of trade openness was felt as from 1990, when trade liberalization was accompanied by a heavy inflow of capital into the region, which led to a significant loss of competitiveness for the great majority of countries in the region because of exchange rate appreciation (close to 10% in the 1990-1995 period).<sup>5</sup> As a result, imports of manufactures more than doubled and the industrial trade balance declined from a surplus of US\$ 8 billion in 1989 to a deficit of US\$ 49 billion in 1994 (see table 4). Even so, this was not a case of de-industrialization either, because almost two-thirds of the increase in imports of manufactures was accounted for by capital goods, which do not usually

compete with local industry. Indeed, national production of capital goods also grew as from 1990, because the investment coefficient rose and the growth rate of the industrial product increased slightly from 2.1% per year in 1983-1990 to 3.4% per year in 1990-1994 (see table 3).

It may be concluded, then, that trade openness has not in itself been harmful for the region. The negative effects have not been due to such openness but rather to the exchange rate appreciation resulting from the heavy inflow of capital and the drop in domestic demand caused by macroeconomic imbalances and the often costly stabilization attempts. The question of whether trade openness could have been even more beneficial, especially for non-traditional exports, is another matter, however, and opinions differ in this respect.

Although both neoliberals and neostructuralists agree on the importance of international trade linkages in the region's present stage of development, neostructuralists consider that neutral export incentives are not enough: they feel that special temporary additional incentives are needed for non-traditional exports. They consider that as both those who discover new export products in which the country can be competitive and those who succeed in breaking into new inter-

<sup>5</sup> The same reasoning may be applied to the Chilean trade openness of the mid-1970s. In that case, most of the "de-industrialization" took place in 1974-1975, not because of the trade openness but because of the depression caused by the anti-inflation policies applied. Likewise, the decline in Chilean manufacturing competitiveness as from 1979 was due much more to the exchange rate lag—caused by the fixing of the exchange rate for anti-inflation purposes and financed by heavy external indebtedness—than to the lowering of tariffs.

TABLE 4

## Latin America: International trade in manufactures, 1980-1994

	1980	1985	1989	1990	1993	1994
<b>Exports</b>						
Foodstuffs	13 602	9 002	13 134	13 752	14 640	17 805
Consumer goods	4 135	4 104	7 127	7 490	10 007	10 712
Intermediate goods	18 377	25 111	33 809	34 015	35 646	39 905
Capital goods	5 780	8 253	14 892	15 150	23 507	27 710
<b>Total</b>	<b>41 894</b>	<b>46 469</b>	<b>68 961</b>	<b>70 407</b>	<b>83 800</b>	<b>96 133</b>
<b>Imports</b>						
Foodstuffs	5 165	2 376	911	5 785	8 264	9 932
Consumer goods	3 282	1 698	3 773	4 248	9 000	10 393
Intermediate goods	25 240	15 803	24 538	25 608	39 345	44 835
Capital goods	33 597	19 025	28 219	35 117	68 796	80 216
<b>Total</b>	<b>67 284</b>	<b>38 903</b>	<b>61 440</b>	<b>70 758</b>	<b>125 405</b>	<b>145 376</b>
<b>Trade balance</b>						
Foodstuffs	8 437	6 625	8 223	7 966	6 376	7 874
Consumer goods	852	2 406	3 355	3 242	1 006	319
Intermediate goods	-6 863	9 307	9 271	8 407	-3 699	-4 930
Capital goods	-2 781	-10 772	-13 327	-19 967	-45 289	-52 506
<b>Total</b>	<b>-25 390</b>	<b>7 567</b>	<b>7 522</b>	<b>-351</b>	<b>-41 606</b>	<b>-49 243</b>

Source: ECLAC, on the basis of official figures.

national markets with traditional export products are equally worthy of being viewed as "Schumpeterian innovators", they both deserve temporary special incentives for their efforts, since the penetration of international markets is the real "infant industry" that should be promoted in order to achieve greater competitiveness.

#### 4. Financial liberalization

Proper functioning of the capital market is essential for a market economy. It is hardly surprising, then, that neoliberals heavily criticize interest rate controls, preferential lines of credit for certain activities and sectors, and restrictions on the inflow and outflow of capital (McKinnon, 1973), because they believe that liberalization of this market will increase saving and improve the allocation, and hence the efficiency, of investments.

The first and biggest financial liberalization exercises in the region were carried out in the mid-1970s

in Uruguay, Argentina and Chile. Since then, this market has gradually been liberalized in the rest of the region, especially as regards interest rates and the inflow and outflow of capital. So far, however, the expected positive effects on saving have not been observed in most countries. In reality, national saving has been more sensitive to increases in the fiscal surplus and compulsory saving policies (through pension systems) than to additional rises in interest rates.<sup>6</sup>

On the contrary, instead of increasing saving, additional increases in interest rates have often reflected heavy imbalances associated with the imminent collapse of financial systems, as occurred in the neoliberal experiences of three Southern Cone countries in the 1970s (Díaz-Alejandro, 1984; Ramos, 1986). Indeed, the existence of interest rates of 20% to 25% per year in real terms for several years was an extremely abnormal sign when the economies in question were only growing by about 5% per year. Such rates were a

<sup>6</sup> Of course, this may also be because financial liberalization has coincided with recessions caused by the heavy macro-economic imbalances suffered by the region. It may also be due, however, to the fact that, once a reasonable real interest rate has been attained, additional increases have

ambiguous effects on saving: although a rise in interest rates encourages the postponement of consumption (i.e., the substitution effect is positive), raising interest rates on past savings makes it easier to achieve a given amount of savings, which leads to lower rates of saving.

reflection, among other things, of an inflated demand for credit due to changes in net worth caused by big movements in relative prices. These movements were associated with trade openness, financial liberalization and persistent macroeconomic imbalances: the activities favoured by these factors needed credit for expansion, while those which were adversely affected needed money to stave off their collapse.

Obviously, it is not normally possible to pay such high interest rates systematically for such a long time when the economy as a whole is only growing by around 5% per year. What made it possible in this case were two phenomena associated with financial liberalization.

First, in the Southern Cone this liberalization coincided with the heavy external indebtedness of the late 1970s. As a result, the values of domestic assets, including very specially those traded on the Stock Exchange, increased several times in real terms (16 times in Chile between the end of 1975 and the end of 1980, and 4 times in Argentina between early 1978 and early 1980). Because of the high value on paper of enterprises' assets, which grew even faster than real interest rates, the indebtedness/assets ratio did not seem to be at risk, and firms confidently believed that they would be able to pay their debts, especially if they also believed that in the long run real interest rates would go down to their normal levels (5% to 7% per year).

Second, the regulations were very permissive regarding loans by banks to firms belonging to the same economic group as the banks in question (by three-way credits through "paper firms" and cross-lending among groups). Instead of safeguarding the interests of their depositors and their own assets, the banks placed themselves at the service of their parent groups. Consequently, when the inflow of capital slackened they were obliged to keep on lending, because if the debtor firms failed, then the groups (and hence the banks themselves) would become insolvent.

Consequently, the persistence of such high interest rates and the "bubble" of asset prices depended on a growing inflow of foreign capital and the corresponding exchange-rate lag that that inflow made possible. Neither of these factors was sustainable in the long term, however. Once the inflow of capital slackened, firms could no longer pay their debts, the values of their assets collapsed, and the banks found themselves with a portfolio of government then had take over this private debt (i.e., "socialize" it).<sup>7</sup>

Thus, the financial liberalization exercises in the Southern Cone turned out to be one of the worst disasters

in neoliberal history. As the critics of these exercises pointed out, the capital market is different from other markets: it is not a question of exchanging one good for another, as in, say, the potato market, but of exchanging one good (money) for a future promise. Thus, this market is not only rationed by price (higher interest rates) but also by quantity (provision of a smaller loan than that requested), since a higher interest rate may indicate higher profitability or a bigger risk. Regulation is therefore needed in order to ensure that banks do not take excessive risks, winning large amounts if they are lucky, or, if they are not so lucky, merely losing their own limited assets (but also the much greater assets of their depositors). Furthermore, as this is a market which adjusts very rapidly, it tends to absorb and reflect the imbalances of other markets (exchange-rate lag, "bubbles" in asset prices, recession in the goods and labour markets), so that it is dangerous to carry out financial liberalization in the midst of serious macroeconomic imbalances, when the key prices of the economy are still significantly removed from their long-term equilibrium values (Corbo and Fischer, 1994).

## 5. Privatization

If the private sector is to recover its leading role in development, then privatization—at least of non-monopoly production firms—should be a top priority for neoliberals, for the assumption is that management will be more efficient and innovative if the resources handled are private funds (as in the private sector) rather than public ones (as in the public sector). Likewise, whereas private enterprise has a clear objective—to maximize its profits—public enterprises usually have multiple aims: not just to make profits, but also to generate employment; to play a distributive function by charging lower prices, at least for the needier groups; to favour domestic production by buying domestic inputs even though they are more expensive or of poorer quality; to locate their activities in less-developed areas, even if this increases their costs, and

<sup>7</sup> Argentina "socialized" this debt by "liquefying" it: that is to say, it accepted an explosive upsurge of inflation while keeping the debts at fixed interest rates. Chile, however, "socialized" the debt without sacrificing its anti-inflation achievements. It did so through intervention by the Central Bank, which took their bad debts off the banks' hands and paid them with fresh money, in return for an undertaking that the banks would return this money out of their future profits, although without fixing any final date for this.

so forth. It is therefore hard to know what their primary function is, and whether they are fulfilling it well.

The region currently welcomes the idea of privatization both because of the above arguments and because of pressing fiscal needs (Cardoso, 1992; Kikeri, Nellis and Shirley, 1994). Indeed, privatization has brought fiscal income equivalent to 1% or 2% of GDP per year, and cumulative totals of the order of 5% to 10% of GDP.

Although the structuralist school supported public sector intervention in production activities in the past, this was for reasons which are mostly no longer valid. Among these reasons were the fact that many projects required so much capital that in those days they could only be carried out by public or foreign entities; that there was a lack of private business initiative, so that the public sector had to step in to make up for this lack, and that many activities, because of the economies of scale involved, only allowed for the existence of a single firm, so that the public sector had to carry them out in order to avoid monopolistic abuses. With the growth of capital markets, the more professional quality of business management and greater trade openness, however, these arguments have gradually been losing their validity. Consequently, neostructuralists now welcome the idea that the public sector should withdraw from production functions and concentrate on the key functions that only the State can carry out. In fact, the main current discrepancy between neoliberals and neostructuralists in this respect is that the former support privatization almost at any cost, whereas the latter emphasize that enterprises should be privatized on the best possible conditions of price, regulation and transparency (Hachette and Lüders, 1992; Cominetti and Devlin, 1994). Indeed, if privatization is going to make an enterprise more efficient, then the most appropriate sale price for the government is that which is close to the income flow that the activity in question will have when it is privately managed, rather than the value it currently has under public management.

This means that privatization operations should only be carried out, as far as possible: i) with enough potential buyers to ensure competition in the tendering process, and not in a hasty manner with few potential buyers and insufficient capital; ii) after due stabilization and liberalization, and not in the midst of a recession, when the price will be lower and the discount rates will be higher; iii) tradeable activities must be privatized first, and only later non-tradeable and monopolistic activities; iv) in the case of natural monopolies, the applicable rules must be perfectly clear, since in the absence of clear regulations the bidders will tend to offer lower prices, in order to protect

themselves against possible future regulations; and v) the privatization operations must be carried out with the utmost transparency, and only after external audits of the accounting position of the firms. Measures must be taken to prevent the purchase of firms by their current managers (except perhaps in the case of small and medium-sized firms), because these managers will have privileged internal information on the firms, and efforts should also be made to prevent their purchase by big conglomerates or banks. In order to comply with these conditions, privatization should be carried out only gradually: an approach which is perfectly possible in Latin America because altogether these firms rarely account for more than 10% to 15% of GDP.

## 6. Pension system reform

Until the 1981 Chilean reforms, the prevailing pension system in Latin America was based on the "pay-as-you-go" principle, in which the contributions of the active labour force financed the pensions of retired persons. This system thus redistributed resources from the present generation to the previous one,<sup>8</sup> in that it paid pensions according to a predetermined percentage of workers' maximum incomes (those of their last years of working life), and these pensions were higher than the present value of contributions. This system was possible: i) as long as the ratio of assets to liabilities was maintained or increased, and ii) as long as wages tended to rise with the development process. This inter-generation transfer would become problematical, however, if growth of the population and of the labour force slackened, so that the ratio of assets to liabilities would fall, and if benefits began to diverge from contributions, leading to collusion between workers and employers to make excessively low contributions during most of a worker's working life and only make proper contributions in the last few years (because these years are the only ones that matter for calculating the worker's pension). Unfortunately, most of the pension systems used in the region have suffered from both of these problems, so that they have gradually been running up actuarial

<sup>8</sup> To a lesser extent, it also permitted the redistribution of resources among retired persons of the same generation.



deficits<sup>9</sup> and also cash deficits equivalent to 2% to 6% of GDP, especially in the case of the older systems.

The pension system favoured in recent years is based on individual capitalization. It is also a form of forced saving, since it obliges workers to save a certain percentage of their wages each year in a special account. Their pension is a direct function of their contributions and the yield on the investments made by the Pension Fund Management Company (AFP) to which they belong during their working life.<sup>10</sup> There is therefore less incentive to under-declare wages,<sup>11</sup> so that the rate of saving will rise (or the deficit will be smaller than under the pay-as-you-go system). A second advantage is that, since it is a question of funds which are invested and not merely distributed, this does away with the tendency of the pay-as-you-go system to distribute the surpluses generated (especially at the beginning, when there usually are surpluses) in the form of greater benefits for those already receiving pensions, instead of establishing reserves and investing them wisely to cover future commitments. Thirdly, the existence of these forced savings makes it possible to strengthen the region's feeble capital markets, especially in terms of the generation of resources for long-term investments.

Although these three benefits are by no means insignificant, it must be noted that there is a cost and a risk, and it is necessary to clear up an error or misunderstanding. The cost is that the competition among AFPs to attract clients significantly increases their

management costs. Thus, a typical AFP spends nearly 20% of the ten percentage points that it collects from a worker's income on efforts to attract members from other AFPs by publicity, sales campaigns, etc., without any benefit for the members themselves.

In order to reduce the cost of excessive transfers from one AFP to another, and in view of the fact that most workers only want a "normal" level of low-risk returns on their funds, it is recommended that they should be offered the possibility of investing in a pension fund which undertakes to pay the average rate of return of the AFPs as a whole, in return for their undertaking not to transfer out of that pension fund for  $x$  years.<sup>12</sup> This would markedly reduce collection costs, resulting in considerably lower commissions than those currently charged and higher pensions, at least for those choosing this alternative; in contrast, a person who wanted the possibility of leaving his AFP in search of possibly higher future yields would be free to do so, but would have to pay a higher commission to cover the cost of his transfer.

Furthermore, it is recommended that workers' contributions should be collected by a single agency, whether State-run or privately operated by concession, for it costs much less to collect contributions on a centralized basis and it is much easier for an employer to deduct the necessary amounts from his payroll and pay them to a single collection agency (Diamond and Valdés, 1994). The agency in question would then transfer the contributions to the appropriate AFP. At all events, this system would maintain the central principle of capitalization in individual accounts.

The risk referred to above is that when the new pension system is set up, in the absence of fuller information, there is a strong tendency for workers to sign up with the AFP that seems to be soundest and most solvent. Consequently, AFPs connected with major banks or big corporations will have a natural advantage which will give rise to a strong tendency towards concentration, with perhaps two or three AFPs controlling 75% of all accounts. This problem could be relieved if, as we proposed earlier, the resources are collected by a central agency and the management of packages of resources is

<sup>9</sup> A pension system may not have a cash deficit, but it may nevertheless have an actuarial deficit if it is accumulating future commitments which are not matched by current income: thus, for example, if life expectancy after pensionable age increases or there is a decline in fertility, as is currently occurring in the region, it may be calculated that the ratio between the working-age population and those over 65 will go down from 12.6 at present to 8.7 by the year 2020. This will mean a commitment 30% greater for each active participant, thus making it necessary to start generating cash reserves as of now (through higher contributions or lower benefits) in order to cope with this reduction in the number of active persons per pensioner.

<sup>10</sup> In fact, however, since many workers only earn low wages, the pension for which they will be eligible at the end of their working life may be so low that the State may decide to supplement their forced savings with a fiscal contribution so that their pensions will reach a socially acceptable level. The Chilean pension reform provides for such a minimum, so that it involves an inter-generational distributive element.

<sup>11</sup> There will still be an incentive to under-declare wages, however, especially in the case of young people or temporary workers who prefer money right now rather than in the distant future, if the rate of readjustment is greater than the probable profitability of the system.

<sup>12</sup> Furthermore, this "average" fund could offer two alternatives: one providing minimum risk and low profitability, with investments in fixed-income instruments, and another offering higher risks and profitability, through an "average" portfolio of stock market investments. In this way, workers could choose, within "normal" levels of risk, the combination of profitability and risk that best suited their needs.

then awarded by tender to some seven or ten different investment agencies for investment over a given period according to the risk criteria laid down in the tender conditions.

The error or misunderstanding we mentioned is that of believing that the individual capitalization system will significantly increase net saving. It is quite true that the new system generates net private savings at the beginning, when the inflow of resources is large (typically from all the new workers or the younger ones) and the outflow of pensions is only small, but this private saving is offset by a corresponding fiscal deficit,<sup>13</sup> since the old system must keep up expenditure on pensions but now no longer receives the contribution of new workers, who now pay into the new system. Moreover, although this new fiscal deficit may be "financed" with loans from the AFPs, the government will generate an additional deficit equivalent to the difference between the rate of interest on deposits (which it paid before) and the rate of interest on loans which it must now pay. Thus, as a first approximation, the individual capitalization system does not generate an increase in saving.

In fact, extra saving will only be generated if the government decides to eliminate this deficit by making additional cuts in its expenditure or increasing its income. If this is done, then saving increases parallel with the introduction of the new pension system, but not because there is greater private saving but because there is a bigger saving effort on the part of the public sector. This is what happened in Chile, where the initiation of the pension system based on individual capitalization gave rise to a fiscal deficit amounting at its peak to some 5% of GDP. Net saving only increased because the government took measures to reduce that deficit by, *inter alia*, raising pensionable age to 65 (instead of the possibility of retiring after a certain number of years of service), thereby increasing revenue and shortening the period during which pensions would be payable. In addition, it reduced all pensions by 10% and cut other expenditure not connected with the pension system.

The moral of all this is clear: the increase in net national saving accompanying the introduction of the new individual capitalization pension system, and the

amount of resources available for strengthening the domestic capital market, will depend on the additional effort made by the public sector to reduce or eliminate the fiscal deficit that the new pension system will generate.

Consequently, the most urgent reform that pension systems need is to eliminate their deficits, which should be achieved by balancing their income and their actuarial commitments, not just their cash situation. Once this has been done, the authorities can consider whether they should continue with a reformed pay-as-you-go system (with investment of reserves) or change to an individual capitalization system with competition in both the collection and investment of contributions, or with centralized collection arrangements and competition in the investment of the resources collected.

## 7. Labour market reform

Neoliberals attribute much of the unemployment problem to rigidities in the labour market created by well-meaning but mistaken public policies and institutions such as severance payments, high minimum wages, restrictions on entry into certain trades, and strong trade unions, to name only a few. They therefore advocate flexibilization and deregulation of the labour market and restrictions on the power of the trade unions. There is no doubt that restrictions on entry into certain trades, such as that of dockers, for example, can strike a mortal blow at the competitiveness of an open economy. It is also quite true that in sectors making intensive use of capital and key natural resources—such as copper in Chile and petroleum in Mexico and Venezuela—, or in natural monopolies such as the electricity industry, many workers often receive wages far above their opportunity cost (World Bank, 1995). Likewise, the aggressive trade union movements of closed economies must adjust to the competitive conditions of open economies.

Neoliberalists, for their part, consider that save in exceptional cases such as those mentioned above these rigidities do not have much significance for the great majority of the labour force, who are not highly unionized and whose main problem is the low productivity of the jobs which are open to them. According to this school of thought, the high level of underemployment typical of the region is due to other types of rigidities, in markets complementary to the labour market. Thus, for example, segmentation of the capital market means that funds for long-term investments are

<sup>13</sup> This deficit would be identical to the apparent new saving, except for the lower level of under-declaration that the individual capitalization system may achieve.

only available to the small nucleus of firms which are quoted on the Stock Exchange or have access to international capital, so that they tend to work with excessively capital-intensive technologies, while the bulk of the labour force has to work in firms with little capital and hence in low-productivity jobs.

With regard to the labour market itself, neostructuralists consider that, in general, the worst rigidities—those responsible for higher unemployment and lower productivity—are due much more to contractual practices than to the prevailing legislation. For example, there is no legislation that requires wage readjustments in periods of high inflation to be made as a function of past rather than future inflation. Nevertheless, this is a frequent practice which leads to inertial inflation, or to unemployment if the government persists in its aim of significantly lowering inflation.

Likewise, if there is a recession and the overall demand for labour declines, it would be better to resort to a reduction in the number of hours worked by the labour force as a whole. However, the customary practices—not the prevailing legislation—mean that such a generalized fall in demand results in unemployment for some workers instead of being shared by all, and this has negative effects from both the macroeconomic and the distributive standpoints.

## IV

### Some lessons

The most successful changes made by the neoliberals have been tax reform, the opening-up of trade, and pension system reform. The increase in trade openness has been quite successful even when carried out rapidly (especially in situations of scanty capital inflow), and so too has been the reform of social security systems, especially when the government was able to reduce or eliminate the public deficit that such reform involves. Likewise, privatization has been successful too, except when carried out over-hastily or in the absence of clear rules, without a suitable regulatory framework or due attention to the possible concentration of wealth. In contrast, it seems to us that liberalization of the labour market has been given too much prominence in view of the problems it is supposed to tackle

Finally, it is because of customary contractual practice—not the legislation—that workers are paid for the number of hours worked rather than for their output, which leads to lower productivity and more unemployment (ECLAC, 1992). In contrast, if a significant proportion of workers' income (say 20 - 25%, as in Japan) were linked to the performance of their firm, department or team, the incentives and social pressure for improved productivity would be greatly strengthened (Blinder, 1990). Moreover—and this is equally or even more important—in periods of lower demand firms with such participative wage systems will tend to lower their prices in order to keep up their sales, production and ultimately employment, since the variable component of wages will also go down, whereas traditional firms will tend to maintain their prices but reduce output and employment, because their wages are fixed by contract (Weitzman, 1984). In boom periods, in contrast—unlike traditional firms, which will tend to increase their prices more than their output in order to make quick profits—firms with participative wage systems will be more likely to expand their output and labour force than to raise their prices, because if they did raise them this would automatically increase the part of wages that varies in line with the economic performance of the firm.

(unemployment and underemployment). The wisest measure of the local neoliberals, however, was not any particular reform, but their appreciation of the fact that the private sector was now in a position to take on the leading role in development and their decision to assign it that role and insist that resource allocation must be centered on the market.

The most costly reforms—both in economic terms and in terms of income distribution—were the anti-inflation and adjustment policies and financial liberalization. The first-named reforms—since they were aimed at securing quick adjustments in prices but not in the volume of production, even in situations of serious imbalances, and were therefore confined to the use of only a few instruments—were accompanied by unnecessarily severe recessions, while the latter re-

forms led to the collapse of the banking system for lack of the regulatory safeguards which are essential in a very special type of market where confidence is vital. Finally, there was systematic neglect of income distribution considerations, both by sins of omission (for example, in Chile the firms which had been nationalized or placed under State management between 1970 and 1973 were returned to their owners later in that decade without charging capital gains tax) and of commission (the biased approach of displaying great concern at the rigidities of the labour market but paying little or no attention to those of the financial market).

In real life, of course, no economic policy is ever completely free of errors, but the striking feature of these reforms –including those in the case of Chile, which is held up as a model to be emulated– is the great magnitude of the errors committed, which were due above all to the blind faith of the local neoliberals in their ideology. In macroeconomic policy, there were serious biases as regards the speed and automatic means with which the balances were restored, because since it was believed that markets adjust quickly, it was felt that State intervention was unnecessary; in the case of financial liberalization, the financial market was treated as though it was just another merchandise market: little attention was given to its regulation or to its very special feature of being a market where current payments are made in exchange for promises of future repayment. With regard to the costs involved in terms of income distribution, these were due both to earlier errors and to the blind faith of local neoliberals in the trickle-down effect and their neglect, if not downright contempt, of distributive considerations.

The fundamental error of local neoliberals has thus been their blind, uncritical faith in the virtues of the market: they acted as though market clearing prices are the same as long-term equilibrium prices, but of course this is not so: if other markets are not balanced (such as a merchandise market with inflated prices, or a foreign exchange market with exchange-rate lag), then the market clearing prices in the other markets (such as the credit market) are not long-term equilibrium prices, because they have had to absorb the imbalances of the other markets. If –as neoliberals tend to believe– it is believed that the key prices at any given moment are always equilibrium prices, then there will be a tendency to minimize or misinterpret elements that point in the

opposite direction, such as the persistence of very high real interest rates for long periods of time, financial bubbles in the assets market, serious exchange-rate lags, perilous levels of domestic and external indebtedness, highly volatile capital inflows or high rates of unemployment and idle capacity. In effect, neoliberals' faith in an ideal market –if they are free, then the key prices at any given moment must necessarily be correct, since they are fixed by the market– rules out all question of government intervention, which is seen purely as a source of distortions.

If they discard such preconceptions, other countries could adopt many neoliberal reforms and concerns without suffering their high costs, and many of their problems could be corrected as suggested above. Indeed, doubts about the sufficiency and automatic nature of the market forces lie at the roots of neostructuralism (Sunkel, 1991), although this school of economic thought stems not only from criticism of neoliberalism but also from self-criticism of structuralists' assumption that every market flaw calls for State action, as though only the market were imperfect. Today, there is an awareness that this too is an idealized view, in this case of the State, which is seen as being free from all limitations and imperfections. Consequently, neostructuralists consider that State action must be selective and must be focussed on the flaws, segmentation and most critical gaps in the market, which neoliberals tend to overlook (ECLAC, 1990, 1992 and 1995a); on the slow and inequitable spread of technological know-how, which means that total factor productivity in our firms is less than a third of that of companies in developed countries; on the absence of a private capital market for investments in human capital and the general underinvestment in this area; on the virtual absence of a long-term capital market, except for the few firms whose shares are traded on the Stock Exchange, which means that the expansion of firms is limited not by their expected future profitability but by their capacity for financing their investments out of their own resources; on the absence of a foreign exchange futures market, which obliges the Central Bank to simulate a future price and intervene in the exchange rate; and on the lack of active policies to promote non-traditional exports and to encourage the export of traditional products to new markets.

If these gaps and imperfections were corrected, this would broaden the productive base and eventually place the region on the road to rapid development, as

## Latin America: Main features of trade, financial and macroeconomic policy reforms

	Trade reform	Financial and capital market reform	Macroeconomic policy reform
Argentina	<p>1976-1981 Elimination of prohibitions and quantitative restrictions. Reduction of tariff rates. Reduction of tariff dispersion.</p> <p>1981-1989 Reversal of reform process; establishment of sectoral and regional promotion systems.</p> <p>1991 → Elimination of prohibitions and quantitative restrictions. Reduction of tariff rates. Reduction of tariff dispersion. Elimination of promotion systems.</p>	<p>1978-1981 Broad opening of capital account. Elimination of barriers to foreign investment. Broad deregulation of capital account. Radical liberalization of interest rates and credit. State guarantee for 100% of deposits.</p> <p>1987-1990 Development of mechanisms for regulation of the system.</p> <p>1991 → Broad deregulation of capital market. Elimination of barriers to foreign investment. Autonomy of the Central Bank. Maintenance of segmented financial system.</p>	<p>1978-1981 Pre-announced exchange rate guidelines. Fiscal deficit. Passive monetary policy.</p> <p>1991 → Convertibility Act (fixed exchange rate). High domestic interest rates. Fiscal adjustment: heavier taxation, less expenditure and more privatization. Passive monetary policy.</p>
Bolivia	<p>1985 → Elimination of quantitative restrictions. Unified import rules. Single, uniform tariff.</p>	<p>1985-1990 Deregulation of interest rates. Minimum guarantee on deposits. Broad deregulation of capital market. Elimination of barriers to foreign investment.</p> <p>1988 Regulatory and supervisory framework.</p> <p>1990 Liquidation of sectoral banks.</p>	<p>1986 → "Dirty Float" exchange rate system. Free convertibility. Monetary restriction. High interest rates. Fiscal adjustment: heavier taxation, less public expenditure, more tariffs.</p>
Brazil	<p>1987 → Reduction of tariffs. Reduction of prohibitions. More flexible financial programmes for imports. Reduction of number of special import systems.</p> <p>1990 → Elimination of administrative restrictions. Elimination of most fiscal incentives. Gradual reduction of tariffs.</p>	<p>1988 Legal recognition of multibanks. Deregulation of entry into financial activities. Sale of indexed financial assets issued against government bonds. Short-term deposits with daily liquidity. Development of the futures and options market.</p>	<p>1987 → Situation of severe instability. Successive failed stabilization processes.</p> <p>1994 → "Plano Real". Coordination of prices, wages and rents by conversion into currency units of account (URVs). Exchange rate used as nominal anchor.</p>
Colombia	<p>1985-1989 → Gradual partial reduction of tariffs. Gradual reduction of export subsidies.</p> <p>1990 → Drastic reduction of tariffs. Elimination of prior import licenses. Reduction of tariff dispersion. Elimination of export subsidies.</p>	<p>1990 → Installation of subsidiaries in banking system. Liberalization of entry into the system. Elimination of restrictions on foreign investment. Liberalization of interest rates. Partial liberalization of foreign exchange market. Prohibition of attraction of foreign-currency deposits. Autonomy of the Central Bank.</p> <p>1993 New regulatory act.</p>	<p>1990 Reform was preceded by heavy devaluations. Stability and maintenance of macroeconomic balances.</p>

## Annex 1 (continued)

	Trade reform	Financial and capital market reform	Macroeconomic policy reform
Costa Rica	1986 → Gradual reduction of average tariff rate. Gradual reduction of tariff dispersion. Fiscal incentives for exports. Simplification and reduction of export formalities.	1984-1988 Maintenance of State banking system. Reduction of regulations and controls on the system. Liberalization of interest rates, except for lines of credit to small and medium-sized firms. Development of private commercial banking system. Development of supervision of the system. 1992 Broad opening of capital account.	1986 → Gradual steady rise in the real exchange rate. Exchange rate float with Central Bank intervention. Macroeconomic stability. Control of fiscal deficit.
Chile	1974-1979 Reduction of average tariff rate. Elimination of non-tariff restrictions. Uniform tariff. 1984-1991 Support price ranges for agricultural products. Introduction of anti-dumping system. Simplified drawback for minor exports.	1974-1981 Privatization of banks. Deregulation of interest rates. Opening-up to foreign investment. Reduction of restrictions on sale and purchase of foreign exchange. Restrictions on external credits. Further development of the system through the investments of the Pension Fund Management Companies (AFPs). 1983-1987 Development of regulation and supervision. 1991-1994 Reduction of restrictions on movements of foreign capital. Autonomy of the Central Bank.	1974-1978 Unified exchange rate and mini-devaluations. Fiscal adjustment: drastic reduction in public expenditure. Passive monetary policy. 1979-1981 Fixed exchange rate. 1984-1990 Heavy devaluation. Stabilization. 1991-1994 Currency float with Central Bank intervention. Control of money supply expansion (sterilization).
Jamaica	1980 Gradual elimination of quantitative restrictions. 1985 → Elimination of import licenses for raw materials and capital goods. 1986 → Gradual reduction of tariffs to match those of CARICOM. Reduction of tariff dispersion.	1982 → Establishment of Agricultural Credit Bank and National Development Bank: allocation of long-term credit to production sectors through financial intermediaries. 1985 → Increase in supervision of the financial system. Introduction of open market operations by the Central Bank.	1980 → Stabilization and structural adjustment programme. 1984 → More flexible foreign exchange policy. 1985 → Fiscal adjustment.
Mexico	1985-1994 Partial elimination of quantitative restrictions. Incorporation of anti-dumping system. Elimination of prior permits for imports of consumer goods. Simplification of tariff system to only five rates. Maintenance of import restrictions in the case of motor vehicles, microcomputers and pharmaceuticals. Elimination of export subsidies. Reduction of industrial promotion measures.	1989 Deregulation of interest rates. Broad opening of the capital account. Elimination of restrictions on foreign investment. 1990 → Reprivatization of the commercial banking system. Access of foreign investors to financial markets. Access of domestic investors to security sales abroad. Rules for the control and supervision of the financial system.	1989 → Stabilization policy with nominal exchange rate anchor. Coordination by consensus of readjustments in key prices and wages. Fiscal adjustment policy. 1994 Massive devaluation.

## Annex 1 (concluded)

	Trade reform	Financial and capital market reform	Macroeconomic policy reform
Peru	<p>1979-1980 Elimination of import barriers and prohibitions. Reduction of tariff rates.</p> <p>1985-1990 Total reversal of the process.</p> <p>1991 → Elimination of export subsidies. Total abolition of import prohibitions. Reduction of tariff rates. Reduction of tariff dispersion. Introduction of drawback arrangements. Target of achieving a single uniform tariff by 1995.</p>	<p>1991 → Liberalization of foreign exchange market. Broad opening of capital market. Unrestricted opening-up to foreign investment. More flexible interest rates. Deregulation of bank credit. Development of multibanks. Development of regulation and supervision of the financial system.</p>	<p>1979-1980 Exchange rate lag. External imbalance.</p> <p>1982-1984 External debt crisis, devaluation, and reversal of the reform process. Speeding-up of inflation.</p> <p>1985-1990 Expansionary fiscal policy. Balance of payments crisis. Marked instability.</p> <p>1991 → Stabilization. Fiscal adjustment: more expenditure, more privatization. Exchange rate lag. Monetary anchor. Balance of payments problems.</p>
Uruguay	<p>1974-1978 Elimination of prohibitions and non-tariff barriers. Expansion of subsidies and benefits for non-traditional exports. Reduction of taxes on traditional exports.</p> <p>1978-1982 Simplification of tariff system. Gradual reduction of tariffs. Elimination of subsidies and tax incentives for exports.</p> <p>1985-1993 Adoption of five tariff brackets. Reduction of tariff rates. Preferential interest rates for exports.</p>	<p>1974 → Broad opening of capital market. Gradual elimination of controls on interest rates. Elimination of compulsory reserve requirements. Liberalization of the foreign exchange market. Public banks maintain long-term lines of credit.</p>	<p>1974-1978 Economic stabilization programme.</p> <p>1978-1982 Pre-announced exchange rate and sharp revaluation.</p> <p>1985-1993 Fiscal adjustment. Exchange rate float with Central Bank intervention.</p>
Venezuela	<p>1989-1990 Elimination of prohibitions and restrictions. Elimination of special-purpose taxes. Gradual reduction of tariffs. Elimination of tariff exemptions. Adoption of countervailing taxes to protect local industry. More flexible administrative procedures for exports. Elimination of tariffs on raw materials, parts, components, semi-manufactured goods and export inputs. Introduction of a system for the return of taxes.</p>	<p>1989-1990 Reduction of interest rate regulation</p>	<p>1989-1990 Stabilization programme. Fiscal adjustment. Unified, free, flexible exchange rate.</p> <p>1993 Introduction of exchange controls.</p>

Source: ECLAC, 1995b

## Latin America: Public sector reforms

	Tax reform	Pension system reform	Privatization and reform of public enterprises
Argentina	<p>1976 Ordering and simplification of tax legislation. Indexing arrangements for taxes. Elimination of export duties. General application of value added tax (IVA). 1976-1981 Unification of IVA rates. Expansion of profits tax base. Elimination of banking and stock exchange secrecy. 1990-1992 Suppression of export taxes. Elimination of industrial promotion systems. Uniform treatment of profits for both residents and non-residents.</p>	<p>1994 Reform of social security system.</p>	<p>1990 → Privatization of public services, without first of all putting them on a sound financial basis. Absence of real competition in tendering processes. Maintenance of monopolistic nature of markets. Deregulation of the oil market. 1992 Sale of gas and electricity services. 1993 Sale of YPF and iron and steel companies.</p>
Bolivia	<p>1986 Simplification of tax system. Reduction of tax rates. 1987 Establishment of Ministry of Revenue Collection, subsequently incorporated as a department of the Ministry of Finance. 1988 → Strengthening and rationalization of institutions.</p>		<p>1985-1986 Radical employment cuts in mining and the State industrial enterprises. Far-reaching reform of COMIBOL and YPF. Adoption of criteria based on maximization of profits and thorough rationalization. 1992 Privatization Act. 1993 Capitalization project for the main public enterprises.</p>
Brazil	<p>1965 Ongoing corrections in tax rates and allocation at the various levels of State organization. Numerous reforms in the income tax system. 1988 Process of decentralization of tax revenue.</p>		<p>1991 → Special measures governing the participation of foreign firms in the privatization process. Privatization operations in: petrochemicals (15 companies), fertilizers (5 companies), iron and steel (9 companies) and other sectors (5 companies). 1995 Privatization process in the area of public services.</p>
Colombia	<p>1974 → Increase in rates and progressiveness of direct taxes. Elimination of a number of incentives and exemptions. Unification of taxes on different types of companies. Correction of financial income for inflation. Introduction of the current value added tax (IVA).</p>	<p>1991 → Initiation of reform of the social security system.</p>	<p>1987 → Privatization of only a small number of State enterprises of marginal importance.</p>



Annex 2 (continued)

	Trade reform	Financial and capital market reform	Macroeconomic policy reform
	<p>Establishment of the National Tax Superintendency. Improvement of the system of collection through the banking system. 1992 → Reduction of tax on remittances by foreign firms. Foreign investment funds placed in the "non-declaring" category. Introduction of system for the return of taxes.</p>		
Costa Rica	<p>1994 Increase in taxation of consumption. Reduction of export taxes. Reduction of business profits tax. General application of sales tax. Increase in wealth tax. 1992 Elimination of exemptions and introduction of higher penalties for tax evasion.</p>		<p>Substantial increase in public service charges. 1984 Privatization of most of the public enterprises in the State conglomerate CODESA. 1985-1990 Privatization of 40 public enterprises.</p>
Chile	<p>1982 Replacement of sales tax with value added tax (IVA). Elimination of exemptions and special tax rates, even for public services. Improvement of the monetary correction system. Elimination of taxes on capital gains and net worth. 1976-1986 Policies designed to reduce tax evasion. 1984 Reduction of income tax. Expenditure tax. 1990 Increase in business income tax and IVA.</p>	<p>1980 Reform of the social security system: introduction of a system of individual capitalization based on membership in private pension funds providing old age, disability and survivors' pensions from the compulsory contributions of members.</p>	<p>1974-1977 Reprivatization of enterprises taken over by the previous government. 1982-1983 Reversal of privatization process through State intervention to rescue the financial system. 1985 Speeding-up of privatization of traditionally State-owned enterprises. 1990 New role for the Production Development Corporation (CORFO).</p>
Jamaica	<p>1986 → Sporadic simplification of tax system. Reduction of tax rates. Increase in tax base. Strengthening of institutions. 1991 Introduction of a general consumption tax, similar to a value added tax, to replace a variety of consumer taxes.</p>		<p>1983-1984 Rationalization of public enterprise management. 1985 → Privatization of public enterprises: services and telecommunications, hotels, sugar and banana industries.</p>

## Annex 2 (concluded)

	Trade reform	Financial and capital market reform	Macroeconomic policy reform
Mexico	<p>1970-1976 Increase in income tax coverage. Increases in special-purpose taxes. Coordination of federal sales tax with the rest of the states.</p> <p>1978-1982 Simplification of indirect taxes; introduction of value added tax (IVA).</p> <p>1987-1989 Reduction of effective rates of business, income and personal taxes and expansion of the tax base.</p>		<p>1984-1988 Privatization of small and medium-sized enterprises.</p> <p>1989 Privatization of large enterprises in strategic and non-competitive sectors. Prohibition of foreign investment through debt-equity swaps.</p> <p>1990 → Privatization of ports, highways, airports, power stations and even prisons. Improvement of the competitive environment for public enterprises (deregulation of prices).</p>
Peru	<p>1991 Simplification of tax system.</p> <p>1993 Simplification of income tax. Strengthening of the general sales tax. Elimination of exemptions. Restructuring of tax administration. Development of systems to check evasion.</p> <p>1994 Process of reform and modernization of SUNAT. Training of staff and functional and economic autonomy. Modernization of the National Customs Service.</p>	<p>1993 Reform of the social security system (still underway): the system is to be privatized, with individual capitalization of employees' contributions, but the old system will remain in being.</p>	<p>1992 Privatization of ten small enterprises for a total of US\$ 209 million.</p> <p>1993 Privatization of mining, air transport and oil marketing companies for a total of US\$ 300 million.</p> <p>1994 Privatization of several large companies, the most important of which was the Peruvian telephone and telecommunications company CPT-ENTEL, for a total of US\$ 3.1 billion. Introduction of the "Citizen Participation" system which gives Peruvians the chance to buy shares in State enterprises. Regulation of monopolistic activities and unfair competition, and adoption of consumer protection measures.</p>
Uruguay			<p>1974 → Privatization of financial services. Privatization of ports and transport services.</p>
Venezuela	<p>1994 Simplification of tax structure. Introduction of value added tax (IVA).</p>		<p>1989 → Restructuring of enterprises: industrial retooling and rationalization of management. Modernization of regulatory framework. Privatization of small enterprises.</p>

Source: ECLAC, 1995b.

occurred in all the successful late-developing countries. Recognizing this would also mean admitting, however, that in order to achieve rapid growth it is not enough merely to ensure that "prices are right". Rapid growth depends on systematic efforts in the field of production to bring our productivity closer to that of the developed countries, to leapfrog certain stages, and thus take advantage of the best international practices which are also the most suitable for our countries. It is true that innovation and the spread of technological

know-how are a kind of "black box" for economists, but the fact that they are not easily handled with our traditional instruments does not mean that they are not important. The fact is that a high growth rate of total factor productivity has been a common feature of all the successful late-developing countries. It is therefore essential to promote policies aimed not only at improving the system of prices but also at systematically raising productivity.

(Original: Spanish)

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# Indebtedness *and fiscal stability:* is history repeating itself?

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Public indebtedness –and especially domestic indebtedness– is steadily increasing in a number of countries of the region, despite the major fiscal adjustment processes that have been carried out since the mid-1980s. This article analyses the main problems that this raises for public policy. It first reviews the question of the sustainability of public indebtedness. It then analyses the possible effects of privatization processes, the accumulation of indebtedness against assets, the increase in indebtedness not backed up by prior financing or contingent liabilities, the sustainability of the debt in terms of the acceptable level of inflation, the factors determining expectations regarding the sustainability of fiscal policy and the effects of those expectations on interest rates and sustainable levels of indebtedness, and the extent to which the management of the debt affects its sustainability, and vice versa.

# I

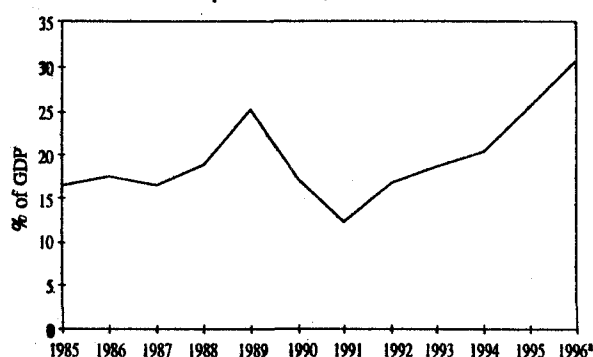
## Introduction

The countries of Latin America have been engaged in a fiscal adjustment process since the mid-1980s. In most of the region, the 1995 and 1996 fiscal deficits were low (see table 1), but public indebtedness, and especially the domestic public debt, has recently increased in a number of countries, including Brazil and Costa Rica (figures 1 and 2). The authorities of these countries and international observers have begun to

show signs of concern in this regard, recalling that a similar process took place in the 1980s in a number of Latin American and Caribbean countries after the suspension of access to foreign credit as a result of the 1982 Mexican crisis, culminating in various forms of liquidation, forced conversion or repudiation of the debt (as in Mexico in 1987-1988 and in Argentina and Brazil in 1990).

FIGURE 1

Brazil: Net domestic public debt, 1985-1996



<sup>a</sup> Preliminary figures.

FIGURE 2

Costa Rica: Gross domestic public debt, 1985-1995

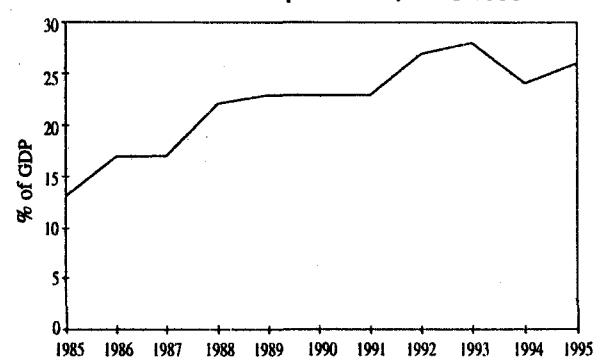


TABLE 1

Latin America: Public sector deficit (surplus)  
(As a percentage of GDP)

	Average 1989-1990	1991	1992	1993	1994	1995	1996 <sup>a</sup>
Argentina (national non-financial public sector) <sup>b</sup>	-3.5	-1.6	-0.1	1.4	-0.1	-0.4	-2.0
Brazil (consolidated public sector) <sup>c</sup>	-2.9	-0.2	-1.8	-0.7	1.1	-4.8	-4.5
Chile (central government) <sup>d</sup>	3.2	1.5	2.2	1.9	1.7	2.6	1.0
Colombia (non-financial public sector)	-1.3	-	-0.2	0.3	2.6	-0.3	-1.2
Costa Rica (central government)	-4.3	-3.1	-1.9	-1.9	-6.9	-4.4	-4.5
Ecuador (non-financial public sector)	-0.7	-1.0	-1.7	-0.4	-0.2	-1.9	-3.5
El Salvador (central government)	-4.3	-5.2	-5.2	-3.3	-2.1	-1.3	-1.8
Mexico (consolidated public sector)	-3.9	-0.4	1.6	0.7	-0.4	-0.1	-0.1
Peru (central government) <sup>d</sup>	-5.6	-1.5	-1.5	-1.4	1.9	-1.6	2.0
Venezuela (non-financial public sector)	-0.5	-2.2	-5.9	-1.3	-13.8	-5.9	-0.0

<sup>a</sup> Preliminary figures.

<sup>b</sup> Excluding provinces and municipalities.

<sup>c</sup> Excluding the inflationary component of interest rates.

<sup>d</sup> The average for 1989-1990 corresponds to the non-financial public sector balance.



This domestic debt buildup raises various queries in terms of policy. What are the similarities and differences between this process and that which occurred in the 1980s? What have we learnt since then about the sustainability of indebtedness and fiscal sustainability? What are the effects of such elements as privatization, fiscal liabilities without prior financing and contingent obligations on the sustainability of the debt? Why is it that the countries of the Organization for Economic Cooperation and Development (OECD) are apparently able to maintain a much greater volume of "sustainable" debt than the Latin American and Car-

ibbean countries? To what extent can the management of the debt condition its sustainability, and vice versa?

These are the questions that will be briefly examined below. We do not aim to give definitive answers. What we do seek to achieve is to encourage further research in a field which we believe will be of fundamental importance for the public finances of Latin America and the Caribbean in the next ten years. In order to facilitate the exposition of our views, we will begin with the simplest definition and a description of the commonest ways of determining the sustainability of a debt, subsequently moving on to some more complex theoretical and practical problems.

## II

### The generally accepted way of determining the sustainability of indebtedness

The most common definition of the sustainability of a debt is the following: public debt is sustainable if the updated value of the future primary surpluses is equal to or greater than the current public debt balance, so that the State will effectively be able to pay the debt from its future surpluses:

$$[1] D(0) \leq \int_0^{\infty} S(t) e^{-rt} dt$$

where  $D(0)$  is the initial outstanding debt balance in real terms,  $S(t)$  is the primary fiscal surplus at time  $t$ , in real terms, and  $r$  is the real interest rate on the public debt.

This definition brings out a first obvious fact: analysis of the sustainability of the debt is the same thing as the analysis of fiscal sustainability. What needs to be determined is whether the (present and expected) fiscal situation will permit repayment of the current debt balance. If the answer is no, then policy measures must be aimed above all at increasing the future primary surpluses.

If we start from the assumption that both the interest rate and the ratio of the primary surplus to GDP are constant (that is to say, if we assume that the primary surplus will grow at the same rate as GDP, with  $n$  representing the growth rate of GDP), the situation can be expressed through the very well known equation which is used in most analyses of debt sustainability:

$$[2] (r - n) D(t) \leq S(t)$$

In this equation, we see that the debt is sustainable if its ratio to GDP remains constant or goes down with time (since it is possible to pay interest rates higher than that growth rate with the current primary surpluses). In fact, equation [2] can also be deduced from that requirement.<sup>1</sup> It can also be interpreted as a stable equilibrium condition. In more general terms, it may be shown that maintaining a constant ratio of debt to GDP is a sufficient but not necessary condition for the validity of equation [1] (Blanchard, Chouraqui, Hagemann and Sartor, 1990). Most debt sustainability analyses therefore try to determine whether this condition is likely to be satisfied or not.

Before going any further, I should like to make it clear that this elementary formulation highlights the fact that debt (or fiscal) sustainability depends to a decisive extent on the real interest rate and the expected growth rate: the greater the difference between them (if  $r$  is greater than  $n$ ), the greater are the primary surpluses needed for the initial debt balance to be sustainable.

<sup>1</sup>  $(D/Y) = D/Y - DY/Y^2 = (rD - S)/Y - Dn/Y \leq 0$ ; whence  $(r - n)D \leq S$ .

Most debt sustainability analyses use exogenously determined interest and growth rates. Unfortunately, these rates will obviously depend on both the debt balance and the size and course of the fiscal surpluses. This is the main –though by no

means the only– disadvantage of using such simple rules. Consequently, before going into some more complex aspects, I should like to note some other limitations of the standard way of analysing debt sustainability.

### III

#### Does privatization help debt sustainability?

One of these limitations is that this type of analysis does not take into account the possibility of reducing the debt by the sale of State assets, as various Latin American and Caribbean governments have done in recent years. It could undoubtedly be held that in principle the privatization of such assets should not have any effect on the sustainability of the debt. As the net income generated by the assets to be privatized should have been included in the primary balance, there would be no difference whatever in the debt sustainability evaluation if that income flow disappeared and the product of the privatization operation was used to reduce the debt. This principle is valid as long as the sale price of the State assets is equal to the present value of the net income

that would have been obtained if the assets in question had remained State property.

From a microeconomic standpoint, however, the principle justifying privatization is that private businessmen can run the privatized enterprises better, so that they would be willing to pay a higher price than the present value of the net income (less taxes) that the enterprises would generate if they remained in the hands of the State. In other words, the present value of the income generated by privatization, plus the taxes paid by the privatized enterprises, could be greater than the present value of the operating surpluses of the public enterprises. In such a case, the privatization of assets to reduce the debt would indeed affect the sustainability of the latter.

### IV

#### Gross or net indebtedness?

If the Central Bank issues debt paper to sterilize capital inflows, what effect does this have on the analysis of debt (fiscal) sustainability? What would happen if debt paper were issued to provide financial assistance to banks with portfolio problems?

This is by no means a minor problem. In recent years, one way or another many Latin American countries have issued considerable amounts of debt paper in order to sterilize capital inflows. Thus, for example, much of the increase in Brazil's domestic debt in recent years has been matched by the accumulation of international reserves and, to a lesser extent, the granting of Central Bank loans to shore up Brazilian banks that were

in difficulties. Both the reserves and these loans to banks appear as assets in the Central Bank accounts.

Foreign exchange holdings must be deducted from the gross debt, since the interest earned does not come within the definition of primary surplus. It must be borne in mind, however, that the yield on them is normally less than the interest payments on the domestic debt, and this consideration must affect the interest rate used in the analysis. In other words, the accumulation of domestic indebtedness in order to increase the international reserves (or to reduce the external debt, as in Costa Rica) affects the sustainability of the debt. Even if the ratio of net indebtedness to GDP remains

constant, the average interest rate on the net debt will increase as a result of these transactions.

A similar problem arises when domestic debt paper is issued against other financial assets. Thus, for example, in Brazil, Mexico, Venezuela, Argentina, Ecuador and a number of other Latin American and Caribbean countries the Central Banks have recently

set up rediscounting mechanisms for banks experiencing difficulties. They generally sterilize the monetary effect by issuing debt paper. The loans to these banks should be deducted when calculating the net debt, assuming that the rediscounts will be paid back in full. But will this really happen? In other words: what is the real value of these assets?

## V

### Contingent obligations, or obligations without prior financing

Another element which must be taken into account is that the Treasury may have contingent obligations, or obligations without prior financing, such as net liabilities connected with the social security system, deposit insurance for the whole banking system, or guarantees given to private individuals investing in infrastructural works.<sup>2</sup>

In recent years praiseworthy efforts have been made to explicitly recognize and fully finance the obligations connected with the social security system. This has been the main guiding principle in the social security reform processes undertaken by various countries of the region (Chile, Argentina, Colombia, Peru and, most recently, Mexico). These measures usually increase the size of the explicit public debt, but at the same time the sustainability of the debt (or the fiscal sustainability) has obviously improved, because the debt already existed but will not increase in the future as long as financing is provided for all new commitments of public or private pension funds. In general, there continue to be some commitments without prior financing (connected with public employees, especially members of the armed forces, teachers,

petroleum sector workers and some others who have remained outside the new system), as well as some contingent liabilities, both old and new (such as guaranteed minimum pensions).

Debt sustainability analysis must take account of the net long-term commitments of the social security system (commitments not covered by the current reserves or expected contributions), either as a long-term flow projection or at their present value as a net debt. In most cases, such an approach would very quickly reveal the unsustainable nature of the present fiscal position, even though the fiscal accounts might appear to be in balance and the explicit outstanding debt is only small (as occurred in all the countries which have reformed their social security systems). This would of course bring out the critical importance of reform of the social security system in order to achieve fiscal sustainability.

How should we deal with the remaining contingent obligations? It would be best, of course, to try to estimate their size and include them explicitly in the budget estimates. This is what the United States is now doing in the case of export guarantees and what New Zealand does with all its contingent liabilities. At a recent conference sponsored by the World Bank (held late in May at Cartagena) this aspect was examined with respect to the guarantees given to private promoters of infrastructural works.

If such a process is not carried out and there are no suitable market indicators, then a good accounting procedure would be to include a percentage of these obligations in the total government debt when analysing the debt sustainability.

<sup>2</sup> The obligations in respect of some insolvent banks or enterprises which are being run by the government and federal government guarantees on states' debts should already be included in the debt balance if there is full consolidation of the public sector in the sustainability analysis.

# VI

## Monetary demand and the debt-inflation tradeoff

Another limitation of traditional debt sustainability analysis techniques, such as that represented by equations [1] and [2], is that such analysis takes it for granted that all fiscal deficits will be financed through indebtedness. In practice, however, governments may choose between financing deficits by contracting debts or by issuing money. How will this affect the standard debt sustainability analysis?

The answer is very simple: public debt is sustainable if the updated value of the future primary surpluses, plus seigniorage, is equal to or greater than the current size of the public debt.

According to this definition, seigniorage includes both the money tax implicit in inflation and the income from money creation due to bigger demand in real terms (for example, as a result of the increase in real income). The concept of money applicable to this definition is the total amount of non-interest-bearing public sector obligations (generally speaking, primary money). This approach permits full consolidation of the non-financial public sector with the Central Bank.

As noted earlier, a sufficient condition for the debt to continue to be sustainable in accordance with this definition is that the course of future primary surpluses plus seigniorage (as a proportion of GDP) should lead to a level of indebtedness (as a proportion of GDP) which is constant in the long term (a stable state).

When matters relating to seigniorage are taken into account and it is assumed that there is a constant ratio of debt to primary money, the corresponding equation is as follows:

$$[1'] \quad d = (r - n)d - s - (p + n)(1/V)$$

where  $d$  is the debt/GDP ratio;

$s$  is the primary surplus/GDP ratio;

$p$  is the rate of inflation, and

$V$  is the income velocity of primary money.

Consequently, the condition for the debt/GDP ratio to remain constant ( $d = 0$ ) is:

$$[2'] \quad (r - n)d - s = (p + n)(1/V)$$

The right-hand part of [2'] represents the seigniorage, which is the result of inflation and the growth of real GDP.

This expression can be reformulated to express inflation as a function of the other variables:

$$[3] \quad p = d/b(r - n) - s/b - n$$

In this context, analysis of debt (fiscal) sustainability becomes a debate on the rate of inflation a country is willing to tolerate. If the other factors remain unchanged, different levels of  $d$  (constant long-term debt/GDP ratio) or  $s$  (primary surplus/GDP ratio) would mean different levels of inflation. The higher the debt with respect to the monetary base ( $Vd$ ), the higher the stable-state rate of inflation (provided the real interest rate is higher than the growth rate of the economy).<sup>3</sup>

Note the fundamental role played by the income velocity of money. Given levels of debt and/or primary deficits will be compatible with levels of inflation that will be lower to the extent that the income velocity of money is lower. In contrast, the higher the demand for primary money (the opposite to the income velocity of money), the higher will be the "sustainable" level of public indebtedness for a given acceptable level of stable-state inflation.<sup>4</sup>

The foregoing clearly shows that there are no magic ratios (debt/GDP or debt/primary surplus) that can be used as international standards for giving warning of the existence of a state of fiscal unsustainability. The great discrepancies observed between the different countries as regards real interest rates, growth rates and income velocity of money show that there are in fact various different levels of sustainable indebtedness.

<sup>3</sup> This result coincides with Sargent and Wallace's "unpleasant arithmetic" (1981).

<sup>4</sup> Naturally, debt sustainability analysis becomes more complex when the income-velocity of money is itself a function of the rate of inflation.

## VII

### Fiscal sustainability, uncertainty and the real interest rate of the debt

As already noted, in all debt sustainability analyses the main problem is to select the "right" real interest rate. In the models analysed so far, exogenous interest rates are used. In fact, however, the interest rate depends both on the level of indebtedness and on the size and structure of the surpluses.

Ghani and Zang (1995) give a very good description of this problem: the sustainability of both domestic and foreign debt is an integral part of macroeconomic stability; the interaction of different policy variables (such as financial policy and policy on indebtedness and interest rates) and the variables of the results (such as GDP and export growth), together with international economic conditions (international interest rates), together determine whether a country has a sustainable level of indebtedness or not.

For example, in an extreme case using pure Ricardian equivalences, the decisive variable conditioning the real interest rate on the public debt would not be the fiscal surplus or deficit but total public expenditure.<sup>5</sup> Public expenditure would represent the amount of resources actually transferred to the private sector. The way that expenditure was financed (through the issue of debt paper or through taxes) would not have much importance with respect to the real variables. Consequently, the total amount of public expenditure could be a variable of critical importance (because of its repercussions on interest rates) for determining the sustainability of the debt (or fiscal sustainability). This is a question that warrants further empirical research.

In more general terms, in view of all the theoretical and empirical problems raised by "proper" measurement of the debt and primary surpluses and the way they influence interest rates, the real interest rate on the public debt can be a useful summary indicator of

the market's expectations regarding the government's solvency.

Indeed, it is quite possible that the main limitation of the customary method of analysing debt sustainability lies in the fact that it does not take account of the degree of uncertainty. Explicit consideration of this element would not only enormously complicate equation [1] but would also call into question the very concept of sustainable indebtedness. Lenders may form different ideas of fiscal sustainability. The more likely they think it is that payment commitments will not be met (i.e., an impression of "fiscal unsustainability"), the higher the interest rates they will demand and the shorter the maturities they will be willing to give.

Since it is impossible to predict the future with total security, the expectations of "unsustainability" of the debt (or fiscal unsustainability), and hence the real interest rates demanded, will depend not only on the fundamental factors of the economy but also on the credibility of the government.<sup>6</sup> The fact that some countries of the region have ceased payments on their domestic (and foreign) debt in the past in one form or another undoubtedly influences current expectations. If all other factors are equal, then in these cases the sustainable debt level will be lower. This is another reason why a given level of public debt or deficit (as a proportion of GDP) might be sustainable in some countries but not in others.

Nevertheless, problems are also raised by the use of the prevailing interest rates on domestic public bonds as a way of determining the debt (or fiscal) sustainability. It may happen that the Central Bank is currently applying restrictive policies, so that the interest rate may not reflect its long-term level, taking into account the parameters of the economy in question. Likewise, the "risk premium" of the government might be affected by transitory forces.

<sup>5</sup> Ricardian equivalences would apply if taxes were only collected once, capital markets were perfect, and all persons acted unselfishly with regard to their inheritances. Under these assumptions, if the level of expenditure were constant, then the debt financing and taxes would be equivalent.

<sup>6</sup> The margins of sovereign indebtedness with respect to U.S. Treasury bonds do in fact reflect these two circumstances.

## VIII

### Debt management and development of capital markets

When domestic debt securities are issued (the same is true of the foreign debt), various policy decisions need to be taken on such aspects as: more or less long-term maturities, fixed or variable interest rates, nominal or inflation-linked rates, and the frequency and form of their issue (agents, auctions, etc.). These decisions affect the expected real interest costs (which will be higher when the maturities are longer) and their variation (since the refinancing cost will be higher when the maturities are shorter). They will also affect the levels of liquidity and development of the domestic bond markets, which will in turn affect the interest rates.

As a general rule, the government is the biggest and most credit-worthy debtor, so that Treas-

ury bonds are usually the biggest and most liquid segment of domestic bond markets. The interest rate on Treasury securities naturally tends to serve as a reference rate for other forms of indebtedness, both semi-sovereign and private. Determining the prices of these securities is therefore important not only in connection with the direct costs of a public loan but also those of private loans on both domestic and foreign markets.

In order for there to be efficient long-term bond markets, consolidated yield curves for Treasury securities are needed, so that public debt management is of fundamental importance for the evolution of long-term capital markets.

## IX

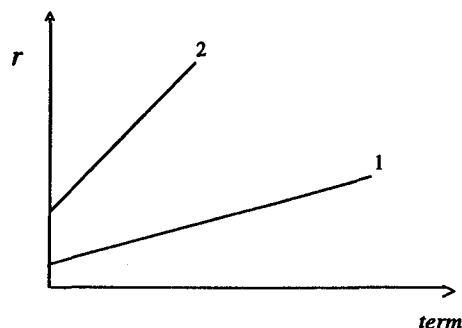
### Debt management and sustainability

Debt management is therefore an important element in the sustainability of the debt, since it affects the real interest rate on the public debt. What happens in the case of the reverse relationship, however?

When a debt is considered to be unsustainable, the options for its management rapidly shrink. In practice, this perception will shift the interest-maturity demand curve upwards and –what is more important– inwards (figure 3).

Consequently, the issue of longer-term debt securities will become an increasingly costly, if not an impossible, option. Not only will the average real interest rate on public bonds increase, but their maturities will also tend to shorten. Debt management will run into serious difficulties, and the situation may turn into a veritable nightmare until inflation breaks loose or the debt is repudiated. In this context, the development of capital

FIGURE 3  
Effects of "unsustainable" debt expectations on  
interest rate and term of debt



markets becomes one more victim of an unsustainable fiscal position.

(Original: Spanish)

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# Reforms in the *oil industry: the* available options

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In the 1990s, a considerable number of countries of the region embarked on substantial changes in their regulations governing the oil industry, with the aim of doing away with public monopolies, promoting competitive markets, and encouraging increased private investment under new forms of contracts. These reforms had a considerable impact on the economic stabilization programmes, since they involved price corrections which helped to reduce fiscal pressures, as well as leading to the restructuring and financial reorganization of public oil companies. The State-centered approach which had imbued public policies up to the 1980s was thus left behind. However, privatization is only one of the possible options. Even more interesting possibilities are opened up by the increasing processes of internationalization of public oil companies through strategic associations among them and also with major oil companies from outside the region. Thus, this article analyses the paradigm behind these reforms and the queries that arise regarding its real applicability, in the light of three main options that are open to the Latin American countries: i) the promotion of strategic associations and the internationalization of public enterprises; ii) a leading role for the State, together with the promotion of private investment, and iii) complete privatization of the industry.

# I

## Introduction

In recent years there have been substantial changes in the regulations governing the petroleum industry in Argentina, Bolivia, Brazil, Colombia, Ecuador, Peru and Venezuela.

These reforms have deregulated the industry in areas where competition is possible and regulated it in those where competition is not possible. They have also sought to promote foreign investment under new forms of contracts which do not rule out a significant State presence in the largest oil-producing countries (Brazil, Mexico and Venezuela) or even in some countries which are predominantly importers (such as Chile, through the National Petroleum Enterprise, ENAP).

At present, the development of the oil industry is fully in the hands of private capital only in

Argentina and Peru, after the privatization of Yacimientos Petrolíferos Fiscales (YPF) and PETROPERU. In Bolivia the privatization of Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) is under way in the form of the investment of private capital, and in Ecuador private investment is welcomed but the State continues to participate on an important scale through PETROECUADOR. In Brazil (PETROBRAS), Colombia (ECOPETROL) and Venezuela (PDVSA), strategic associations are being promoted between the State enterprises and major international oil firms, and only in Mexico is there still a State monopoly, although PEMEX is becoming increasingly internationalized.

# II

## The progress of the reforms

In general lines, the sequence of the reforms has been as follows: correction of prices, restructuring and financial rehabilitation of the public enterprises, organization of a competitive market, promotion of private investment, and finally privatization (although in only a minority of cases for the moment).<sup>1</sup>

The rate of progress has been variable. The process is still under way, but the biggest achievements so far have been in the field of the correction of prices and the rehabilitation of the public oil companies, as part of larger economic reform processes.

### 1. Price adjustments

To begin with, price correction was motivated by fiscal considerations and was aimed at reducing the budget transfers needed to cover the deficits of the public enterprises; in some cases it therefore took

place in a gradual manner, in line with the aims of economic stabilization programmes.

The public enterprises gradually increased their share of final fuel prices, and in a second stage they therefore mostly adopted policies taking international prices as their benchmark, although this pattern was not fully applied in all the countries of the region, taking the opportunity cost as the basic criterion.

### 2. Restructuring and financial rehabilitation of public enterprises

The financial rehabilitation of State oil companies has been favoured –although not in all cases, and depending in each instance on the actual national conditions– by such factors as the following: reorientation of price policies, lower transfers of resources from the companies to the government, restructuring of liabilities, and refinancing of the external debt.

The formation of conglomerates has been promoted in State business activity, and efforts are being made to improve operating efficiency by providing for separate costs and profit or loss margins in each of the

<sup>1</sup> Chile is a special case in this respect as it began its reform of the oil industry in 1978, following this sequence of measures, but without privatizing the National Petroleum Company (ENAP), which controls all the refineries.

“business units” and rationalizing current expenditure, in order to reduce costs. In some cases, poorly performing units have been closed or decentralization schemes have been applied in order to make the functioning of the different “business units” more open to public scrutiny.

### 3. Establishment of competitive markets and promotion of private investment

The petroleum market has some special characteristics which are worthy of note. It is a “multisourcing” market for energy products tradeable under certain universally accepted conditions.

Since the early 1990s, there have been two opposing options in Latin America. One of them acknowledges the multisourcing nature of supply and calls for the suppression of State monopolies, with or without the privatization of State oil industries, while the other, which has been adopted by a minority of countries, insists on maintaining barriers to private investment in view of the perceived strategic nature of oil supplies.

This latter position considers that although petroleum is a tradeable product, it is a very widely used non-renewable energy source which affects a great many activities and users and has a heavy macroeconomic and environmental impact, and it is also subject to a number of geopolitical factors which could affect national sovereignty and security.

The other position holds that in a free economy there should be no “entry barriers” which affect the use of resources (absence of any restrictions on supply) or the satisfaction of demand (free access to supply). In such a context, it would be pointless for suppliers or consumers to try to influence the market jointly or severally. Consequently, petroleum should be treated like any other tradeable good, discarding its perceived strategic nature.

This position therefore advocates a regulatory State, rejecting an entrepreneurial State that excludes private investment, and it calls for the elimination of monopolies because it considers them to be inappropriate for industrial development, since they limit the attraction of foreign capital and the transfer of technology.

In reality, what is still under discussion is whether the State should continue to play a leading entrepreneurial role: an approach which served to justify the nationalization processes which were particularly strong in the 1960s and 1970s and lasted up to the 1980s, so that at the beginning of the 1990s 85% of the region’s petroleum industry was under the control of State enterprises.

The liberal position also highlights the fact that State control affected resource allocation, by tending to fix domestic prices below the opportunity cost of supply, thereby giving rise to an income transfer scheme which did not take due account of the profitability of the capital invested, depriving the public enterprises of the financial resources they needed and leading to high levels of external indebtedness.

Most of the countries of the region, with the exception of Mexico, have done away with barriers to the entry of private investment into the various phases of the petroleum industry, giving preference instead to independent operations or projects in association with State enterprises.

Considerable progress has been made compared with the previous decade as regards the entry of private capital into prospecting, refining and marketing activities, under various forms of contracts with domestic and foreign capital (Campodónico, 1996b).

The establishment of competitive markets has basically meant the elimination of import restrictions and, in general, of public foreign trade monopolies, although these still exist in some countries of the region. This progress has been accompanied (although not in all cases) by regulatory criteria based on the idea of the generation of competition, thus making it possible to establish free-price policies.

### 4. The privatization of public enterprises

The privatization of public petroleum enterprises is not a generalized trend in the region, since only in Argentina, Bolivia and Peru has it been adopted as a strategic option for the development of the industry.

The Argentine enterprise Yacimientos Petrolíferos Fiscales (YPF) was not only the first public oil company in the world (set up in 1921) but also the first major State enterprise to be privatized in the region. In 1993, 45% of the stock of YPF was sold on Argentine and international stock exchanges, while 13% was given to the firm’s employees as a contribution to their pension fund. The State retains 20% of the stock, the provinces 11.3%, and the staff of YPF the remaining 10%.

Although the majority of the stock is in the hands of private investors, its ownership is quite dispersed, so that the State continues to have a strong influence in the firm’s decisions. Moreover, the favourable vote of the State is indispensable for the approval of mergers, operations to acquire more than 50% of the stock of YPF, total transfers of prospecting and operating rights, and the dissolution of YPF.

The system adopted for the privatization of the Peruvian petroleum industry is radically different. In this case, it was decided to sell "business units" resulting from the division of PETROPERU into smaller parts. The Pampilla refinery—the largest in the country—was sold to a consortium led by REPSOL and YPF, with the Peruvian State retaining 40% of the stock. The lubricants plant was sold to MOBIL OIL in its entirety, while the blocks formerly operated by PETROPERU are being awarded under licensing contracts which involve payment for the value of the reserves they contain, plus royalties for the use of the deposits in the block.

### III

## Changes in the terms of oil contracts

There are various forms of oil contracts in the region, and they have been changing with time, in line with public policy aims and the changes which have taken place in the world oil market. In these contracts, many of which were signed in the 1970s, investors usually have to assume the risks of the prospecting operation (Campodónico, 1996a).

Thus, "service contracts" or "operating contracts" were signed in those years instead of the traditional system of oil prospecting concessions. The changes involved were substantial, for previously the concession-holders had much more flexible deadlines and conditions for bringing the possible proven reserves into operation, while moreover they retained ownership of the oil produced.

The new system, which originated in the Middle East nationalization operations, involved the provision of services to the State petroleum company which owned the oil and which, in return for the services provided (prospecting risks and operating expenditure), paid the contractor in kind or in cash, according to a tariff linked to international oil prices.

Around that time there was also considerable use of "output sharing" contracts, fairly similar to the system mentioned above, under which the contractor continued to assume the prospecting risks in exchange for a share of the production which, according to the particular case, could be either sold to the State enterprise at international prices or sold on external markets.

Public policies insisted that the State, as sovereign owner of the resources, not only had a right to a

In Bolivia, the new Petroleum Act has set afoot the privatization of YPF under the scheme laid down in the Capitalization Act. Under this scheme, the buyer must make a capital contribution big enough to allow him to gain control of the "business unit" he is interested in. The remainder of the stock is shared out among the firm's workers as a contribution to their pension fund. At the time of writing, the main oil production blocks and the oil pipeline installations have been capitalized, while the capitalization of the refineries remains pending.

proportion of the production but also the right to decide what should be done with the rest of the crude extracted, using it to ensure supply of the domestic market or selling it on the international market, depending on its trade interests.

These types of contracts spread to various countries of the region (Argentina, Bolivia, Brazil, Chile, Ecuador and Peru) in the 1970s, parallel with the strengthening of officially concerted action on petroleum within the Organization of Petroleum Exporting Countries (OPEC).

In the midst of the impact of the first oil crisis (in the early 1970s), because of the fear that the oil supplies of the importing countries might be at risk, oil industry contractors signed agreements giving 50% (or even more) of the oil extracted to the State oil companies, without the latter assuming any risks whatever.

In Colombia a different system was adopted: contractors assumed the prospecting risks, and if they found commercially significant reserves they were under the obligation to enter into association with ECOPETROL for the operation of the reserves thus located.

These new forms of contracts were even actively supported by the big oil companies, which chose to provide services or enter into association with the State oil companies because they knew that sharing out the benefits of oil negotiations was always a source of conflict which often led to policies of State intervention and nationalization. Such policies had long been applied in some countries of the region, but they began to gain force from the late 1960s onward and

were further strengthened by the new attitudes arising from the creation of OPEC.<sup>2</sup>

Peru nationalized its oil industry in 1968, Ecuador did the same in 1971, and Venezuela followed suit in 1975. The 1970s thus mark the beginning of a long period in which the governments of the region played a leading role in petroleum activities. Except in Mexico and Venezuela, however, the new rules regarding contracts did not exclude private participation.

These rules clearly defined the contractors' obligations, demanding compulsory work programmes in the prospecting stage, development programmes with specific investment commitments in the operating phase, and suitable bank guarantees to ensure the fulfillment of all these commitments.

In the 1980s, as a result of the more plentiful supply of crude on the world market, the levels of payment of the contractors began to be negotiated more flexibly, in order to attract more investments, but there was no major change in the pattern of contracts.

The opening up of the oil market in the 1990s has meant new forms of contracts. These have come into effect basically in Argentina and Peru, with the return of oil concessions and "licensing contracts" respectively, whereby the contractors become the owners of the petroleum extracted, in return for the payment of royalties.

The most important new developments are undoubtedly the elimination of PETROBRAS's monopoly in Brazil in 1995 and the new contracts for the operation of marginal oilfields signed by Venezuela in

1992-1993, along with the recent profit-sharing contracts which that country began to sign as from 1996.

In view of the size of the reserves involved, Venezuela's policy of greater openness will undoubtedly have a decisive impact on the world market and on the production and export quotas agreed upon in OPEC.

It may be noted that the profit-sharing form of contract is undoubtedly most attractive in the case of a country like Venezuela. It would be much more difficult to apply in most of the other countries of the region, where prospecting risks are significantly higher than in Venezuela.

Another interesting development in terms of contract systems is the introduction of conditions linking the contractors' shares with the amount and quality of the oil extracted (Ecuador) or the income obtained (Colombia). In the first case, the greater the amount of oil extracted the lower is the contractor's share, while in the second case a rise in prices would mean a lower share in percentage terms.

With regard to tax and tariff treatment, a noteworthy feature is the application of criteria which are in line with those applied to all other production activities, in order to maintain the neutral nature of taxation. Thus, the treatment given to the oil industry is neither more nor less favourable than that accorded to other activities, although some countries (Ecuador, Guatemala, Peru) still retain tariff incentives for the prospecting phase.

It should be noted that income tax rates have been significantly reduced in some countries, so that in this respect the treatment now accorded is more favourable than in the 1980s.

## IV

### From model to reality

The quest for greater competitiveness and a less prominent role for the State form the basis for the model behind the oil industry reforms in the region,

although the relative importance of these two factors depends on the resource endowment and the nature of the local markets.

The model holds that State intervention only makes sense if there are flaws in the market; the State is normally seen as playing a regulatory role designed to ensure greater competition and to protect the national heritage. Questions of reliability of supply or social equity would represent exceptional situations where the subsidiary role of the State would apply.

<sup>2</sup> As noted earlier, Argentina set up the first State oil company in the world (YPF) as far back as 1921. In the 1930s, the Empresa Petrolera Fiscal was set up in Peru in 1934 and YPFB was established in Bolivia in 1936, while in 1938 Mexico nationalized its oil industry and formed PEMEX. The 1950s witnessed the establishment of ENAP in Chile (1950), ECOPEPETROL in Colombia (1951) and PETROBRAS in Brazil (1953).

Some aspects of actual conditions raise doubts about the effects of the application of this oil industry reform model in the areas indicated below, however.

### 1. Concentration of the oil industry

The first doubt that arises concerns the increased concentration of the industry resulting from massive privatizations that would endanger the balance between producers and consumers and, ultimately, the continued existence of a free market.

The public policies applied as from the 1970s favoured the deconcentration of the world oil industry. In 1971, the so-called "Seven Sisters"<sup>3</sup> controlled 58% of world oil supplies, but in the mid-1990s they accounted for only 13% of world production (Gutiérrez and Jaramillo, 1995).

The economic power of the oil companies is very considerable and derives not only from the size of their operations but also from the significant proportion of intra-firm trading they engage in. Suffice it to mention that the annual operations of the 52 oil companies which are among the 600 largest companies in the world amount to some US\$ 800 billion. This is three times the region's 1996 exports and the amount of foreign capital which entered the region between 1990 and 1996 (United Nations, 1988; ECLAC, 1996).

It is hard to say for sure what effects greater concentration of the oil industry would have on the operation of the world market. What is clear is that privatization will affect the concerted adoption of policies among developing country producers in OPEC. Such concerted policies would be at variance with the free market model. Thus, while the reforms mean a smaller role for the public authorities, geopolitics counsels a more pragmatic approach which would not make any major changes in the important role of the State in the coordination of the developed countries' energy policies.

The European countries which have signed the European Energy Charter recognize the right of States to participate in the prospection and operation of energy resources through their governments or State enterprises, and they also acknowledge the possibility of expropriation in the public interest.

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<sup>3</sup> The Seven Sisters are British Petroleum, Standard Oil of New Jersey, Exxon, Royal Dutch Shell, Gulf, Standard Oil of California and Mobil Oil.

The member countries of the International Energy Agency, for their part, have made significant progress in coordinating their strategic planning policies: they have fixed import ceilings and minimum reserve levels, and they have made arrangements to cope with world crises in the supply of crude and refined products. Furthermore, since the Gulf War the countries of the Organization for Economic Cooperation and Development (OECD) have been paying increasing attention to energy supply security, and many of them (including France, Belgium and Italy) have given strategic status to their companies operating in this field.

Consequently, the elimination of barriers to the entry of private investment has been effected cautiously, and it has been viewed mainly in terms of "strategic alliances" in the countries that account for most of the region's oil reserves (Mexico and Venezuela), in order to maintain more leeway for formulating national initiatives regarding the behaviour of the world market.

### 2. Distribution of oil rents

The second doubt concerns the distribution of the benefits arising from the exploitation of natural resources: a consideration which was always foremost among the motives behind policies favouring a State-run oil industry.

The use made of oil rents in the region has not been the best. In some cases, it caused the postponement of urgent tax reforms which would have ended the excessive dependence of fiscal expenditure on income from the oil industry. In others, prices were distorted and this income was reduced for anti-inflation purposes, or else there was a tendency to siphon off the income of public enterprises, depriving them of the capital they needed and severely affecting their investment expenditure.

This question is important both in approaches that favour a leading role for the State and in those that advocate the privatization of the oil industry. On the one hand, it is necessary to avoid a situation where the fiscal appropriation of oil income adversely affects the development of the oil industry, and on the other hand the promotion of private investment should not lead to a deterioration in the average income retained by the State authorities.

The important thing is to maintain a sustainable balance in the distribution of benefits, so that the contractual arrangements between the State and private operators remain stable in the long term.

### 3. Security of supply and its effects on prices

Another doubt that arises in connection with the reforms concerns security of supply and the behaviour of prices: questions that are important both for producer and consumer countries.

Security of supply will continue to be a crucial issue in world geopolitics, even if the share of oil in the primary energy consumption structure goes down, as estimated, from nearly 40% in the early 1990s to 37% by the end of the first decade of the next century (Campodónico, 1996b).

Over this period of time, the OECD countries are expected to reduce their share of world oil consumption from 56% to 47%, through the replacement of energy sources and more efficient energy use. They will become even more dependent on imported supplies, however, because on average the reserves/production ratio is 8 years in Western Europe and 11 years in North America. In Latin America, in contrast, it is 50 years, which explains why the OECD countries are so interested in increasing Latin America's share in their supplies (Campodónico, 1996b).

In view of the continuing political uncertainty in the Middle East and Russia, bringing more Latin American reserves into production would make the supply of oil more secure, while at the same time the increased supply from the region would help to reduce upward pressures on world oil prices. As real prices are currently depressed compared with the high prices of the 1970s, the Latin American oil exporting countries will have to make a bigger production effort in order to obtain the goods they need to import from the world market. Consequently, business management will have to concentrate on costs in order to avoid any reduction in oil income.

### 4. Market flaws

Most of the countries of the region have done away with controls on external trade and made substantial reforms in the oil refining and transport stages. Only in Mexico and Venezuela are there still barriers to entry into these activities. In the other countries, private investment is permitted in oil refining, and private operators can build pipelines, subject to free access to

the pipeline systems and regulated tariffs; petroleum products are freely sold in service stations, and there are practically no price controls.

In applying the model it is important not to overlook the possible existence of natural monopolies. Although some phases of the industry permit competition, the decisive element is market size. Because of their different sizes, the domestic markets of the countries of the region may be conducive to a variety of situations, ranging from full competition to various forms of oligopolies and even monopolies, in the case of the smallest countries.

This gives rise to some doubts connected with domestic price levels (including taxes) and their impact on the macroeconomic accounts and international competitiveness.

There are those who consider that, taking into account the opportunity cost, producer countries could have more leeway in fixing domestic oil prices, even at the risk of reducing the profitability of their State enterprises, in order to check inflationary pressures or improve competitiveness.

Countries which depend on imports, however, simply have no efficient option but to fix domestic prices as a function of international prices. At all events, tax levels must be handled cautiously in order not to generate inflationary pressures or affect the competitiveness of fuel users.

### 5. Integration or disintegration of the industry?

The history of the oil industry shows that vertical integration has been and continues to be essential in order to gain the difference between the income from production and the value added in refining and marketing, although this in no way rules out decentralized management.

Whether or not to maintain the integration of the industry has been one of the items of discussion when considering privatization. Selling off various "business units" may be advisable in large markets, but in small ones it may adversely affect competition, if monopolies are created in each phase of the industry. In such a case, the scope for deregulation is a good deal more limited when changing an integrated public monopoly for a private one.

# V

## The oil industry in the 1990s

The countries with the biggest reserves have serious doubts about the validity of the model currently in vogue, in view of the importance of petroleum in their international relations. The concerted adoption of price policies (in OPEC) has lost its vigour, however, not only because of greater private intervention but also because the countries of the region that have the biggest reserves do not want to become involved in multilateral options that reduce their freedom of action.<sup>4</sup>

This weakening of concerted action is one of the costs of the marked interest in attracting more private investment: an objective which could also have a certain fiscal impact (a matter which still remains to be evaluated) if the new contract conditions mean that the State transfers its control over oil rents in exchange for royalties or payment of income tax.

Only countries with an extensive and well-trying history of oil production can secure more even-handed benefits or even impose their own bargaining conditions. In contrast, those countries which have witnessed a decline in their proven reserves under State leadership and have high prospecting risks tend to take a realistic attitude and opt for more flexible and attractive types of contracts.

The high level of available reserves and the expected positive evolution of supply place consumers in a better bargaining position, although this does not mean that oil has ceased to be a crucial product in world geopolitics.

The important thing is that, within the reform process, the countries of the region should reconcile the objectives of supplying their own needs or increasing their share of the world market, attracting bigger investment flows, and retaining a growing share of the total value of oil production (through domestic purchases, wages, taxes, royalties, etc.), since they should not only take account of the benefits obtained by the government authorities, but the integral effect on their national economies.

<sup>4</sup> Ecuador has left the OPEC, Mexico was never part of it, and Venezuela has tried to increase its own quota within that organization.

The question of oil rents is undoubtedly of the highest importance. It is in the interests of the oil exporting countries to establish tax and regulatory systems which ensure that the prices declared by operators are indeed in line with the best selling options on the world market and avoid the possibility that managed trade strategies may lead to the fixing of transfer prices that adversely affect the value of exports and hence the national tax revenue. The importing countries, for their part, need regulatory mechanisms to ensure that they enjoy the best price conditions and that dominant market positions do not result in supply shortcomings.

In both cases, the point of reference should be the international price of the type of product required, so that both oil company operations and tax receipts effectively correspond to the opportunity cost.

The countries of the region should set up institutional bodies (taking due account of their national potential) which are empowered to sign contracts (for prospecting and operation), to exercise control functions (supervision of contracts, taxation and revenue collection) and to apply regulations in order to ensure that the market operates on a competitive basis. It may be noted that many countries of the region still suffer from serious shortcomings in these areas.

The privatization of public oil companies is one alternative, but it is not the only one, nor can it be said that it is shared by the majority of countries in the region. Where there is clear and undeniable consensus is on the need to promote private investment under the forms of contracts or association that are most appropriate to national conditions (Campodónico, 1996c).

With regard to the future development of the oil industry, at the time of writing the following three options are open.

### 1. Promotion of "strategic association" arrangements and internationalization of public oil companies

This option, which is most evident in Brazil, Chile, Mexico and Venezuela, with differences and variations in each individual case, offers various possibilities, including entry into operations in countries other than



that of the State enterprise in question in order to satisfy domestic oil needs (Brazil and Chile), operating or production sharing contracts, or the establishment of various types of "strategic association" arrangements to place prospecting and operational activities on a broader and technologically stronger basis.

In Brazil, constitutional reform did away with PETROBRAS's monopoly and gave private operators the possibility of taking part in all phases of the industry. Privatization was rejected, however, because of the importance of PETROBRAS in the national economy.<sup>5</sup>

PETROBRAS's international operations are carried out through BRASPETRO, generating gross annual income of US\$ 1,428 million and net profits of US\$ 39 million. They cover activities in oil prospecting, development and production and the provision of services in Africa (Angola and Libya), South America (Argentina, Ecuador and Colombia), the United States, and the United Kingdom (North Sea oilfields) (PETROBRAS, 1995).

In the case of the Mexican State company PEMEX, its willingness to enter into strategic alliances is reflected, for example, in its acquisition of 3.5% of the Spanish company REPSOL and in the establishment of a company for projects, co-investment and oil supply contracts which has opened up new trading prospects in the European Union. Furthermore, MEXPETROL has been set up, in association with private capital, to export services and products connected with oil production projects and the petrochemical industry (Arpel, 1990, pp. 86-87).

In 1992 PEMEX also entered into a strategic association with Shell in order to expand its refining capacity, acquiring 50% of a refinery in Texas (Deer Park, with a capacity of 220,000 barrels per day).

The internationalization of the Venezuelan State company PDVSA is advancing more rapidly than that of PEMEX. Since the early efforts to guarantee markets for its exportable oil surpluses, while at the same time

expanding its vertical integration in order to increase added value by exporting refined products and acquiring refineries abroad. Under this policy of internationalization it has entered into strategic association agreements with UNOVEN and UNOCAL in the United States, Ruhr Öl GmbH in Germany, and AB Nynas Petroleum in Sweden (Campodónico, 1996c).

The promotion of private investment in the Venezuelan oil industry forms part of this internationalization strategy. PDVSA envisages investments totalling some US\$ 60 billion in the 1997-2006 period: 55% by PDVSA itself, 18% through association agreements, and the remaining 27% arranged with private companies under operating contracts. Out of this total, firm commitments have been made for some US\$ 33 billion: nearly US\$ 4 billion under operating contracts for marginal oilfields; US\$ 10 billion under profit-sharing contracts; US\$ 14 billion under strategic association agreements in the Orinoco strip, and some US\$ 5 billion under the Cristobal Colón Gas Project (PDVSA, 1996).

The internationalization strategies of State enterprises also provide for strategic association agreements with public and private companies of the region. Examples are the agreements between the Chilean State enterprise ENAP and the Argentine companies BRIDAS and YPF; the agreements between PETROBRAS and YPF and the joint project of PDVSA and PETROBRAS to form PETROAMERICA, and the interest shown by MARAVEN (a subsidiary of PDVSA) in operating in the markets of Colombia, Ecuador and Peru (Campodónico, 1996c).

In Chile, the 1980 constitutional amendment authorized private participation through concessions and "own risk" contracts,<sup>6</sup> but the privatization of ENAP was rejected. This company was restructured in 1981 and two further companies (PETROX and Refinería de Concón) were formed to run the refineries as subsidiaries of ENAP.

As the results of prospection activities were not encouraging and the domestic supply deficit was increasing, the search for oil abroad was promoted through the establishment of SIPETROL. To begin with, priority was given to operations in the region, through agreements with Argentina, Ecuador and Venezuela, but oil prospection prospects were also studied in countries outside the region (Campodónico, 1996c).

<sup>5</sup> PETROBRAS's operations are equivalent to nearly 2% of the Brazilian GDP. If its operations as a conglomerate and its purchases of domestic goods and services are included, however, its share could amount to as much as 25%. The conglomerate itself generates 50,000 jobs and it is estimated that the indirect effects of its operations extend to 1.5 million jobs, while its net worth is over US\$ 50 billion (Mendes Renno, 1994). It is estimated that since it was set up the foreign exchange savings due to the increase in refining capacity amount to US\$ 223.8 billion, and in its 40 years of activity it has invested some US\$ 88 billion. In 1995 the PETROBRAS conglomerate paid US\$ 6,516 million in taxes (PETROBRAS, 1995).

<sup>6</sup> In these contracts the contractor assumes the whole of the prospecting risk.

## 2. Maintenance of a leading role for the State, with promotion of private investment

This is an option that lies half way between the formation of strategic associations and the internationalization of public enterprises, on the one hand, and total privatization on the other.

In this intermediate option, the development of the industry is based on the maintenance of a State enterprise which negotiates various forms of participation in production, leaving the prospecting risk to be assumed by private investors, while not excluding strictly private participation in some phases of the industry.

It may be considered that a good example of this option is that adopted in Colombia, where there is a scheme involving compulsory association with ECOPETROL. Ecuador, for its part, has given preference to "own risk" contracts; the privatization of PETROECUADOR is not currently on the agenda, for various reasons, including its fiscal importance and the fact that various national bodies (such as the armed forces) share in the income obtained from the oil industry.

## 3. Total privatization of the industry

This option is in operation in Argentina, Bolivia and Peru, with differences in the actual form of privatization. As noted earlier, Argentina and Peru have privatized their State enterprises in different ways. The maintenance of YPF's vertical integration has the virtue of sustaining a growing process of internationalization. YPF has planned to spend 15% of its prospecting expenditure outside Argentina, in order to help satisfy that country's petroleum requirements: thus, it proposes to carry out prospecting activities in various countries of the region (Bolivia and Peru) and in the Gulf of Mexico.

At the same time, its internationalization strategy involves agreements with a number of important international operators (Campodónico, 1996c), such as its association with British Petroleum, AMOCO and MAXUS (in the last-named of which it acquired 25% of its capital in 1996) for prospecting in Venezuela; its relations with British Gas to evaluate the potential of areas around the Falkland Islands, and its association with REPSOL of Spain and Mobil Oil of the United States in the privatization of the main Peruvian oil refinery (La Pampilla).

With its acquisition of 25% of MAXUS, YPF will be able to project its activities outside the region (to the United States and Indonesia), taking advantage of

MAXUS's technology for offshore operations and that company's participation in Bolivia, Ecuador and Venezuela. At the same time, its projection within the region will be strengthened by its association with public enterprises and its strong entry into domestic fuel marketing in Brazil, Chile and Peru (Campodónico, 1996c).

YPF's activities are worth watching closely in the future, as they have some special features which could be of interest to other developing countries inside and outside the region. The privatization strategy adopted by this company is based on the maintenance of its degree of vertical integration, the adoption of a system of "gold shares" (with the power of veto) for the State's share in the company's stock, and the opening-up of the share package offered for sale on international stock exchanges, in order to attract institutional investors. It should also be noted that YPF's stock market operation was one of the largest in the century as far as the entry of countries of the region into international capital markets was concerned.

The interesting feature of this type of privatization is that it does not deprive the State of the possibility of influencing the future course of the enterprise but allows it to participate instead in a growing process of internationalization stemming from a new business strategy in which the State has an active role to play; if it had been decided to sell the bulk of the stock to a big international operator, the Argentine oil industry would have been subordinated to the strategy of that operator. From the national standpoint, this process has also been strengthened by the active participation of private Argentine companies (BRIDAS, PLUSPETROL, etc.) in oil prospecting and production in various countries of the region.

The case of Peru is very different. Here, the integration of the enterprise was not preserved, and instead PETROPERU was split up into several "business units" in the privatization process, so that the Peruvian market is now in the hands of big international operators such as MOBIL, REPSOL and the Argentine company YPF, which have established various ownership relationships among themselves. Although it is early as yet to appraise the Peruvian experience, it seems to be tending towards a reintegration of the industry which, in view of the size of the domestic market, sheds doubt on the effective level of competition.

The Peruvian experience, like that of YPF, can serve as a lesson for other countries of the region where the model in vogue is being applied almost 100%. In Bolivia, the privatization process is still under way, so that it is too early to draw conclusions.

## VI

### Evaluation criteria

In conclusion, it is worth listing the criteria to be used in appraising the results of the three options in use in the region. The most important point is to determine what proportion of the total oil income remains under State control in each of the options in question.

The oil income arises from the difference between production costs and the international price of oil, which is determined not only by supply and demand but also by factors foreign to the market. This margin of difference is considerable in most of the oil producing countries of the region, even at the prevailing low prices.

It does not therefore appear to be sufficient simply to compare the profits of the companies after privatization with the losses suffered when they were in State hands, since when they were State-owned they were

generally prevented from fixing their prices at international levels. If they had enjoyed this possibility, which the private companies now use to fix their prices, it would be fair to use such a criterion, but as this is not the case it would be preferable to use as an evaluation criterion the improvements in efficiency deriving from the reduction in costs, since the industry now "takes" international prices. A matter which remains to be examined in a future analysis is the way in which these improvements in efficiency because of the bigger spread between costs and prices could be passed on to consumers, bearing in mind that the whole idea of the reform is that domestic fuel prices should be in line with international prices.

(Original: Spanish)

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# Indigenous organizations: *rising actors* in Latin America

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This article analyses the recent increase in the importance of indigenous peoples as political and social actors in the region, reviewing the changes that have taken place in the situation of the indigenous peoples, the relationship between the State and such peoples, the forging of new identities, and cultural changes: questions that are all being reappraised in the light of what has become known as "the ethnic question". The author highlights the existence of a number of leading threads which appear and reappear in the various types of indigenous movements. These threads may be grouped in five main categories: the definition and legal status of what "indigenous" means; land rights and agrarian aspects; the cultural identity of indigenous peoples; their social organization and juridical recognition of their customs, and the participation of their organizations in politics. The article concludes that indigenous issues stand at the point of intersection of considerations relating to human rights, democracy, development and the environment. It has become increasingly clear that indigenous demands do not only concern the indigenous peoples themselves but involve the whole of national society. The indigenous peoples are not just demanding more and better democracy, better application of mechanisms for the defence and protection of human rights, or a bigger share in the benefits of development programmes: they are in fact questioning and challenging the basic premises on which the Nation-State has been built in Latin America for almost two centuries.

# I

## Introduction

In recent years, the indigenous peoples have emerged as new political and social actors in Latin America: they are becoming active subjects instead of continuing as passive objects of the course of history. Something has changed in the living circumstances of indigenous people, and something is changing in the relationship between the State and such peoples. Old claims and new demands have joined together to forge new identities; new ideologies are competing with old, long-standing paradigms; the theories of social change, modernization and nation-building are being rethought in the light of the so-called "ethnic question" which was ignored and looked down upon for so long, and finally, the manner of practicing politics in connection with indigenous problems has changed too.<sup>1</sup>

Perhaps the best starting point for our analysis would be the formal initiation of a continent-wide policy on indigenous matters (known as indigenism) at the First Inter-American Indigenist Congress, held in Mexico City in 1940. At this congress, government delegates from many countries of the continent decided to put into effect policies to improve the living conditions of indigenous people, mainly through a process of assimilation or integration into so-called "national society". This dominant national society, reflecting the nationalist ideology of the white and

racially mixed urban middle class, however, completely rejected the indigenous components of national culture and simply did not envisage any future for them, except in an idealization of the past mainly represented in museums and, more recently, as a way of earning foreign exchange from tourism and the sale of handicraft products.

The policies adopted with regard to indigenous peoples, though well-meaning, turned out in fact to be ethnocidal and rather ineffective even in terms of their own declared objectives. At subsequent periodic inter-American indigenist congresses (the eleventh congress was held in Nicaragua in December 1993) the government delegates consistently deplored the lamentable conditions of the indigenous peoples of the continent, but while governments reported on their development programmes and projects, often in a self-admiring manner, the economic and social situation of the indigenous peoples, which were often allowed only a symbolic presence at these congresses, visibly deteriorated. A recent World Bank study concludes that poverty among the indigenous peoples of Latin America is severe and persistent. It also considers that the living conditions of those peoples, linked with poverty, are generally speaking abysmally bad (Psacharopoulos and Patrinos, eds., 1994).

# II

## Who are the indigenous people of Latin America, and how numerous are they?

Although the criteria used in the definitions vary from country to country and the available census data are not reliable, it is estimated that there are over 400 identifiable groups, with a total population of around

40 million, ranging from numerically insignificant and almost extinct bands of natives in the Amazon jungles to Andean peasant societies numbering millions of people. Mexico has the most numerous indigenous population in Latin America, amounting to some 10 million people, but they only represent between 12% and 15% of the total population. In contrast, the indigenous populations of Guatemala and Bolivia form the majority of the national population, and in Peru

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<sup>1</sup> With regard to the ethnic question, see Stavenhagen (1990); with regard to ethnocide and ethnodevelopment, see Bonfil and others (1982).

and Ecuador they form almost half of it. In Brazil, they represent less than ½% of the total population, but as they are the original inhabitants of Amazonia they have played an important part in resisting the depredation of their territories, demanding territorial rights

and political representation, fighting for the preservation of the Amazonian environment, and securing the incorporation of this objective in the new Brazilian Constitution adopted in 1988 (see González, 1994; CELADE, 1994).

### III

## Indigenism and the indigenous movement

The Latin American countries have a long and complicated history of indigenist legislation, in which the indigenous populations were generally put at a disadvantage with respect to the rest of society, although many of the laws were protective and tutelary. Although the right to formal citizenship was granted to almost the whole of the national population in the years following political independence, indigenous inhabitants continued to be treated as minors and as legally incompetent in many countries until very recently. It was only in the last few decades that the basic laws of Latin America were modified in this respect, as part of a wave of constitutional reforms which include not only rules regarding indigenous languages and cultures but also in some cases indigenous communities and their territories, as a specific form of social organization. Constitutional reforms of this type have been carried out in recent years in Argentina, Bolivia, Brazil, Colombia, Ecuador, Guatemala, Mexico, Nicaragua, Panama, Paraguay and Peru. Some observers see this restructuring as part of the wave of democratization that swept over Latin America in the 1970s and 1980s. Others, however, recognize the active role that the indigenous organizations have played in giving rise to these changes.

The emergence of indigenous organizations in past decades may be viewed as both cause and effect of the changes that have taken place in the public sphere with regard to indigenous peoples. Back in the 1950s, there was only a handful of formal organizations set up and run by indigenous people to pursue objectives that were of interest to the indigenous peoples as such. In the mid-1990s, however, there are hundreds of associations of all types with the most varied purposes: local-level organizations, intercommunity and regional associations, formally constituted interest groups, national federations, leagues and unions, and transnational alliances and coalitions with

well-developed international contacts and activities. It can justly be said that indigenous organizations, their leaders, objectives, activities and emerging ideologies make up a new type of social and political movement in present-day Latin America whose detailed history and analysis have yet to be prepared.

One of the first organizations, often mentioned as the prototype for others, is the Shuar Federation, established in the 1960s to protect the interests of the various Shuar communities in the Amazonian lowlands of Eastern Ecuador. The Shuars decided to form this federation in order to defend their territory from the invasions of settlers from outside and various commercial interests, and in the process they discovered that the struggle for land rights could not be divorced from the question of their survival as an ethnically distinctive people, with their own traditions and cultural identity. They also discovered—as so many other oppressed peoples have done in the course of history—that they could only attain their objective by building up their strength and joining forces. Although motivated by economic and social considerations (preservation of the lands of their ancestors and access to productive resources) the Shuars' struggle cannot be described simply as a class struggle, unlike the agrarian conflicts between peasants and landowners which took place more or less at the same time on the Altiplano. Since the Shuars and other lowland indigenous peoples did not fit clearly within an agrarian class structure, their organization took on a more communal and ethnic nature than the more class-oriented movements of indigenous peasants in other parts of Latin America (Salazar, 1981; Descola, 1988; Ibarra, 1987).

Organizations similar to that of the Shuars sprang up during the 1970s in several other countries and further consolidated their activities during the 1980s. They soon managed to break out of the constraints of the community-level activities to which State develop-

ment projects often limited them. Although community development projects, some of them financed by multilateral agencies and non-governmental organizations, did manage to generate growing participation by the local population, it soon became clear to the emerging indigenous elites that local-level activity was very limited from the political point of view. Like the Shuars, they managed to construct a trans-community indigenous identity, incorporating a growing number of local communities and making ethnic identity a unifying link and mobilizing agent. Thus, several ethnic organizations entered on the political scene, with leaders who spoke for their ethnic group as a whole rather than merely representing one or another rural community. These organizations were very soon followed by regional associations which included a number of ethnic groups, such as the Confederation of Indigenous Nationalities of Ecuadorian Amazonia (CONFENIAE), the Indigenous Association of the Peruvian Selva (AIDSESEP), the Cauca Regional Indigenous Council (CRIC) in Colombia, the Eastern Bolivia Indigenous Confederation (CIDOB) and many others. All of them organized congresses, published manifestos and declarations, sent petitions to state and national governments as well as to the international community, and frequently organized militant actions—such as protest marches, manifestations, sit-ins, occupation of land, or other forms of active resistance— or embarked on legal proceedings and lobbied legislatures and public officials to achieve their various objectives.

A more recent form of organization is the national-level indigenous confederation. Once again, the Confederation of Indigenous Nationalities of Ecuador (CONAIE) led the way in political activity when it organized two massive peaceful indigenous uprisings in Ecuador in 1990 and 1993 which practically paralyzed the country and obliged the government to negotiate with the indigenous people on agrarian and other problems. The National Union of Indians (UNI) of Brazil, which brings together numerous Amazonian tribes, was very active in the political discussions on the new Brazilian Constitution in 1988, as also was the National Indigenous Organization of Colombia (ONIC) in 1991 (Guerrero, 1993).

Indigenous organizations have also expanded beyond their national frontiers to take part in international activities. In Central and South America, indigenous activists have attempted, with different degrees of success, to establish transnational regional organizations. Since the second half of the 1980s, various

international meetings of regional and continental scope have been held in connection with the activities to commemorate the Meeting of Two Worlds (or rather 500 years of indigenous and popular resistance) and the International Year of Indigenous Populations (1993) and the International Decade of Indigenous Populations (which began in 1995), both proclaimed by the United Nations. Indigenous representatives of Latin America have also taken an active part in the discussions of the United Nations Working Group on Indigenous Populations, which is preparing a draft declaration on the rights of indigenous peoples for consideration by the General Assembly, and they have participated in the debates prior to the adoption by the International Labour Organisation of its Convention 169 on Indigenous and Tribal Peoples. Indigenous representatives are also present in the governing bodies of the Fund for the Development of the Indigenous Peoples of Latin America and the Caribbean, set up by the Second Ibero-American Conference of Heads of State and Government (Madrid, July 1992) and they are taking part in the consultations currently being held by the Inter-American Human Rights Commission of the Organization of American States on a future inter-American legal instrument on indigenous rights.

Through these activities, the representatives of the indigenous peoples of Latin America have made contact with representatives from other parts of the world and have become familiar with international law and the mechanisms and procedures for the protection of human rights in the international system: a relationship which both furthers their own cause and helps them to improve their political negotiating capacity in their own countries (Brysk, 1994).

A detailed analysis of the declarations, resolutions and proclamations of these various organizations and congresses (which is of course outside the scope of this article) would reveal a clear progression of ideas and sequence of items of concern to their members over the years. In the first few years, the indigenous manifestos reminded the public in general of the historical subordination of their peoples and their long-standing poverty, and called upon governments to grant some kind of compensation and justice for the wrongs of the past. At the same time, many of these documents idealized the pre-colonial indigenous past, sometimes described as a kind of Golden Age in which there was no exploitation, discrimination or conflict, while the pre-Columbian indigenous cultures were perceived as being morally superior to so-called Western civilization.



In later years, the demands posed by the indigenous organizations have been aimed more at specific problems such as access to land, agricultural credit, education, health, technical cooperation, investments in infrastructure, etc., whose solution they see as being the responsibility of governments. More recently, in addition to concrete economic and social demands they have also called for autonomy and self-determination. Ethnic identity has become a central issue for many of these organizations; concern with the environment is also an item of prime importance, especially in the case of the Amazonian lowlands, and there are increasingly frequent demands for changes in legislation and the fulfillment of recent international legal instruments, such as Convention 169 of the ILO and the draft United Nations declaration on the rights of indigenous peoples (Stavenhagen, 1988).

Indigenous organizations do not only hold meetings and spread their programmes and ideas: they also

negotiate with the public authorities, send representatives to international conferences, and often receive financial aid from international agencies for specific purposes. But who do these organizations really represent, and how representative are they of the indigenous population? This matter is often raised by governments when they want to question the "authenticity" of indigenous representation at the national and international levels, or by rival factions and groups competing for official recognition or access to resources. It is true that in many cases the existing indigenous organizations were constructed from the top down and are made up of indigenous intellectual elites which do not have an authentic "popular" base, but such indigenous organizations are increasingly being constructed from the bottom up, through a laborious process of mobilization and organization which gives rise to a new leadership with popular bases and which expresses the true concerns of members.

## IV

### The indigenous leadership

The question of representation will assuredly continue to be raised for some time to come. The traditional community-level leadership is generally carried out by an older generation of local authorities who, although steeped in the culture of their group, are not always well prepared to meet the challenges of "modern" organizations and political negotiations. These traditional authorities are gradually being displaced by a younger generation of indigenous activists, many of them professionals who have lived and matched their skills in a non-indigenous environment. Although tensions may arise between these two generations, their roles are often complementary: the traditional authorities made up of older people take care of community matters, while the younger leaders devote their efforts to building organizations and alliances and dealing with the outside world.

As more and more young indigenous people pass through the formal educational system and obtain professional positions as agronomists, teachers, doctors, lawyers, etc., an indigenous intellectual elite has been growing up in a number of Latin American countries which is becoming the lifeblood of the new organizations. Indigenous intellectuals are actively engaged in

developing the "new indigenous discourse" which gives these organizations their distinctive identities. Not only do they devote their efforts to formulating the political agenda of their movements but they are also rediscovering their historical roots, concerning themselves with indigenous languages, culture and cosmology, and playing an active part in "inventing traditions" and constructing new "imaginary communities". And in proportion as the new indigenous intelligentsia participates in national and international networks and succeeds in spreading its message to other sectors of the population, and as it proves capable of mobilizing resources and obtaining a certain amount of "collective goods" (material and political resources, public and legal recognition, etc.), so the indigenous intellectuals have been developing into indispensable links in the process of organization and mobilization. At the same time, the indigenous leadership is also succeeding in winning the support of the grass-roots elements of the community, the local activists who are fighting against violations of human rights or struggling for land rights or protection of the environment: matters in which indigenous women are often particularly active. There sometimes seems to be some tension between

local activists and the intellectuals, however, because the former deal with more immediate issues and seek concrete solutions, whereas the latter are more involved in building up institutions in the medium and long term. Furthermore, while indigenous intellectuals are helping to develop an "indigenist" ideology and *Weltanschauung* and are also sometimes involved in discussions with different ideological trends in Latin America (nationalism, marxism, the theology of liberation, the Christian Democrat movement, evangeli-

cal protestantism, etc.), local activists do not have much patience with these intellectual debates and are more interested in negotiating solutions for specific problems with the existing powers rather than pursuing ideological purity or coherence. These different approaches, along with other factors, have led to quite a few disputes over questions of organization, strategy and tactics which sometimes give the impression that the indigenous movement is seriously fragmented and split into factions.

## V

### Alliances

As most of the indigenous communities in Latin America consist of rural peasant societies, indigenous demands have much to do with the concerns of all peasants over such matters as their rights to water and land, agrarian reform, agricultural credit, technical assistance, access to markets, agricultural prices and subsidies, etc. These questions have been particularly urgent on the Altiplano, as in other parts, since the 1960s, when numerous militant peasant movements sprang up in Latin America. Although indigenous organizations are very aware of their identity and independence, they also know that their impact and scope will be limited if they cut themselves off from other social movements. They have therefore had to cope with two interrelated types of problems: the role of indigenous movements in the framework of the conflicts and coordination of interests within their own national society, and the crucial issue of the building of strategic alliances with other organizations.

With regard to the first of these points, I will not waste time here with the outworn debates, common in the nineteenth century and the early part of the present century, about the alleged inferiority of the indigenous "races" in Latin America, nor with the national elites' objective of eliminating the indigenous "barbarians" who were endangering the survival of civilization. Instead, the debates in more recent decades have centered on two alternative concepts. On the one hand, there is the idea that indigenous cultures are not integrated into national culture and that national integration calls for the rapid incorporation of indigenous populations, which would mean their disappearance as such. This model presents indigenous organizations with the options of accepting the assimilationist policies of the State, while negotiating their terms; rejecting them out of hand; or putting forward other possible alternatives. Each of these three stances has been adopted at some time by one or another of the indigenous organizations.

## VI

### Ethnicity and class

On the other hand, extensive debates have been held since the 1930s about whether the indigenous peoples should be considered as an example of a subordinate and exploited social class (subsistence peasants, agricultural labourers) or as culturally different oppressed peoples (nationalities) which in fact can also be internally differentiated in economic and social respects.

This is the debate on ethnicity or class which has been heard so frequently in academic circles and which has various different connotations for the objectives and strategies of indigenous and other social movements.

If indigenous populations are to be considered simply as a segment of the exploited peasantry, then the solution to their problems may be found in the class

struggle and organization (peasant unions, agrarian reform); from this standpoint, emphasis on ethnic identity would dilute their class consciousness and their corresponding political attitudes.

If indigenous identity is considered to be of fundamental importance, however, then matters connected with the class situation will be relegated to a secondary plane.

It would appear that in recent years indigenous organizations have mostly opted for the second of these positions. Without denying or ignoring considerations of class, they have emphasized their ethnic identity and the "ethno-national" aspects of their struggles, which has also given them some prominence both at home and abroad. One of the reasons why they have adopted this position is the rather prejudiced attitude that traditional left-wing political parties have taken in Latin America to the "indigenous question". For many years, these parties promoted a conventional "classist" attitude to social conflicts, thereby alienating many potential indigenous allies who did not feel that their own concerns were reflected in the marxist discourse of many of these political parties. Examples of these tensions may be seen in the conflict between the Sandinistas and the Miskitos in Nicaragua in the 1980s and the evolution of revolutionary ideology and armed conflict in Guatemala over the last thirty years (Díaz-Polanco, 1985; Arias, 1990; Le Bot, 1995).

The debate on class versus ethnicity also has broader implications with regard to political strategy and tactics, because it concerns the possibility that indigenous movements may make alliances with other social and political organizations. From the very beginning of their process of organization and mobilization, indigenous activists realized that in order to achieve their broader objectives and avoid being left in watertight compartments they must seek alliances with other sectors of society, especially trade unions, peasant organizations, students and urban intellectuals, as well as with established institutions

such as the Catholic Church (or at least with some of its current trends, such as the promoters of the theology of liberation) and, in certain circumstances, with some political parties.

Some indigenous organizations started off as branches of some political party. In Mexico, the Institutional Revolutionary Party (PRI) tried to organize and control some indigenous organizations in the 1970s, and in Bolivia the various political parties had, and some of them still have, indigenous branches: a clearly indigenous party, the Tupac Katari Indigenous Movement, or "Kataristas", openly competed for political power and their long-standing Presidential candidate, the Aymara Víctor Hugo Cárdenas, was Vice-President of Bolivia from 1993 to 1997 in a coalition government. Usually, however, indigenous organizations (though not their individual members) have avoided linking up with any specific political party, and their leaders generally reject the offers of political parties to incorporate or coopt them into the established party structures (Albó, 1994).

Indigenous leaders realize, however, that they need to establish tactical alliances with other social organizations, especially when they share the same social objectives, such as the defence of human rights under repressive regimes (like the successive military dictatorships in Guatemala). The question of alliances has been publicly raised at some international congresses attended by indigenous organizations, where participants held that broad popular mobilization will have a bigger political impact than isolated actions by smaller, fragmented groups. On the other hand, indigenous leaders say that their specific interests (ethnic identity, recognition of the historical rights of indigenous peoples) are easily lost sight of and subordinated to the more general concerns of broad popular organizations. They generally fear (perhaps quite rightly) that indigenous organizations may come to be minor players in a game dominated by the established mixed-race organizations and that they will run the risk of being manipulated by the more experienced non-indigenous politicians.

## VII

### External support

Indigenous organizations would not have progressed as much as they have done in all these years without external support. Indeed, many organizations originally started with the aid of outside agents who still often maintain their influence over them. Catholic and Protestant missions helped some of the Amazonian indigenous associations to organize their activities in the 1960s and 1970s, and the organization of the indigenous movement has also

been aided at various times by teachers, government agronomists, anthropologists from academic institutions, health workers, and other non-indigenous professionals, as well as activists from different kinds of political groups. Many of these organizations now receive financial aid or subsidies from the many international agencies and different kinds of non-governmental organizations that have been established in Latin America.

## VIII

### Prospects of the indigenous movement

Is the emergence of the indigenous movement a passing phenomenon, or is it a permanent element which represents some profound change in Latin American society? Only time will tell, but at the moment it is clear, at least for the writer, that the indigenous movement expresses fundamental social forces which are behind some of the changes that have been taking place in the continent during the last third of this century.

There are various factors which can account for the emergence of indigenous awareness and of these new social movements on the public scene. First, there is the general disenchantment with the failure of the traditional developmentalist policies assiduously applied by national governments and multilateral organizations since the end of the Second World War. "Economic development" was the magic expression, used by generations of official planners and academics, which was supposed to bring better standards of living and higher incomes to the poor, the marginalized, and the under-privileged people of Latin America. This promise was not fulfilled, however, as is shown by the "lost decade" of the 1980s. The indigenous peoples were indeed incorporated into the modern sector of the economy through the market mechanisms, labour migrations, and the expansion of the transport and communications infrastructure, but they saw that the benefits of growth went, as always, to the elites. Except in the case of a few experimental projects, the indigenous

peoples witnessed the deterioration of their situation during this period, as they steadily lost their autonomy and means of subsistence and became increasingly dependent on market capitalism.

In this process of unequal development, the indigenous populations were everywhere victims rather than beneficiaries: the most vulnerable and fragile population groups, caught up in a maelstrom of rapid and unstable economic and social changes. This did not go unnoticed by the emergent indigenous intelligentsia, who quickly became sceptical of the optimistic economic projections and promises of their governments and the predictions that they were on the threshold of progress and civilization. Thus, their disillusionment was just as great as their hopes had once been (Davis, 1977).

Another factor, connected with the foregoing, was the increasing awareness of the emergent indigenous intelligentsia that the modern nation-state that the racially mixed ruling elite had been building so diligently since the nineteenth century was flawed in its very foundations. Instead of being an integrative State it was exclusive: indigenous cultures were denied and "Indians" were victims of overt or covert racism and discrimination, and the indigenous peoples—even when they were the majority population groups in the nation as a whole, as in Bolivia and Guatemala, or in many subnational regions in the other countries—were excluded from economic well-being, social equality,

political decision-making processes, and access to justice through the legal system. Indians saw no place for themselves in the prevailing model of the nation-state as constructed by the mixed-race or white elites of the ruling class (mixed-race elites came to power in some countries such as Mexico, but the traditional racial-cultural elites dominated by the locally-born descendants of the Spanish colonists or other Europeans continued to prevail until well into the twentieth century in the other countries).

Latin America's indigenous roots were long considered a painful burden by the "European" elites, and the assimilation-oriented indigenist policies of their governments clearly indicated that indigenous cultures had no future in the modern nation-state. In spite of having received formal citizenship rights in most Latin American countries, the indigenous peoples have often been treated as second-class citizens, if not completely deprived of their rights as citizens (in some countries they were treated as minors, wards of the State, or legally incapable). Representative democracy, institutional political participation, equality before the law, due process, respect for their languages, cultures, religions and traditions, and the dignity accorded to the rest of national society were simply not for the Indians, many of whom reluctantly accepted the stereotypes and stigmas imposed on them by the dominant sectors and gave in to self-negation and self-denigration in order to be accepted by non-Indians. Others developed a "culture of resistance", becoming more introverted and avoiding contact with

the outside world as much as possible (a reaction which has been increasingly difficult to maintain in recent years). Still others, conscious of the fact that the existing model of nation-state denies them their identity and their possibility of survival as viable cultures, have begun to question the prevailing idea of the nation and to propose alternative concepts of a multicultural and polyethnic State. This is one of the demands that the new indigenous movement has been putting forward in recent years.

There can be no doubt that the indigenous movement has also been inspired by the anti-colonial independence struggles of the post-war years. Indigenous intellectuals have identified themselves with the national liberation movements, often considering that their own struggles are also anti-colonial, because their peoples were victims of an earlier form of colonialism which became domestic colonialism after Independence. When they saw the achievements of the anti-colonial and national liberation movements, they probably asked themselves "And why not us too?". Indeed, in the many indigenous manifestos and proclamations the Indian peoples of Latin America are presented as the victims of colonialism, and their struggle is seen as an anti-colonial resistance movement. This was expressed and repeated very clearly at many national and international meetings on the occasion of the 500th anniversary of the Meeting of Two Worlds: a celebration which further stimulated the establishment of indigenous organizations in the continent.

## IX

### Towards a new approach

The emergence of indigenous organizations also reflects the emergence of an indigenous or "Indianist" *Weltanschauung* which does not yet constitute a structured and coherent political ideology but does contain elements of such an attitude that clearly distinguish it from other ideologies which have permeated social thinking for many decades. It would seem that the emergent indigenous intelligentsia rejected the leading ideologies of the time because they did not tackle the problems of the indigenous population and the nation-state satisfactorily, deciding instead to formulate their own ideological texts.

A concept closely linked with the ideas of economic development and nation-building is that of modernization, which was once put forward as a universalizing social process that would eventually embrace all the traditional, backward or pre-modern forms of society. It was considered that these forms were typical of indigenous communities and cultures and were therefore doomed to disappear. Modernization policies, touted as a remedy for under-development and poverty, were designed to accelerate this process, which was felt by many to be both inevitable and desirable. The modernization paradigm, still proudly maintained by national leaders

as a synonym of progress and hence morally legitimate, is now considered by many indigenous activists and their sympathizers as something tantamount to ethnocide. The emergent "Indianist" ideology finds little support in this paradigm and does not support it in its turn. On the contrary, in many cases it explicitly rejects modernization as a viable objective for the indigenous peoples. This tension is clearly expressed in the conflicts over ecological changes, particularly in tropical rain forest areas. In these areas, modernization is often identified with vast ecological changes that destroy the bioresources of the tropical forests, which are the habitat of many indigenous groups.

The theory of modernization (one of the intellectual modes associated with the sociology of development) also asserted the need for profound changes in the cultural values of "backward" and "traditional" population groups. Various schools of "applied social scientists" used their skills to inform the indigenous populations of the world that their lifestyles were morally wrong (the missionary approach) or dysfunctional to the modern world (the technocratic approach). Indigenous peoples which accepted these arguments very soon found themselves morally dispossessed, culturally impoverished and materially devastated. The current indigenous (or Indianist) ideology therefore condemns the modernization paradigm as irrelevant in the best of cases and potentially destructive of indigenous values.

For decades, the modernization approach to social and cultural changes competed among indigenous peoples with the marxist view of the world, which served not only as a cognoscible map of the "real world" in which the indigenous peoples lived but also as a revolutionary guide for action and for changing the course of history. The various currents of marxist political groups (communists, trotskyites, maoists, Castroists, etc.) sometimes had their own "indigenist" platforms (when they thought of the indigenous peoples, which was not very often). This generally meant inviting these peoples to give up their indigenous identities to join in the class struggle as poor and exploited peasants. Sometimes, however, it meant simply rejecting the indigenous peoples as being too primitive to understand the class struggle and concentrating instead on fomenting the revolution of the "advanced" classes of Latin America, especially the urban proletariat. It was claimed that once the battle was won, an enlightened revolutionary government would bring progress to the backward indigenous groups.

Indigenous intellectuals perceived the orthodox marxist view of the "indigenous problem" as being not very different from that of the advocates of "modernization" mentioned earlier. Some of them rejected both approaches because they considered them to be products of the colonialist West. Indigenous scepticism increased still further when they saw how some indigenous groups were literally in the middle of the crossfire between leftist guerrilla movements and repressive armed forces under various Latin American governments (Bolivia, Colombia, Guatemala, Peru) during the 1970s and 1980s, while in Nicaragua they were caught between a leftist revolutionary government and the United States-organized "Contras" (Vilas, 1992).

Thus, the "Indianist" ideology arose as an alternative to the ideological vacuum displayed by the main political philosophies (both liberal and marxist) with regard to the indigenous peoples. Although it would be hard to talk at present of a perfected, structured and coherent Indianist ideology (indeed, this could never exist), there are a number of issues and lines of thought which persistently appear in the various currents of "Indianism", as reflected in the documentation of indigenous organizations, groups, seminars, conferences, workshops, reviews and periodicals. These issues, which are usually associated with specific demands made mainly to governments but also sometimes to society as a whole, may be grouped under five main headings.

#### a) *Definition and legal status*

While bureaucrats, legal experts and anthropologists, as well as the occasional missionary, have racked their brains over the question of who is or is not an Indian (or what qualifies as "indigenous"), since the definition and quantification of the indigenous peoples of Latin America is an ambiguous matter, the right to self-definition is one of the recurrent demands of indigenous organizations. This has become a question of cultural identity and often a matter of honour (independently of such "objective" criteria as the language or style of dress used, or active participation in community life). Rather than seeing this as a matter of individual choice, many organizations call for official recognition of indigenous groups and collective identities. When being an indigenous person was a source of social stigma there was little incentive for self-identification, but as times are changing, self-identification as an indigenous person has become a political instrument in a disputed social space.

Since social and cultural labels often imply a specific legal status, and the attribution of such status has typically been a prerogative of governments, indigenous organizations which claim the right to self-definition (now considered as a fundamental human right) also question the authority of governments to impose this status unilaterally (which is what actually occurred right from the start). The indigenous movement claims a new status for indigenous peoples within a democratic society: a demand which has been reflected in recent years in the legislative and constitutional changes mentioned at the beginning of this article.

b) *The right to land*

Although land rights –from which the agrarian reform question stems– no longer receive much attention in this era of economic globalization, they are of fundamental importance for the survival of the indigenous peoples of Latin America and form one their main demands. Loss of their lands (which are essential for their lifestyle) has been a constant feature of the history of the indigenous peoples of Latin America, and the struggle to preserve or recover their land tenure rights lies at the root of many recent attempts by the indigenous peoples to organize themselves. Land and its various resources (forests, water, animals and even minerals) are viewed mainly as collective, communal goods, although the notion of individual property rights has made some headway among indigenous communities after decades of capitalist expansion. There have been struggles for land tenure rights by the Mapuches of Chile, the inhabitants of the Altiplano in Peru and Ecuador and the Mayas of Guatemala, and they also lie at the root of social conflicts in Mexico, including the 1994 indigenous uprising in Chiapas. For the indigenous peasants of Latin America, the land tenure question is far from being solved, and the neglect of this by governments –after the wave of agrarian reform measures during the 1960s as part of the programme of the Alliance for Progress– is a heavy burden for the indigenous peoples to bear.

Although land tenure rights in the strict sense refer to production resources, the indigenous peoples insistently lay claim to their territorial rights, that is to say, the recognition and legal delimitation of ancestral territories occupied continuously by an indigenous group for time immemorial, which generally represent the geographic space needed for the cultural and social reproduction of the group. Indigenous territories have suffered serious losses as the result of colonization

from outside or expropriations decreed by governments, and there is a general consensus that, without their own territory, the social and cultural survival of the indigenous peoples is seriously threatened.

c) *Cultural identity*

Spontaneous cultural change and the process of acculturation, as well as State policies of assimilation of indigenous peoples, have been considered to represent a form of ethnocide: that is to say, they endanger the survival of indigenous cultures. Through a passive culture of resistance, many indigenous peoples have managed to preserve elements of their culture and keep alive their ethnic identity: efforts which have been strengthened in recent years by the conscious cultural rebirth promoted by the indigenous elites and cultural militants. Thus, for example, the Mayan culture is being actively promoted in Guatemala by numerous indigenous organizations (furthermore, in highly repressive environments purely cultural activity is somewhat less dangerous than openly political actions). The Quechua and Aymara languages and traditions have been revived in the Andean countries, and in Mexico an organization of indigenous writers and intellectuals is promoting indigenous literature. Sometimes these activities receive government support, but they are generally dependent on their own resources, with perhaps some aid from a sympathetic non-governmental organization.

Back in the nineteenth century, Spanish was declared to be the official and national language of the Spanish-speaking States of Latin America, and in the best of cases the indigenous languages were dismissed as dialects which did not deserve to be preserved. Consequently, formal and private (generally missionary) education imposed the State language on indigenous groups, and the use of indigenous languages was often even forbidden in public activities such as legal proceedings, municipal administration, etc. With such a disadvantage imposed on them in respect of the use of their own languages, the rights of the indigenous peoples were easily and systematically destroyed. In recent years, however, as the result of indigenous demands and the reappraisal of indigenist policies by teachers and social scientists, some governments have applied bilingual education programmes in indigenous areas. The indigenous organizations now demand educational services in their own languages, teachers' training programmes for their own people, and curricula which take the indigenous cultures into account.

In some States (such as Peru) indigenous languages are now recognized as national languages, while in others members of the indigenous population are officially allowed to use their own language in administrative and legal matters that affect them.

d) *Social organization and legal customs*

Indigenous community life, and hence the viability of indigenous cultures, depends on the vitality of the group's social organization and in many cases on the active use of local legal customs. In recent years this has become an important demand of indigenous organizations, since failure by the State legal system and the public administration to recognize the local form of social organization and legal customs is yet another factor contributing to the weakening and possible disappearance of indigenous cultures.

No Latin American State formally recognizes multiple legal systems, but there has always been some degree of tolerance for local "usages and customs" (in Colonial times, a special legal system was established by the Crown for the "Indian Republics"). Many indigenous organizations have now adopted the objective of securing formal recognition of legal customs, traditional forms of local authority and settlement of disputes, practices regarding inheritance and patrimony, rules on land use and communal resources, etc. These represent political demands which are often expressed in the indigenous population's objective of achieving a higher degree of political participation.

e) *Political participation*

The indigenous organizations are now not only claiming greater political representation in government institutions (municipal councils, state legislatures, national congresses) but are also trying to win the right to self-determination (guaranteed in international law), as expressed in local and regional autonomy and self-government. Many States are still fearful of these demands because they see them as a step towards secession and fragmentation of the nation-state, but indigenous organizations generally insist that all they want is internal self-determination and greater participation in national politics, not as an excluded minority but as descendants of the first inhabitants of the country and hence "authentic" representatives of the "nation".

Various countries, including Brazil, Nicaragua and Panama, have adopted statutes giving autonomy to indigenous regions, while others are considering doing so. This is a matter which will undoubtedly give rise to much controversy in the future.<sup>2</sup>

The progress made in recent years at the international level in the field of indigenous rights has strongly influenced the position and evolution of the indigenous organizations of Latin America, and may also have influenced the evolution of governments' positions. The United Nations Working Group on Indigenous Populations has been preparing a draft declaration of indigenous rights since 1982. To begin with, Latin American governments paid little attention to these efforts, but as time has gone by they have been showing greater interest. At first, few representatives of the Latin American indigenous population participated in this work, but in recent years more and more indigenous organizations of the region have taken part in the annual debates of the Working Group in Geneva. Attending these meetings gives many indigenous leaders the chance to get to know the international environment, make contact with their opposite numbers in other countries, and thus strengthen their own domestic organizational work. Whatever the final result of the draft declaration (the United Nations General Assembly may adopt it in an amended form), the indigenous organizations already consider its various articles (though still only provisional, of course) as a necessary point of reference in their own political discourse. This is so, for example, in the case of the assertion that the indigenous peoples, just like all other peoples, have the right to self-determination.

On the other hand, there were few indigenous representatives at the debates leading up to the adoption of ILO Convention 169 in 1989. The indigenous points of view were mainly expressed by the workers' delegates, who were not always very familiar with these matters. Since Convention 169 has been ratified by a number of Latin American countries, the indigenous organizations rightly see it as one of the existing legal instruments which are binding on governments,

<sup>2</sup> For an earlier study of these questions, see Stavenhagen, 1992, pp. 63-118.



and they are consequently actively promoting its ratification by the remaining countries.

As international law on indigenous rights grows up, the indigenous organizations of Latin America will use it for both legal and political purposes.

The indigenous discourse stands at the crossroads between matters of human rights, democracy, development and the environment. It has become increasingly clear that indigenous demands are not just of interest to the indigenous peoples themselves

but also involve the whole of the respective national societies. The indigenous peoples are not just calling for more and better democracy, better application of the mechanisms for the defence and protection of human rights, or a bigger share in the supposed benefits of development programmes. What they are really doing is questioning and challenging the basic assumptions on which the Nation-State has been built up in Latin America for almost two centuries past.

(Original: Spanish)

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# Non-agricultural *rural employment* in Central America

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Non-agricultural rural employment accounts for an increasing proportion of total rural employment in Latin America. Its potential for stimulating rural development has been noted, but it has also been analysed as a focal point of poverty. This article considers the magnitude and composition of this employment in some of the Central American countries and examines the conditions under which non-agricultural activities may help to improve rural employment and income. It is noted that non-agricultural rural employment is heterogeneous and different types of employment arise in response to different dynamics. Although there are potential sources of non-agricultural rural employment which have no connection with agriculture, in the countries analysed it is the characteristics of the agricultural sector which influence most heavily the composition and characteristics of such employment. Agriculture influences both the generation of non-agricultural productive employment and the creation of makeshift alternative jobs, primarily through demand for non-agricultural goods and services and the discharge of surplus labour. Consequently, in order for non-agricultural rural activities to make a significant contribution to rural development it is necessary to adopt an approach which integrates both the agricultural and non-agricultural elements of such development.

# I

## Introduction

Studies on employment in Third World countries generally concentrate on urban employment on the one hand and agricultural employment on the other, ignoring non-agricultural rural employment, which is of increasing importance in many countries. Recently, however, this type of employment has been seen as a low-cost option for solving the labour market problems of such countries, especially in the light of the slackening in the growth rates of productive urban employment since the early 1980s and the limitations which exist for any significant increase in agricultural employment.<sup>1</sup> It has been argued that non-agricultural employment could also be a stabilizing force for peasant agriculture by providing the family unit with income generated outside the farm, combating rural poverty and helping to reduce migration from rural to urban areas.<sup>2</sup>

As in other areas in Africa, Asia and Latin America, the share of non-agricultural rural employment in total employment in Central America has increased in recent decades. According to ILO calculations, the share of non-agricultural rural employment in the total rural labour force of a group of Central American and Caribbean countries rose between 1950 and 1980 from 11.3% to 24.3%, while its share in non-agricultural employment as a whole rose from 15.8% to 20.3% over the same period (ILO, 1983, p. 17).

However, these data –like the expected effects mentioned above– conceal a situation which is very heterogeneous as regards both the dynamics that generate this employment and its characteristics and the income levels it provides.

The two main hypotheses used to explain the expansion in non-agricultural rural employment (NARE) are the following:

i) Non-agricultural rural employment is mainly generated by the demand for non-agricultural rural goods and services: its expansion is therefore determined on the demand side and reflects dynamic growth;

ii) Non-agricultural rural employment is essentially a refuge for surplus labour from the peasant sector: its expansion is therefore determined on the supply side and reflects a further advance of poverty.

Obviously, these two basic hypotheses on the global behaviour of NARE and its underlying dynamics are not mutually exclusive, and it may be assumed that in the Central American countries both tendencies are at work, with their corresponding effects on employment. What is not so clear, however, is the relative weight of each of these factors (and possibly of others too) and the extent to which they serve to explain the global behaviour and composition of non-agricultural rural employment.

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□ This article is based on a more extensive study carried out for the then Focal Point for Central America and Panama of the Regional Employment Programme for Latin America and the Caribbean (PREALC) of the International Labour Office (ILO), where the author worked as an associate expert and rural employment consultant (Weller, 1994).

<sup>1</sup> As Singer (1992, p. 112) points out, although there is some room for increasing both food production and employment in agriculture, the potential for absorbing labour by this means is limited. It is therefore generally recognized that much of the necessary expansion in rural employment must be of a non-agricultural nature.

<sup>2</sup> Saith analyses the various reasons for the strong current interest in non-agricultural rural activities, with special reference to the different institutional interests and theoretical contexts (Saith, 1992).

## II

### Non-agricultural rural employment and integrated rural development

The above two hypotheses emphasize the links between NARE and the performance of the agricultural sector. In particular, the relationship posited by the first hypothesis is highlighted by the concept of linkages, which describes the unequal effects of the growth of some sectors on the growth of others, from which the corresponding investment strategies have been deduced.<sup>3</sup> Authors such as Mellor and Hazell, among others, have drawn attention to the dynamic effect of the expansion of agriculture on the markets for non-agricultural rural goods and services, taking into account the demand for goods, services and inputs by the agricultural sector as well as the demand for consumer products generated by higher agricultural income (Mellor, 1976; Haggblade, Hazell and Brown, 1989).

In this sense, agricultural development would lead to integrated rural development.<sup>4</sup> Studies in Asian countries, for example, have found that NARE increases by 1% to 1.5% when agricultural production grows by 1% and that incomes in non-agricultural rural activities rise by US\$ 0.80 for every dollar of additional agricultural income (Hazell, 1987). In Africa, the linkages observed were less marked: each dollar of additional agricultural income generates US\$ 0.50 more non-agricultural rural income (Haggblade, Hazell and Brown, 1989).

Increases in agricultural production and income can have very different effects, however, depending on the types of producers benefitted, the prevailing consumption patterns, the nature of the linkages with urban and rural markets for non-agricultural goods and services, the absolute levels of agricultural income involved, and the distribution of the additional income. Four examples can help to clarify this statement:

i) An increase in agricultural production can intensify its forward and backward linkages (for example, processing and inputs) and increase the demand for the corre-

sponding goods and services; this may make it feasible to produce them locally, but it can also make it cheaper to "import" them from urban areas, thus displacing existing small-scale rural activities (ILO, 1983, p. 38 *et seq.*).

ii) According to Engel's Law, when income increases there is a decline in the proportion of it spent on food and other basic products; the better-off farmers will tend to use the additional income mainly to obtain products which are not of agricultural but rather of urban origin. Consequently, the effects on the rural economy will be quite small when the agricultural expansion is concentrated in the larger production units, as has often happened in bimodal Latin American agriculture.<sup>5</sup>

iii) The expansion of agricultural production will not necessarily coincide with a substantial increase in employment or lead to higher wages that increase the purchasing power of the agricultural labour force, as shown by the experiences of polarized modernization of Central American agriculture since the war (García-Huidobro, Haan, Hintermeister, Klein and Tokman, 1986). There was thus only a limited increase in demand for consumer goods, despite the increased generation of added value.

iv) An increase in the demand for non-agricultural rural goods and services can lead to labour-saving technological changes (mechanization), so that in spite of the dynamic effects of agricultural expansion the effects on NARE would only be small.

In short, it is not possible to deduce the effects of an increase in agricultural production and income on NARE simply from these linkages: while there may generally be a possibility of generating or expanding the production of non-agricultural rural goods and services to replace "imports", there may also be a possibility that such "imports" may increase. The nature and volume of the residual effects will depend on the particular circumstances and cannot be determined in a generalized manner.

<sup>3</sup> The "father" of this concept is Hirschman (see Hirschman, 1961 and 1977).

<sup>4</sup> Understood here as a process which increases rural productivity and income and fulfills basic rural needs better through greater integration of the different rural economic activities with a broad social base.

<sup>5</sup> Saith, 1992, p. 23. The same trend would apply, however –if the level of development is higher– in the case of a generalized increase in agricultural income. Consequently, in such cases it is not so much the production of goods but of services which is in greatest demand (see UNDP/Netherlands Government/ILO/UNIDO, 1988, p. 29). The overall balance could be negative if these "imports" take the place of existing local production.

Another important aspect that should be taken into account when dealing with the strengthening of the linkages between the agricultural sector and the non-agricultural rural goods and services sector is the contribution that integrated regional development can make, through the spontaneous decentralization of secondary and tertiary activities and the appearance of different levels of rural functional centres, ranging from villages to small townships integrated into rural dynamics.<sup>6</sup>

Thus, rural development and regional development, which are two aspects of the effects of the

integration of agricultural and non-agricultural activities in rural areas, are closely interlinked, since the same factors which tend to reduce the effects of agricultural expansion on the production of non-agricultural rural goods and services and the generation of NARE also limit regional integration.<sup>7</sup> In contrast, where there is close integration of both sectors at the local and regional level under favourable framework conditions, the non-agricultural sector can provide positive feedback to the agricultural sector, supplying it with goods and services that increase its productivity and income.

### III

## Measurement of non-agricultural rural employment

The following analysis of non-agricultural rural employment in Central America is based on the information from household surveys of the countries of the region available to the ILO Data Bank on the Labour Market, Income and Poverty (previously the PREALC Focal Point in Panama), which made a special tabulation of these surveys.<sup>8</sup> Many questions on the dynamics of non-agricultural rural employment would have required the collection of additional data, which is beyond the scope of this study. Consequently, the present article will only refer to some issues of importance for the analysis of non-agricultural rural employment and present the information provided by household surveys in this respect. For the comparative analysis, data were available from Costa Rica, Guatemala, Honduras and Panama.

The use of these household survey data conditions some of the basic definitions of the study and thereby creates some methodological problems. Statistical de-

partments generally define urban areas on the basis of their position in the administrative hierarchy, their number of inhabitants, and/or the characteristics of their infrastructure, with the remaining areas being defined as rural. The definitions used in the countries of the region also differ slightly.<sup>9</sup>

The main measurement problem is the need to calculate non-agricultural rural employment on the

<sup>6</sup> "In many countries, small townships and marketing centres are displaying population growth rates much higher than those of larger urban complexes (although these growth rates start from a lower level). These tendencies indicate the spontaneous emergence of "growth poles" which can play an important function in integrated regional development" (ILO, 1983, p. 22).

<sup>7</sup> In a comparative analysis of three rural areas in Costa Rica, it was found that the highest levels of regional integration coincided with a more homogeneous agricultural structure (Altenburg, Hein and Weller, 1990, pp. 209-274).

<sup>8</sup> In view of the situation at the time this study was prepared, this source will be referred to as PREALC-Panama.

<sup>9</sup> The definitions of urban areas used in the different countries are as follows: *Costa Rica*: "... the administrative centres of the various cantons of the country, i.e., all or part of the first district, together with other adjacent areas. These areas were demarcated primarily on the basis of physical and functional criteria, taking account of tangible elements such as blocks, streets, sidewalks, electric light, urban services, etc." (DGEC, 1987). *Guatemala*: "Urban areas comprise all population centres with the category of city, township or village which are municipal administrative centres ..." (INE, 1989). *Honduras*: "... municipal administrative centres ... and other places which, although not municipal centres, are considered as urban areas, such as population centres with 2,000 or more inhabitants which have piped water services, access roads, a full primary school (six grades) and postal or telecommunications service, plus at least one of the following services: electric light, sewerage or a health centre" (Department of Statistics and Censuses, 1990). *Panama*: "localities with 1,500 or more inhabitants which have the following characteristics: electric light, public water supply, sewerage and paved streets. Such localities must also have secondary educational facilities, shops, social and recreational centres and sidewalks. The foregoing characteristics may apply to the entire locality or only part of it" (DEC, 1980). Although the definitions applied do not completely coincide in all the countries, they are quite similar, so that the differences probably do not affect the analysis much. Klein (1996, Annex) gives the corresponding definitions for other Latin American countries.

basis of the than where he works, the employed person lives rather than where he works, because the surveys do not give the latter information. Consequently, as it is not possible to identify people who travel each day from their rural place of residence to an urban workplace, there is a tendency to overestimate non-agricultural rural employment.

On the other hand, as an appreciable proportion of agricultural workers actually live in urban areas (10%

of all agricultural workers in the Central American countries), there may also be workers who travel daily from urban areas to work in non-agricultural rural activities (ILO, 1988, p. 57).

Although these and other measurement problems complicate the study of non-agricultural rural employment,<sup>10</sup> the comparative analysis nevertheless allows important conclusions to be drawn on the characteristics and dynamics of NARE.

## IV

### Volume and characteristics of non-agricultural rural employment in Central America

#### 1. Elements for interpreting the characteristics of non-agricultural rural employment

Table 1 shows that non-agricultural rural employment accounts for a significant share of the labour market in the four countries studied (between one-sixth and a quarter of total employment); the percentage is markedly higher in Costa Rica, but there are no major differences among the others.

The share of NARE in total rural employment is naturally very considerable in countries with a low rate of agricultural employment. In Costa Rica and Panama,

where less than 30% of all workers are employed in agriculture, NARE reaches impressively high rates: 50% and 40% of all rural employment, respectively. Even in Guatemala and Honduras, however, where its level is around 30%, NARE accounts for a substantial proportion of the rural labour market.

NARE's share of non-agricultural employment as a whole is more uniform: it represents between a quarter and one-third. The smallest proportions correspond to Panama and Costa Rica, apparently because of those countries' higher levels of urbanization. In the process of differentiation between agricultural and non-agricultural activities, the latter are marked, in a first phase, by the predominance of activities linked with the agricultural sector and located in rural areas, but in later phases they are increasingly concentrated in activities which have nothing to do with agriculture and are located in urban areas. Consequently, NARE may continue to grow in relation to rural employment, but it stagnates or goes down in relation to non-agricultural employment as a whole.

When NARE is analysed from another standpoint, we see that there are a considerable number of dynamics, not mutually exclusive, which affect labour supply and demand in non-agricultural rural activities.

If we look at the generation of NARE in terms of its linkages with agriculture, which continues to be the

TABLE 1  
Costa Rica, Guatemala, Honduras and Panama:  
Size and relative importance of non-agricultural rural employment (NARE), around 1990  
(Percentages)

	Costa Rica (1989)	Guatemala (1989)	Honduras (1990)	Panama (1989)
NARE (total)	239 372	487 535	258 701	127 583
NARE/total employment	24.3	17.2	17.4	18.6
NARE/rural employment	50.2	28.1	30.8	40.8
NARE/non-agricultural employment	32.9	34.2	30.8	26.4
Agricultural employment/total employment	26.2	49.9	43.3	29.6

Source: PREALC-Panama, data bank based on national surveys carried out and processed by national statistical institutions.

<sup>10</sup> Saith (1992, pp. 13 *et seq.*) and Weller (1994, pp. 21-24) analyse measurement problems and possible alternatives in greater detail.

most important branch of activity in rural areas of Central America, we see that some non-agricultural rural activities, and the demand for labour for them, depend directly on the performance of agriculture, whereas others are relatively or completely independent of the situation of that sector.

With regard to the generation of NARE originating from the non-agricultural rural goods and services market, we see that although the production of such goods and services obviously generates a demand for labour, there are factors external to that market which also influence NARE, either on the side of another type of demand, or on the supply side.

Table 2 shows what may be called five different dynamics of the generation of supply or demand in the non-agricultural rural labour market, marked by different relations with the factors mentioned above.

Dynamic A covers economic activities directly related with agriculture, either through the supply of goods and services that serve as production inputs (transport and trading of inputs, machinery and equipment, credit services, repairs, veterinary services, etc.) or through the processing, marketing and transport of agricultural products. These two types of economic activities represent backward and forward linkages, respectively. The generation of employment as a result of this dynamic is closely dependent on the performance of the agricultural sector, as changes in its demand for non-agricultural rural goods and services are channelled directly by the market to the corresponding activities (Klein, 1992, p. 7).

TABLE 2  
Dynamics affecting  
non-agricultural rural employment

	Dynamics directly linked with agriculture	Dynamics not directly linked with agriculture
Dynamics originating in the market for non-agricultural rural goods and services	A: Linkages with agriculture B: Rural final consumption	D: Non-rural final consumption not linked with agriculture
Dynamics external to the market for non-agricultural rural goods and services	C: Surplus agricultural labour force	E: Public services

Source: Prepared by the author.

Dynamic B generates NARE through the demand created by the rural population's consumption, as regards both the rural production of consumer goods and services and the provision of auxiliary services (transport, retail trade) in connection with the consumption of goods from urban areas. The link with agriculture is due to the preponderance of agriculture in rural areas, so that the generation of NARE through dynamic B is strongly influenced by the performance of agricultural activity. Both dynamic A and dynamic B influence the non-agricultural rural labour market on the side of the demand for non-agricultural rural goods and services.

Like the previous two dynamics, dynamic C also depends on the situation of agriculture, but in this case this sector affects the labour supply for non-agricultural rural activities through the surplus labour from agriculture which migrates to urban areas or seeks non-agricultural employment in rural areas, sometimes without leaving the family unit. It may be assumed that this labour is concentrated in the lowest-quality segment of NARE, which we may call the "refuge sector".<sup>11</sup>

Dynamic D generates demand for labour through activities which have no connection with agriculture, such as "folk" handicrafts, tourism and, more recently, assembly activities transferred to rural areas to take advantage of the wage differential with the cities.<sup>12</sup> In all such activities, the NARE generated depends more on the behaviour of the economy as a whole than on that of the agricultural sector.

Finally, dynamic E has no direct links either with the processes taking place in the non-agricultural rural goods and services markets or with the agricultural sector. The NARE generated by this means is due above all to public services in rural areas (education, health, security, etc.). The consequent expansion of NARE does partly reflect the needs of rural areas, but those needs are not channelled in the form of market demand, so that this expansion depends largely on factors which are not specifically rural (such as the budgetary situation).

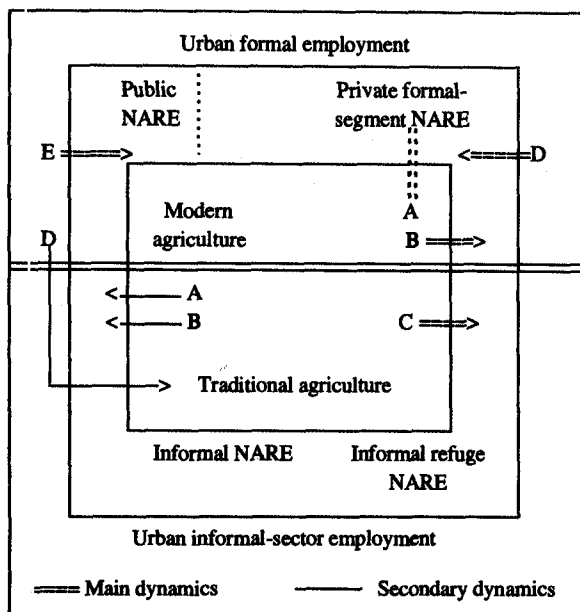
Figure 1 summarizes these dynamics and shows which segments of NARE they affect in a primary or secondary manner.

<sup>11</sup> This does not mean, however, that all the members of agricultural families employed in non-agricultural rural activities are concentrated in this "refuge sector".

<sup>12</sup> Klein (1992, p. 11) gives examples of assembly activities carried out in the workers' homes in Ecuador and Mexico.



**FIGURE 1**  
**Dynamics affecting the volume and composition of non-agricultural rural employment (NARE)**



Source: Prepared by the author.

Obviously, these dynamics are not mutually exclusive as far as the generation and nature of NARE are concerned but affect each other mutually, as may be seen from the following examples:

i) Expansion of NARE through dynamics A, B, C and D gives rise to bigger concentrations of population and hence to greater needs for health, education and other services (dynamic E).

ii) The construction of roads and highways with public funds tends to promote NARE through dynamics A and D, by facilitating access to new markets, but on the other hand—and with growing impact—it increases the competitiveness of “imported” goods (brought in from urban areas or from abroad) and facilitates changes in consumption patterns in the direction of the consumption of urban goods, and this limits the generation of NARE by dynamic B, since it reduces local production of such goods.

All the above-mentioned dynamics tend to increase non-agricultural rural employment, so that it may be assumed that there is a direct relation between their existence and the magnitude of NARE. However, the conditions of the employment they generate (such as income levels and the sex of the workers hired) vary widely depending on which dynamic predominates.

## 2. Non-agricultural rural employment formation dynamics in Central America

In order to analyse the impact of the different dynamics on NARE, we must on the one hand establish indicators which reflect the relative weight of these dynamics (the independent variables) in the different countries and, on the other hand, estimate the segments of NARE (the dependent variables) where the main effects of those dynamics will be felt. If they do in fact decisively affect the volume and composition of NARE, there should be a direct relation between the behaviour of the indicators of the independent variables and that of the dependent variables.

We will first examine the indicators for the independent and for the dependent variables. We will then present the figures corresponding to the indicators for the independent variables in the four countries studied and deduce hypotheses on the composition of NARE in those countries. Finally, these hypotheses will be compared with the data collected in the household surveys.

Dynamics A and B are based on the behaviour of agriculture, both in terms of its production linkages and in terms of the income they generate, which are converted into demand for final consumption goods and services. The weight of the demand generated by these dynamics depends mainly on the average productivity of the agricultural labour force. This largely reflects the incorporation of non-agricultural goods and services (inputs, machinery, transport) and also represents the net income of the economic agents of the sector as a whole, which is partly converted into demand for consumer goods and services.

If we use the average productivity of the agricultural labour force as the main component of an indicator for dynamics A and B, it would be desirable to supplement it, because the volume of demand generated obviously depends not only on productivity (the value added per capita) but also on the total value generated by the agricultural sector, as reflected in its share of GDP.

In order to determine the weight of dynamic C, which is based on the surplus agricultural labour force, we must use the percentage of the agricultural economically active population with employment problems (unemployment, visible underemployment and concealed underemployment). As an indicator of the weight of dynamic D, which reflects the demand for non-agricultural rural goods and services not connected with the agricultural sector, we must use the per capita non-agricultural GDP, while the indicator for

dynamic E, which reflects the effect of public services, will be central government expenditure as a proportion of GDP.

It may be assumed that the different dynamics affect different segments of NARE, in line with the existing linkages. When we go on to construct the indicators for the dependent variables, however, we see that the measurement problems deriving from the characteristics of the data base mentioned earlier are much more serious in this detailed analysis than in an appraisal of the global behaviour of NARE.

It is impossible to establish any links between these dynamics and certain branches of activity at the single-digit level of the International Standard Industrial Classification (ISIC). At the two-digit level, it is possible to identify some activities which are related with agriculture in terms of the processing of agricultural products (agroindustries). Other activities – such as commerce, transport, etc. – are seen to be connected with various dynamics (A, B, C). Construction, for its part, depends partly on the demand generated by these dynamics (especially with regard to building construction) and partly on public expenditure (construction of roads and bridges), that is to say, dynamic E.

Since we do not have any data on the linkages created by dynamics A, B and D of the demand for non-agricultural rural goods and services (input-output table), we will use the formal private segment of NARE (excluding public services) as an indicator of their overall effect on the non-agricultural rural labour market, on the assumption that the activities of this segment are a better reflection of the changes in demand generated by the three dynamics in question. At the same time, we will be obliged to construct a joint indicator for these dynamics, on the basis of the indicators for each of them. This joint indicator consists of a composite index in which agricultural productivity has a weighting of 50%, the relative importance of agriculture (agricultural GDP/total GDP) has a weight of 25%, and the purchasing power generated in non-agricultural sectors (per capita non-agricultural GDP) also has a weight of 25%.

Employment in the industrial and services branches of the traditional segment of NARE serves as an indicator for the effects of dynamic C. The assumption that it is this part of the labour market which best reflects the nature of NARE as a refuge sector is based on observations of the average incomes received in it. In the four countries studied, the traditional services segment registers average incomes below those generated in traditional agriculture. Traditional industry (better described as artisanal activities) generates average

incomes which are in almost all cases around the level of incomes in traditional agriculture (sometimes slightly higher, equal, or slightly below that level). It may be deduced that neither traditional services nor traditional artisanal activities have any attraction for the labour force of traditional agriculture. The low levels of income, especially in services, give grounds for assuming that members of peasant households only engage in such activities if they have no chance of obtaining better incomes in agriculture or other activities, so that these segments represent a refuge option for such persons.

Public employment is the most appropriate indicator for the effects of dynamic E on NARE. Table 3 summarizes the indicators for the independent and dependent variables.

Table 4 shows the indicators for the independent variables of the four countries studied, for the purpose of developing hypotheses on the composition of NARE for those countries, on the basis of the relationships analysed earlier. All the indicators vary greatly from one country to another, but some similarities are to be observed between Costa Rica and Panama, on the one hand, and Guatemala and Honduras on the other.

These data for the indicators of the independent variables of the four countries lead to the following hypotheses:

i) In Costa Rica, NARE is concentrated mainly in the formal private sector, because of high agricultural productivity, the large share of agriculture in GDP, and relatively high average non-agricultural incomes. There is also a significant level of public employment. Agricultural employment problems are less serious in this country, so that the Costa Rican refuge sector is not very large.

ii) In Guatemala, there is a large refuge sector because of the employment problems in agriculture. Public employment is only limited. Although agricultural productivity is low, the considerable weight of the sector can help to increase demand for goods and services produced by the formal private segment.

iii) The situation in Honduras is similar to that of Guatemala, the main difference being in the bigger share of public employment.

iv) In Panama, there must be a bigger share of public employment in NARE. The formal private sector may be assumed to be relatively large because of the levels of agricultural productivity and average non-agricultural income, but the small size of the agricultural sector will limit the volume of the demand for non-agricultural rural goods and services generated by

TABLE 3

**Indicators for measuring the effect of different dynamics  
on the composition of non-agricultural rural employment (NARE)**

Dynamics	Indicators for the independent variables <sup>a</sup>	Indicators for the dependent variables <sup>b</sup>
A, B and D	Index made up of: i) Per capita productivity of agriculture ii) Agricultural GDP/total GDP iii) Per capita non-agricultural GDP	Non-agricultural private formal sector
C	Proportion of persons with employment problems in the agricultural economically active population	Traditional segment of the industrial and services branches
E	Central government expenditure/GDP	Non-agricultural rural public sector

Source: Prepared by the author.

<sup>a</sup> Agricultural or urban non-agricultural dynamics which affect NARE.

<sup>b</sup> Segments of NARE.

TABLE 4

**Costa Rica, Guatemala, Honduras and Panama:  
Indicators for independent variables, around 1990**

Indicators	Costa Rica (1989)	Guatemala (1989)	Honduras (1990)	Panama (1989)
Productivity of agriculture (1980 dollars per person employed)	3 244	1 171	1 048	1 857
Agricultural GDP/total GDP (%)	17.2	22.8	21.3	10.8
Per capita non-agricultural GDP (1980 dollars per capita)	1 168	613	473	1 308
Index made up of the above indicators <sup>a</sup>	100	64	57	72
Proportion of agricultural labour force with employment problems (%) <sup>b</sup>	36.2 <sup>c</sup>	80.8	64.9	37.7 <sup>d</sup>
Central government expenditure/GDP (%)	19.3	13.2	22.1	36.8 <sup>e</sup>

Source: ECLAC, 1992; DEC, 1991; PREALC-Panama data bank.

<sup>a</sup> For the way the composite index was prepared, see section IV.2.

<sup>b</sup> (Unemployed + underemployed) / agricultural economically active population \* 100.

<sup>c</sup> 1990 figure.

<sup>d</sup> This figure is underestimated because of the exclusion of peasants from the underemployment measurements.

<sup>e</sup> Figure refers to 1987. Because of the political and economic crisis which broke out in that year, the budgets for the following years were sharply reduced, without however any mass layoffs of staff in the public sector. Consequently, use of the figures for 1989 (the year to which the employment figures refer) would have distorted the ratio in question.

that sector. The refuge sector may be expected to be smaller than in Guatemala and Honduras.

Table 5 gives data on the shares of the three segments of NARE selected as indicators for the dependent variables.

As suggested by the hypotheses, it is observed that the formal private sector is very large in Costa Rica, public employment is large in Panama, and the refuge sector is large in Guatemala and Honduras. Figures 2,

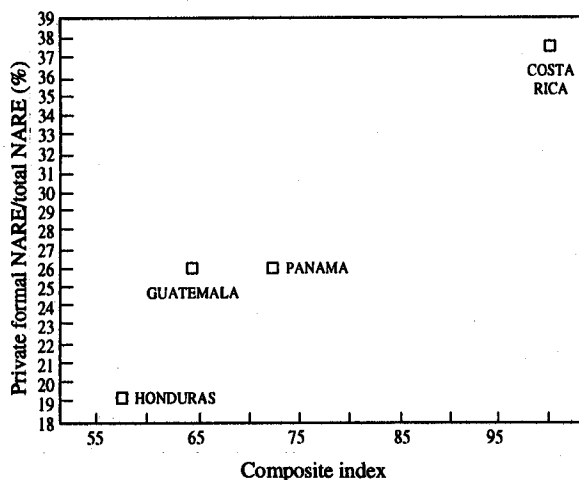
3 and 4 show the ratios between the indicators of the independent variables and those of the dependent variables. Figure 2 shows the ratio between, on the one hand, the composite index representing the demand for non-agricultural rural goods and services originating in both the agricultural sector (indicated by the productivity of labour in the agricultural sector and the relative weight of that sector in GDP) and in activities not connected with the agricultural sector (indicated

TABLE 5  
Costa Rica, Guatemala, Honduras and Panama:  
Shares of selected segments in non-agricultural  
rural employment, around 1990  
(Percentages)

Segments	Costa Rica (1989)	Guatemala (1989)	Honduras (1990)	Panama (1989)
Private formal segment	37.6	25.9	19.1	26.0
Public segment	17.8	8.4	12.8	26.5
Refuge segment	23.1	35.5	33.6	24.0
Other informal segments	21.5	30.2	34.5	23.5
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Same as table 1.

FIGURE 2  
Costa Rica, Guatemala, Honduras and Panama:  
Share of private formal segment in  
non-agricultural rural employment (NARE)



by the per capita non-agricultural GDP), and on the other hand, NARE in the formal private segment. It is clearly visible that in the countries studied, a higher level of the composite index coincides with higher levels of employment in the formal private segment. The stagnation observed in the case of Panama, where the levels of employment do not fully correspond with the high level of the composite index, may be explained by the high levels of urbanization of that country, which, together with Panama's small size and well-developed road system which efficiently links the main rural areas with the metropolitan area, may

FIGURE 3  
Costa Rica, Guatemala, Honduras and Panama:  
Share of refuge-type employment in  
non-agricultural rural employment (NARE)

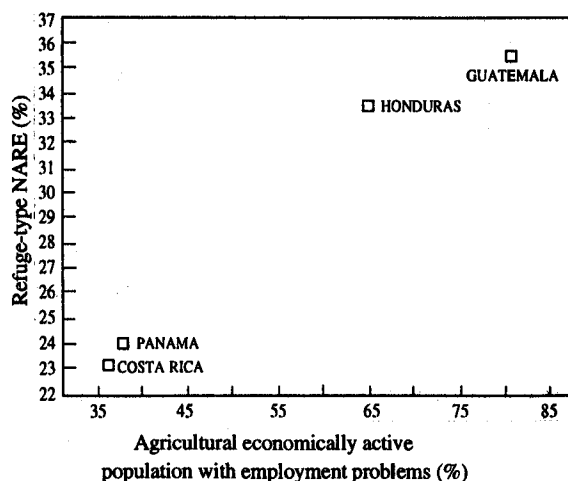
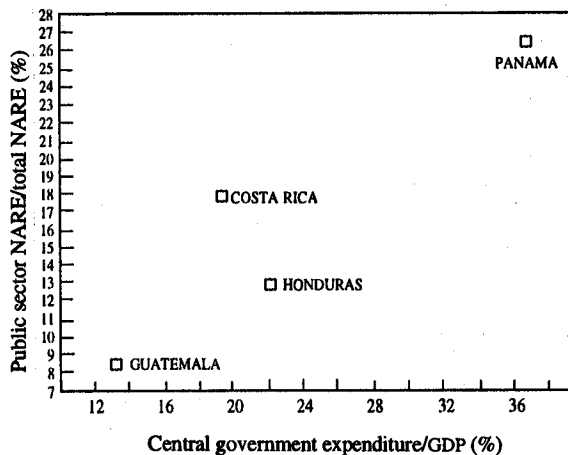


FIGURE 4  
Costa Rica, Guatemala, Honduras and Panama:  
Share of public employment in  
non-agricultural rural employment (NARE)



mean that there is too much competition for many rural activities.

Figure 3 shows the ratio between the percentage of the agricultural economically active population who have employment problems and the proportion of NARE in the refuge sector. In this case, the relationship is even clearer: the countries with the fewest agricultural employment problems (Costa Rica and Panama) display a smaller proportion of NARE in the refuge sector, while the countries with bigger problems of this type (Guatemala and Honduras) register high proportions.

A striking feature of figure 4 is that, although this would seem to be the most immediate causal relation, the link between central government expenditure and the proportion of public employment in NARE is not as clear as the other relations, although the trend does indeed seem to coincide with the corresponding hypothesis (figure 4). Public employment has a higher share in Costa Rica and a lower share in Honduras than is suggested by the hypothesis.<sup>13</sup> This deviation is probably explained by the fact that the samples used in the surveys excluded military installations. Because of

the structure of the respective security forces, their share in the total population should be greater in Honduras than in Costa Rica.

It may be concluded that the size and composition of NARE are determined by the relative weight of the different dynamics. NARE's potential for contributing to integrated rural development does not therefore depend solely on growth. In the following sections, we will go into this matter more deeply, analysing the labour income generated in the various segments of NARE and its relation with the agricultural sector.

## V

### Income from non-agricultural rural employment, and rural development

In the previous section, it was suggested that there is a clear relationship between the relative weight of the different dynamics identified and the relative weight of the segments making up NARE. If we analyse NARE's potential for contributing to integrated rural development, we see that dynamics A and B play a leading role. Although other factors may be important for the generation of employment opportunities and income (dynamic D) and also for improving the general conditions for agricultural employment (dynamic E), it is the first two dynamics which, through the integration of production at increasingly high levels of productivity, can help to generate virtuous circles in which supply and demand in rural areas stimulate each other.

In order to gain a better idea of the prospects for integrated rural development of this type, this section will review some of the relations between agricultural and non-agricultural labour income (i.e., dynamic B). This can only be done in an indicative manner, however. On the one hand, not all the labour income of the agricultural sector is paid in rural areas themselves, while on the other hand, only part of the non-agricultural labour income in rural areas comes from the demand for consumer goods and services generated by the labour income of the agricultural sector (dynamic B). Although part of the impact of these other dynam-

ics—that which generates labour income in the public sector (dynamic E)—can be separated out using the available data, this is not possible for the other dynamics. Consequently, the comparison of agricultural and non-agricultural labour income only allows us to establish indicative, not causal, relations.<sup>14</sup>

As a first step, table 6 shows the relative levels of rural labour income, in the formal and informal sectors of agriculture and non-agricultural activities, for three Central American countries. Average agricultural labour income for the respective reference years was US\$ 147 in Costa Rica, US\$ 42 in Honduras, and US\$ 113 in Panama, which is important for our subsequent interpretation.<sup>15</sup> It may be noted from the table that the income levels of the modern segments are noticeably higher than those of the informal or traditional segments, both in the agricultural sector and in non-agricultural activities. A striking feature is the high level of labour income in the modern agricultural sector of Honduras and Panama: higher than average labour income in the modern segment of NARE. In Honduras, this income even exceeded the average labour income for the country as a whole. The reason for this situation is the fact that modern agriculture forms a kind of enclave in both countries: relatively small and with relatively high wages. In Costa Rica, in

<sup>13</sup> The same ratios are obtained if the calculations are based on the expenditure of the non-financial public sector rather than that of the central government.

<sup>14</sup> An exception in this respect will be mentioned later.

<sup>15</sup> The calculations were based on income data from the PREALC-Panama Data Bank and the exchange rates taken from CMCA, 1992. In the case of Panama, only agricultural wages were used.

TABLE 6  
Costa Rica, Honduras and Panama: Index of average rural labour income and income gap, by sector and segment of activity, around 1990 (Average national labour income = 100)

	Costa Rica	Hondura	Panama
<i>Index of income</i>			
Agriculture	64.8	65.0	72.0
Modern agriculture	80.2	119.0	93.9
Traditional agriculture	52.4	50.7	29.4
Non-agricultural rural employment (NARE)	87.4	76.8	62.7
Formal NARE	104.9	117.2	83.4
Public sector NARE	120.8	139.9	94.6
Private formal NARE	96.0	101.5	73.1
Informal NARE	63.2	57.9	38.7
Refuge-type NARE	48.4	34.8	28.3
NARE in other informal activities	81.5	80.3	49.8
<i>Average income gap between the modern-formal segment and the traditional-informal segment</i>			
Agriculture	1.53	2.35	3.19
NARE	1.66	2.02	2.16

Source: Same as for table 1.

contrast, the difference between average incomes in the modern and traditional segments of agriculture is much smaller, reflecting a less heterogeneous production structure and a more productive type of peasant agriculture.

The difference in income between formal and informal activities is also marked within NARE, especially the low level of income in refuge-sector activities. The difference between average incomes in the informal and formal segments of agriculture and non-agricultural activities is quite uniform in all the countries,<sup>16</sup> which would appear to indicate a structural relationship. The segmentation of agricultural employment would appear to be reproduced in NARE, linking together the higher-income (formal) segments and likewise the lower-income (informal) segments. This would obviously militate against the possibility of generating NARE with satisfactory income levels as an alternative for surplus peasant-sector labour and against the possibility that non-agricultural activities could stimulate the agricultural sector.

<sup>16</sup> This difference is greater in Panama, which is probably attributable to the exclusion of own-account agricultural producers from the measurements.

TABLE 7  
Costa Rica, Honduras and Panama: Composition of rural labour income, <sup>a</sup> around 1990 (Percentages)

	Costa Rica	Hondura	Panama
Modern agriculture	19.8	19.9	14.2
Traditional agriculture	21.3	41.7	24.8
Subtotal agriculture	41.0	61.6	39.0
Public service	14.7	8.9	23.8
Non-agricultural private sector	44.3	29.4	37.2
Formal sector	25.1	9.7	20.4
Informal sector	19.2	19.7	16.8
Subtotal non-agricultural	59.0	38.4	61.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Same as for table 1.

<sup>a</sup> Rural income was calculated by multiplying the average incomes of the different subsegments by the numbers of persons employed in them, with the average incomes of the corresponding subsegments being imputed to those persons whose incomes were not known. As unpaid family workers are included in the calculation of average income in Costa Rica and Honduras, the corresponding average was imputed to them in the case of both countries. In the case of such persons in Panama, the average income of agricultural wage-earners in the subsegments corresponding to own-account workers was imputed to them.

Table 7 shows the composition of overall rural labour income, by main employment segment of the workers in question. NARE has great relative weight in rural labour income in Costa Rica and Panama, with public sector employment accounting for a larger share in Panama and private sector employment (both formal and informal) having greater weight in Costa Rica. In spite of the high average income levels in the modern sector (see table 6), almost two-thirds of agricultural income in Panama is concentrated in the traditional sector, whereas in Costa Rica the relative weight of the two sectors is very even. In contrast, almost two-thirds of rural income in Honduras is generated in the agricultural sector, with the traditional sector predominating despite the big difference between the average income levels of the two sectors. In non-agricultural activities, income from the informal sector predominates, while the public sector and the formal private sector account for only limited proportions of the total.

The results of table 7, which are summarized in table 8 below for analytical purposes, show that the ratio between the volumes of agricultural and non-agricultural labour income is much greater in Costa

Rica and Panama than in Honduras. How should we interpret this fact?

Let us assume that there is integration in terms of production among the formal modern segments and among the informal/traditional segments of agriculture and non-agricultural activities, as already shown in figure 1. Thus, the demand arising from modern agriculture in line with dynamics A and B generates labour income in non-agricultural rural activities in the formal segment, while that arising from the peasant sector mainly generates income in informal activities. On the basis of this assumption, we can compare the generation of non-agricultural labour income at the level of the different segments.

In analysing the ratio of agricultural sector income to income in the formal segment of non-agricultural activities, however, we should exclude the public service from the latter, because its behaviour is due to causes unconnected with changes in the rural economic situation (dynamic E). Because of the relative weight of the public sector in the composition of rural income (see table 7), this leads to a reduction in that ratio, especially in Panama.

Even so, in Costa Rica and Panama the ratio of this income is much higher in the case of the modern private sector than in that of the traditional informal sector. This may be due to the size of the demand for non-agricultural rural goods and services that arises in non-rural areas (urban areas, or abroad), as suggested by dynamic D. On the other hand, however, this may be due to the measurement problem mentioned earlier: a certain percentage of the population registered as rural may in fact work in urban areas.<sup>17</sup> Because of the considerable number of dynamics that affect formal NARE and the generation of income which is not measured by the surveys (capital income) in the formal modern sector, it is not possible to calculate the effects of the linkages between agriculture and non-agricultural activities in the modern subsegments.

At least in Costa Rica, where there is a more homogeneous structure of agricultural income (see table 6), however, it may be assumed that in reality a large proportion of this income generates demand for

non-agricultural goods and services, and hence NARE. In contrast, the very low ratio of non-agricultural to agricultural income in Honduras suggests that the highly polarized structure of agricultural income could limit the generation of NARE in the formal private subsegment, because it may be that the relatively high income generated in modern agriculture largely generates demand for urban or imported goods and services.

The ratio of non-agricultural to agricultural rural labour income in the traditional informal sector is considerably higher in Costa Rica than in Panama and, especially, Honduras. This may be explained by the greater homogeneity of agricultural income and the higher income levels in traditional agriculture in Costa Rica, which give rise to greater demand for non-agricultural rural goods and services. In contrast, the high degree of polarization of agricultural income in Honduras and Panama, with very low absolute and relative levels in the traditional segment, generates little purchasing power for the workers in that segment, which moreover, according to Engel's Law, would be directed mainly to the agricultural sector itself. Likewise, Mellor found that in India an increase in the income of the poorest peasant units was used mainly to buy foodstuffs, thus generating little additional employment in non-agricultural activities (Mellor, 1976, pp. 164 *et seq.*); only the middle- and higher-level groups spent a substantial part of the increased income on non-agricultural products (although Mellor did not distinguish between the geographical destinations of that demand). To sum up, there is only limited generation of income in non-agricultural informal activities that mainly depend on such demand in a situation of marked heterogeneity and low income in traditional agriculture.

Table 8 shows the effects of the linkages between the traditional agricultural sector and the informal segment of NARE. These effects are so because, firstly, in traditional informal segments labour income is practically identical to total net income,<sup>18</sup> and secondly, it is assumed that the balance of the demand for non-agricultural goods and services from the informal segment comes entirely from tradi-

<sup>17</sup> This problem could be more serious in Panama, where nine years passed between the cartographical definition of urban and rural areas and the date of the survey which was used; the corresponding period was five years in Costa Rica and three years in Honduras.

<sup>18</sup> Capital income is only minimal, because of the preponderance of microenterprises and own-account activities.

TABLE 8  
Costa Rica, Honduras and Panama:  
Ratio of total labour income in  
non-agricultural rural activities to total  
labour income in agriculture, around 1990

	Costa Rica	Hondura	Panama
Total <sup>a</sup>	1.44	0.62	1.56
Total private sector <sup>b</sup>	1.08	0.48	0.95
Modern private sector <sup>c</sup>	1.27	0.49	1.44
Traditional rural sector <sup>d</sup>	0.91	0.47	0.68

Source: Table 7.

<sup>a</sup> Total labour income in NARE/total labour income in agriculture.

<sup>b</sup> Total labour income in the private sector of NARE/total labour income in the private sector of agriculture.

<sup>c</sup> Total labour income of the formal private sector of NARE/total labour income of the modern private segment of agriculture.

<sup>d</sup> Total labour income of the informal segment of NARE/total labour income of the traditional segment of agriculture.

tional agriculture.<sup>19</sup> Thus, for each monetary unit generated in traditional agriculture, the income of informal NARE increases by 0.47 (Honduras), 0.68 (Panama) and 0.91 (Costa Rica). These figures are very similar to those for some countries in Asia (0.80) and Africa (0.50). The differences—both between the three Central American countries studied and between the Asian and African cases—indicate that the linkages increase as income rises in traditional agriculture and there is an increasing degree of replacement of home-produced non-agricultural goods for domestic consumption.

The information presented on the relations governing the demand for non-agricultural rural goods and services generated by increased agricultural income therefore confirms the results of the previous section:

i) In Costa Rica, the agricultural sector plays a very important role in the generation of NARE.

ii) In Honduras, in spite of its large total volume agricultural income generates only a limited demand for NARE.

iii) In Panama, non-rural factors (dynamics D and E) have greater relative weight.

It may be concluded that there is a circular causality which permits but also limits the effects of NARE on the improvement of rural income. NARE depends to a large extent on agricultural income and agricultural demand for non-agricultural rural goods and services. The expansion of NARE as an income option in rural areas is therefore closely linked to increases in agricultural productivity and income, especially in traditional agriculture, and hence ultimately to a reduction in the heterogeneity of agriculture. Unless there is a growing demand for non-agricultural rural goods and services by agriculture, the rural labour market for non-agricultural activities becomes saturated and income in the informal segment sinks to very low levels.

If, on the other hand, relatively homogeneous expansion of agriculture stimulates demand for those goods and services, this gives rise to better-paid employment opportunities and this in turn leads to better agricultural wages.<sup>20</sup>

NARE can therefore make an important contribution to integrated rural development and help to overcome rural poverty. The promotion of NARE must be closely linked with agricultural development, however. Otherwise, the high degree of heterogeneity of the agricultural sector is reproduced in NARE too, with relatively high incomes in a small pole of formal activities (both private and public) and a large informal segment with low incomes and high poverty indexes.

<sup>19</sup> It is therefore assumed that the income of traditional agriculture which generates demand for agricultural goods and the income of informal NARE which generates demand for non-agricultural goods and services cancel each other out. Moreover, as noted in the previous section, the demand for these goods and services generated by dynamic D is felt in the formal sector of NARE.

<sup>20</sup> This relationship between opportunities for NARE and better wages in agriculture has also been observed in Asia (see Ray, 1987).



## VI

### Conclusion, and the future outlook

This article has tried to analyse the potential of non-agricultural rural activities for generating employment and furthering integrated rural development strategies in some Central American countries. An attempt has therefore been made to differentiate empirically between the effects of the various dynamics that affect the size and composition of NARE.

It was observed that the relative weight of segments that generate employment of higher or lower quality depends on factors external to NARE, most especially the performance of the agricultural sector. Thus, in all the countries there are segments of NARE which are in a mutually favourable relationship with dynamic sectors of agriculture (i.e., virtuous circles), together with segments characterized by the reproduction of the poverty affecting broad strata of the peasant sector.

Differences were observed between the countries which further emphasize these results. Thus, a relatively homogeneous agricultural sector, with a smaller income gap between the modern and traditional sectors, generates greater purchasing power (especially in the peasant sector) which stimulates the production of non-agricultural goods and services in rural areas. In contrast, where there is still a large peasant sector with very low absolute and relative income levels, the demand for this type of goods and services remains low, and the incomes generated in NARE are further depressed by the increased supply of labour coming precisely from the peasant sector.

The recent behaviour of NARE in two countries of the region (Costa Rica and Panama) shows how important the performance of the dynamics analysed in this study is (Weller, 1994, pp. 170 *et seq.*). In both these countries, during phases of severe economic crisis, stabilization and recovery between the early 1980s and the 1990s, NARE increased its contribution to rural employment and became more informal, while the formal sector (both private and public) lost relative weight.

Since the late 1980s, all the Central American countries have pursued structural adjustment policies. The future behaviour of NARE will depend on the way these policies affect the different dynamics important

to NARE, which is not at all clear. By way of hypothesis, however, the following points may be made:<sup>21</sup>

i) The adjustment policies tend to promote export agriculture and –in the Central American context– to increase the heterogeneity of the agricultural sector. It may therefore be expected that modern agriculture will generate more demand for non-agricultural rural consumer goods and services (dynamic B), but the expansion of such export activities usually generates few local linkages (dynamic A).

ii) In the absence of a policy designed to improve the supply conditions of the peasant sector, this sector will be in danger of losing its former opportunities without being able to take advantage of the new ones. This would reduce the generation of demand for non-agricultural rural goods and services connected with agricultural production (dynamic A) and with consumption (dynamic B) and would increase the pressure on the labour supply side (dynamic C) because of the accessible options (rural-urban migration).

iii) Policies of greater openness, favoured by peace processes, can give rise to new sources of employment which are independent of the agricultural sector (dynamic D), such as tourism and assembly (maquila) activities.

iv) Policies designed to contain public expenditure tend to limit the growth of public employment (dynamic E). If specially targetted policies are applied, however, rural areas might be less affected, because of their big deficits in terms of social and physical infrastructure.

The conclusion of this article is that policies to promote NARE should be aimed mainly at increasing the demand for non-agricultural rural goods and services, especially from agriculture and above all from the peasant sector, in order to strengthen dynamics A and B. Without this stimulus, programmes designed to improve

<sup>21</sup> For a more detailed discussion of these aspects, see Weller, 1994, pp. 157-163.

supply (through credit facilities, technology transfer, marketing, etc.) run the risk of failing because of the absence of substantial unsatisfied local demand. The prevailing macroeconomic policies, however, although intended to promote agricultural development

as a matter of priority, tend to repress such demand, especially from the peasant sector, when they do not take account of the prevailing heterogeneity of Central American agriculture.

(Original: Spanish)

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# Marginality and *social integration* in Uruguay

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Within Latin America, Uruguay stands out by its equalitarian income distribution, the solidity of its democratic institutions, and its level of social integration. Over the last decade, however, there have been signs of cracks in this desirable image which adversely affect the harmony of social relations. These cracks take the form of marginal behaviour: i.e., types of behaviour which are not governed by socially accepted patterns. In this study, the explanation for these types of behaviour has been sought in the divergences between cultural goals, the structures of opportunities for attaining those goals, and the shaping of individual capacities for taking advantage of them. A central premise of the approach adopted is that the factors determining marginal forms of behaviour build up their effects in a cyclical manner throughout the different stages of individual lives and from generation to generation. In view of this cyclical character, no decisions on the priorities to be followed in tackling situations of marginality can be fully effective unless an overall view is taken. Hence, the design of an integrated social policy that seeks to restore the links of marginal persons with society must, at the very least: i) assemble the fullest possible picture of situations of marginality in the course of a person's life; ii) identify, in each stage, the conditions that help to build up and consolidate marginality, and iii) identify points of intervention which, because of their cost-benefit ratios, are of crucial importance for breaking the links that make possible the individual accumulation and intergenerational reproduction of situations of marginality. The article highlights the differences between poverty and marginal poverty, not because it assumes that marginality is confined to the poor, but because it is in that sector that the forms of marginality of greatest individual and social cost are concentrated. It is suggested that the key element in this differentiation is social capital, the depletion of which is due mainly to the break-up of the family and to processes of segmentation such as housing segregation—the most extreme example of which is the shanty towns— and deterioration of the integrative function of the educational system.

# I

## Introduction

Ever-increasing concern is being expressed at the signs of social decomposition currently observed in the big cities of Latin America, the most prominent of which are the high crime rates and the increase in violence, drug trafficking, drug addiction and corruption. Among the causes mentioned for these problems are cultural factors (emphasis on individualism, self-fulfillment, excessively self-centered lifestyles and consumerism), social factors (the weakening of the most basic institutions, the family, the neighbourhood, the community and the Church; growing housing segregation and stratification of access to basic services), and economic factors (especially the impact on employment of the demands for greater competitiveness, which are both cause and effect of the growing openness of international trade).

The clearest consequence of the action of these factors is the depletion of social capital. Every member of a community has a stock of social capital whose amount is directly proportional both to his confidence that the other members of society will keep their behaviour in line with certain basic standards of harmonious coexistence and to the degree of legitimacy of his expectations that he will be able to mobilize the goodwill of others in a manner that is beneficial to him. The depletion of social capital means a decline in the quality of life which is reflected, *inter alia*, in the feeling of insecurity of the population with regard to crime and violence, as shown by the opinion surveys carried out in some urban centres of Latin America.

To outside observers, Uruguay appears to be a society with a very high degree of social integration, which combines a soundly-based social democracy with an equally firmly established political democracy. The level of integration is reflected in the functioning of the country's institutions, the absence of major social gaps, the smooth and equitable communi-

cation between persons of different social backgrounds, and the many ways in which social solidarity is expressed when needed. Despite these characteristics, however, signs are also emerging in the cities of Uruguay, and especially in Montevideo, of the same ills that beset other urban centres: a considerable increase in violent crime and a frightened public which presses the government to give more priority to the fight against crime. Both the public authorities and specialists in these issues feel that these problems are associated with processes of marginalization which affect the lower-class urban strata in particular. The present article seeks to explore the nature, causes and consequences of such processes.

From the point of view of researchers, academics and politicians who are particularly concerned with the cases of social decomposition in the region, perhaps the most attractive feature of the Uruguayan case is that the general situation of the country gives grounds for greater optimism than in other cases regarding the possibility of taking effective action to deal with the problem. This optimism is based on two aspects of the Uruguayan situation: first, the marginalization processes are at a relatively incipient stage and the kind of marginal subcultures that generate both their own reproduction and a structural resistance to their dissolution are not yet firmly established, and second, the proposals aimed at blocking the paths to marginality, checking the deterioration of social capital, and creating or strengthening institutions that build up such capital probably have a greater capacity for motivation and mobilization than in other parts of the region.

The importance of studying marginalization processes in a society which offers reasonable expectations of being able to check or reverse such processes should be weighed in the context of one of the main concerns of observers of Latin American conditions: the fact that there often seems to be a kind of loss of composure and desperation which inhibits the capacity to react to the problem: an attitude of "every man for himself" which seems to affect both the population in general and the economic and political elites. It is as if, in view

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of the apparent inevitability of the effects of the decomposing forces, the general response were to seek refuge in one's private life, holing up in one's house and restricting one's movements to "safe" areas, in the conviction that any effort to check or reverse those forces is doomed to failure. Although it cannot be claimed that such attitudes or forms of behaviour do not exist in Uruguay, comparison with the other countries of the region shows that Uruguayan society still has a solid stock of social capital which can be mobilized to avoid its own depletion. Furthermore, it may reasonably be presumed that the generation currently responsible for running the country still mentally associates the high level of social integration which has characterized Uruguayan society throughout the present century with the good quality of life that the population enjoyed in that period. These facts give grounds for hoping that a timely diagnosis of the characteristics of current marginality in Uruguay can give rise to initiatives along the right lines which could give useful pointers for dealing with similar problems in other Latin American societies. This article aims to make a contribution to such a diagnosis.

Because of the need to keep the scope of our analysis within certain limits, and because it is assumed that the forms of marginality which have the highest family and individual costs are concentrated in the lower-class urban strata, we have studied the conditions favouring marginality only in those strata. The working hypothesis of the study is that this phenomenon involves the growing vulnerability of those strata due to the combined action of three processes: i) a change in the patterns of entry into employment; ii) the weakening of family structures, and iii) growing social segmentation which translates into isolation from the rest of society. Concentration on the lower-class urban strata does not imply any denial of the importance of other forms of marginality or the significant contribution such forms make to social disintegration (consideration of the problem of corruption suggests that in many countries it is other strata of society which are

making the biggest contribution to the dissolution of society).

This article begins by analysing the change in the frequency and violence of crime, as a sign of cracks in the fabric of society. The relation between variations in crime rates and the sense of insecurity of the population is examined, and it is noted that a perverse mechanism may be at work whereby crime gives rise to insecurity and the latter, in turn, generates forms of conduct which weaken society.

We then review the special features of marginality in present-day Uruguay, distinguishing it both from poverty and from the forms of marginality which affected the region in past decades. It is noted that one of the driving forces behind the current marginality is the disparity between goals, the means of attaining them, and the capacity to make use of such means. Special emphasis is placed on the importance of the disparity between the production structure and the structure of the family, which weakens the capacity of families to provide the resources that the new generations need to enter the channels of social mobility of modern society.

The relationship between the family, marginality and delinquency is then studied, using data on the family background of minors sent to the Instituto Nacional del Menor (INAME) as "offenders" or for "socially unacceptable conduct". The conclusions of this analysis point to the importance of unstable or incomplete types of families, and two factors associated with such phenomena are therefore investigated: changes in adolescent sexuality, and the reluctance of young men from the urban lower classes to form new households.

It is then argued that the processes of housing segregation and segmentation of services, especially in the case of education, further strengthen the tendencies towards marginality. Finally, the conclusions of the study are presented and some general guidelines for action to block the paths towards marginality are set forth.

## II

### Uruguay in the Latin American context

Comparison of the indices of poverty and income concentration in Uruguay with those of the other countries of the region (especially those having similar levels of per capita income) reflects a society with a relatively high level of equity (table 1). These criteria of equity, rooted in the country's institutions, have served as the foundation for an effective social democracy which is reflected, among other things, in even-handed everyday relations and the absence of barriers to fluid communication between persons of different economic standing.

This social democracy serves in turn as the basis and driving force for a political democracy whose solidity makes Uruguay an outstanding example in the region. This is shown by the answers given to a series of questions posed to citizens in eight Latin American countries with the aim of determining the strength of democracy through the population's degree of support for its main institutions (table 2): Uruguayans obtained the highest marks, calculated as the total percentages of affirmative answers to questions about the functioning of democracy in those countries.

The resulting profile, which combines equity with democracy, is typical of a society with high levels of integration, which is how Uruguayan society appears within the overall Latin American context.

TABLE 1  
Latin America: Indicators of living conditions, around 1992

Country	Per capita GDP (1980 dollars)	Households under the poverty line (%)	Gini coefficient
Argentina (1992)	3 757	13.5	0.408
Bolivia (1992)	685	46	0.478
Brazil (1990)	1 916	50	0.535
Chile (1994)	3 172	24	0.479
Colombia (1992)	1 474	38	0.454
Costa Rica (1992)	1 523	25	0.362
Guatemala (1990)	923	...	0.479
Honduras (1992)	662	66	0.461
Mexico (1992)	2 558	30	0.414
Panama (1991)	1 657	34	0.448
Paraguay (1992)	1 265	...	0.391
Peru (1986)	1 107	45	...
Uruguay (1992)	2 480	8	0.301
Venezuela (1992)	3 644	32	0.380

Source: ECLAC, 1995.

TABLE 2

Latin America (eight countries): Views on democracy, 1995  
(Percentage giving affirmative answers)

	Argentina	Brazil	Chile	Mexico	Paraguay	Peru	Uruguay	Venezuela
1. Is democracy preferable to any other form of government?	82	48	54	57	58	58	86	64
2. Are you satisfied with the way democracy works in your country?	53	31	34	24	31	47	59	38
3. Does democracy make it possible to solve the country's problems?	59	51	51	52	39	71	63	53
4. Are elections in your country clean?	78	26	82	13	10	64	83	19
5. Do all groups and political parties have an equal chance to make known their views through the television?	42	27	48	31	56	45	57	40
6. Do senators and deputies care about what the common people think?	19	16	24	24	28	29	38	16
7. Can the way you vote make things different in the future?	75	53	56	53	62	75	77	52
<b>Total</b>	<b>408</b>	<b>252</b>	<b>349</b>	<b>254</b>	<b>284</b>	<b>389</b>	<b>463</b>	<b>282</b>

Source: Prepared by the author on the basis of Basáñez, Lagos and Beltrán, 1996.

### III

## Signs of cracks in an integrated social fabric: rising crime rates in Uruguay

### 1. Public insecurity<sup>1</sup>

Quite apart from the statistics on delinquency, drug addiction and acts of violence, most residents of big Latin American cities are agreed that over the last two decades there have been important changes in the patterns of social coexistence. This is the view of the great majority of those interviewed in public opinion surveys, who state that they perceive a significant increase in antisocial forms of behaviour such as delinquency, violence, drug addiction and corruption (table 3). A similarly large majority express lack of confidence in the institutions which are supposed to control such conduct, such as the police and the judiciary (Basáñez, Lagos and Beltrán, 1996).

The relative equity of the Uruguayan social structure has not been enough to avoid these problems. Public opinion is strikingly unanimous in its perception that these problems have got worse in the last few years (table 3). Although, as we shall see later, the level of realism behind these opinions may be open to doubt, the high degree of public consensus reveals the existence of a social phenomenon whose importance cannot be denied, in so far as it models attitudes and determines behaviour. The surveys also indicate a low degree of approval of the institutions responsible for controlling delinquency. Out of all those interviewed, 41% have little or no confidence in the judiciary, and this level rises to

TABLE 3

Uruguay: Views on the evolution  
of some social problems, 1995

Social problems	Percentage who believe that over the last five years these problems have:			
	Increased	Remained the same	Gone down	Total %
Drug trafficking	87	12	2	100
Delinquency	90	9	1	100
Drug addiction	92	7	1	100
Corruption	83	15	1	100

Source: Prepared by the author on the basis of Basáñez, Lagos and Beltrán, 1996.

51% in the case of the police.<sup>2</sup> Another source registers even higher levels of negative opinions on these institutions, with 53% of those interviewed expressing little or no confidence in the judiciary and 71% having a similar opinion of the police.<sup>3</sup>

This combination of views expressing a belief that criminal behaviour is on the increase and that the institutions responsible for its control do not inspire confidence can only result in a generalized feeling of insecurity. According to a survey carried out in June 1995, such a feeling affected 62% of those living in Montevideo and 34% of those living in the interior of the country.<sup>4</sup>

<sup>1</sup> There are of course many sources of insecurity in modern society, especially those connected with the weakening of traditional standards and uncertainty over employment and income. In this article, however, the term "public insecurity" will be used to refer only to the insecurity arising from crime and violence.

<sup>2</sup> Basáñez, Lagos and Beltrán, 1996. This survey shows the low level of confidence in the police and the system of justice in the eight Latin American countries in question. Uruguay is clearly the country where the system of justice enjoys the highest level of approval. In the rest of the countries, the proportion expressing "little or no confidence" in the judiciary is considerably higher, the lowest level of disapproval (59%) being registered in Chile and Brazil, with Peru registering the maximum (73%).

With regard to the police, the data reveal that in Chile 36% of those interviewed have "little or no confidence" in this institution, while in the remaining countries (except Uruguay) the proportion is over 58%. Despite the relatively higher level of favourable opinions in Uruguay, it is still disturbing to note that four out of every ten people in the case of the judiciary and rather more than half in the case of the police express little or no confidence in these institutions.

<sup>3</sup> Measurements made by CIFRA/González, Raga y Asociados (*El País*, 1995).

<sup>4</sup> Survey carried out by CIFRA/González, Raga y Asociados (*El País*, 1995). The question asked was: "If your family comes home late at night, do you feel secure or insecure?"

This also helps to explain why Uruguayans place measures to deal with delinquency high among the priorities that the government should tackle. According to opinion surveys, crime has been viewed as the main problem by Uruguayans since 1994. In a survey carried out in April 1996, the percentage of persons stating that delinquency occupied first place among the country's problems (32.4%) was double that of the persons who felt that the main problem was employment (16.2%).<sup>5</sup>

## 2. Changes in society due to the climate of terror caused by the rise in crime and violence

The increase in crime causes fear, and those who feel such fear naturally seek ways of protecting themselves. Although strategies differ, they have some common elements, such as greater sensitivity for identifying and avoiding dangerous places and situations, which in the case of those with sufficient economic resources may even mean moving from one neighbourhood to another; increasing fortification of dwellings; and greater vigilance and supervision of the movements of children and young people outside the home. The accumulation of these types of behaviour gradually shapes new lifestyles which leave their mark, little by little, on town planning, the economy and the social structure.

### a) *Lifestyles and quality of life*

Although there are no studies specially designed to investigate these changes in Uruguay, there are indirect signs of changes in citizens' everyday behaviour due to fear of crime.<sup>6</sup> Parents more frequently accompany their children to school or hire transport services to take them there. People avoid travelling at night or even in the daytime in certain streets and neighbourhoods, and they also avoid carrying much money or valuable articles. The climate of insecurity also furthers a tendency to spend leisure time at home, watching television or videotapes. As already ob-

<sup>5</sup> Survey carried out by Vox-Opinión y Mercado (*Búsqueda*, 1996a). The collective demand for greater security was echoed in the political system, which, with a level of consensus much higher than is usual in Uruguay, declared in 1995 that it was necessary to provide more effective means of guaranteeing public safety. In one of its first actions that same year, Parliament put forward a new Citizens' Security Act, which was adopted with the votes of the great majority of the legislators.

<sup>6</sup> In a survey carried out by the *Washington Post* in the United States, 40% of those interviewed said that they had changed their lifestyles in recent years because of their fear of crime (see UNRISD, 1995, p. 76). No similar survey has yet been carried out in Uruguay.

TABLE 4  
Uruguay: Firearms registrations, 1944-1995

Period	Number of registrations	Annual average	Percentages (1944-1972=100)
1944-1972	157 947	5 446	100.0
1973-1985	92 381	7 106	130.5
1986-1991	115 312	19 219	352.9
1992		20 017	367.6
1993		22 279	409.1
1994		23 893	438.7
1995		26 967	495.2

Source: Prepared by the author on the basis of information given in Klein (1994) and data from the Military Supply and Ordnance Service.

served in countries where the problem of public insecurity is much more serious, in the long run these situations discourage the spontaneous sociability that arises through informal meetings in public places such as cafés, squares, clubs, etc., and in particular it tends to reduce the opportunities for interaction among people of different social backgrounds.

Both because of the risks that it involves and the degree of fear that it reflects, an important indicator of the changes in lifestyles and in the quality of life is the decision to acquire a gun. Recent public opinion surveys covering urban Uruguay reveal that 40% of the population feel that it is best to have a gun in the house for the sake of the greater security it provides. Out of the total number of persons interviewed, 22% said they already had a gun in the house, while a further 12% were thinking of buying one.<sup>7</sup> A recent study gives an idea of the way gun ownership has increased over time (table 4).<sup>8</sup> The data very clearly show the big increase in gun registrations. Another sign that points in the same direction is the 50% increase in the membership of the Gun Club between the beginning of 1994 and the end of 1995.<sup>9</sup>

<sup>7</sup> According to the survey carried out by CIFRA/González, Raga y Asociados (*El País*, 1996a).

<sup>8</sup> Klein, 1994, and also data from the Military Supply and Ordnance Service.

<sup>9</sup> According to a report published by *Posdata* on 5 January 1996. Another sign of the perceived need for personal defence is the considerable increase in the demand for paralyzing gases. Their importation was prohibited until a March 1993 decision by the Supply and Ordnance Service authorized their sale to the public, which is further encouraged by the fact that the purchase of gas sprays and other means of defence such as electric stun guns does not involve any formalities and their use for self-defence is not against the law.



b) *Urbanism*

The changes in lifestyles due to the generalized feeling of insecurity are also changing the structure of the cities. Thus, for example, middle-class suburbs of Montevideo which until a few years ago were notable for their open gardens are now completely enclosed with railings or walls. The profile of the city has also been changed by the increase in the number of apartment buildings whose construction was partly stimulated by the number of families who moved to apartments in search of the security they did not feel in their houses. The fact that such moves often do not have the desired effect is shown by the growing number of apartment buildings with protective grilles on the balconies and security locks on the doors. The same reasons are behind the advertisements for condominiums: groups of houses whose residents share the security costs for protecting their common "frontier".

c) *The economy*

The climate of public insecurity is also having important effects in a number of areas of the economy, such as the spread of shopping malls and the expansion of security services and the sale of articles for personal defence.

i) *Shopping malls.* The fact that these shopping centres publicize the vigilance maintained on their premises and in their parking lots as an important feature of their services suggests that the provision of security may be a factor in the expansion of these types of commercial organizations.

ii) *Theft insurance.* According to data provided by the Surety Department of the State Insurance Bank, between 1985 and 1994 the number of policies issued and premiums collected in respect of household and commercial theft and fire insurance increased by 30% per year.

iii) *Security agencies.* As already noted, public opinion surveys register a low level of approval of the institutions responsible for law enforcement. The perception that the State agencies of this type are ineffective for coping with the crime wave explains why so many people settle for the hiring of private security agencies. In 1991 there were 96 registered agencies of this type, but this number rose to 147 in 1993 and 185 in May 1995.<sup>10</sup> A report by the Uruguayan Chamber of Security Companies gives an idea of the economic and social projections of the sector: some 6,500 em-

ployees and fiscal contributions amounting to some US\$ 24 million per year.

iv) *Trade in security articles.* Firms offering security articles such as burglar alarms for cars, houses and other types of premises; electronic surveillance equipment; arms; articles for personal defence, and so forth, are doing a roaring trade.

In short, to judge by the growth rate of their activities, security services have rapidly become one of the sectors of the economy with the most buoyant performance and the biggest capacity to absorb technological innovations.

d) *The social structure*

All these changes have consequences for the level of integration of society which are reflected in the appearance of new rifts, disincentives for investment in social capital, and an increase in the social gaps between different economic and social strata.

i) *New social rifts.* People belonging to different economic and social strata have unequal access to goods and services for the defence of themselves and their families. Since security against crime and violence is a good which is becoming increasingly important in people's lives, the differences between households that can and those that cannot guarantee reasonable protection against criminal acts and adequate compensation for the resulting material damage give rise to an important new dimension in the stratification of modern urban societies: the level of satisfaction of the demand for security.

ii) *Interest in tackling the root causes of the problem.* It seems reasonable to assume that the easier the access to private security options, the less incentive there will be to take on an active commitment with actions designed to tackle the root causes of criminal behaviour, even though such actions may be the only ones that permit effective treatment of the problem in the long term. Thus, the privatization of security may be helping to reduce public sensibility to a basic social problem and reducing the will to act among those who have most power and influence because of their economic capacity and could bring the greatest benefits to society if they consistently fulfilled their civic responsibilities. It is therefore no surprise that poorer neighbourhoods, which cannot meet their security needs by private means, are those which most often generate mutual support initiatives for combatting crime and display a shared concern with the elimination of its causes.

iii) *Social segmentation.* The behaviour patterns which become established in a context of insecurity due to crime and violence are reflected in the social

<sup>10</sup> According to official data from the National Register of Security Companies maintained by the National Intelligence Department.

structure, and especially in the relations between different economic and social strata. Fear favours the formation of criminal stereotypes which incorporate many of the features of poverty itself, which begins to be seen as the breeding-ground for "dangerous classes". This further strengthens the middle sectors' tendency to steer clear of the poor, avoiding their neighbourhoods, their places of leisure, the means of public transport they travel on, and the public services they use. Thus, public insecurity ends up by heightening social segmentation, which, as we will see later on in this article, is one of the phenomena that give rise to such insecurity.

In short, both crime and the responses to it are important parts of the causes and effects of the deterioration in the social capital of communities. Social capital is built up in systems of mutual relations based on confidence, which make possible the generation of collective undertakings that benefit the whole community. When social capital is lacking or depleted, this increases personal insecurity. Urban ghettos are an extreme example of the deterioration of social capital.

### 3. The evolution of crime

Let us now look at the facts that form the basis for this set of perceptions, forms of behaviour and legal and institutional initiatives concerning public security. There are some who claim that Uruguayan society is displaying a degree of fear of crime that is quite unnecessary and unjustified—possibly encouraged by the importance that the mass media give to shocking or violent news items—and that crime is given much greater prominence on the television and in the press than it actually has in people's everyday life. In order to clarify this point, we must look at the available information on the evolution of the number of victims and offences in recent years in that country.

If we look at the results of a June 1995 opinion survey, we learn that rather more than four out of every ten Uruguayans (42%) had first-hand experience of public insecurity, as victims of robbery or attempted robbery in their homes (31%) or outside them (21%). On the basis of these data, the analyst concludes that "The concern about public security, especially in Montevideo, is firmly based on the personal and family experiences of the population" (González, 1995).

The figures on some offences in Uruguay between 1980 and 1994 also appear to support this conclusion. The increase in crime in recent years is more evident in robbery and homicide than in theft (table 5). According to the Uruguayan Penal Code, the difference between theft and robbery is that the latter involves violence or the threat of violence, so that the official

TABLE 5  
Uruguay: Evolution of selected offences,  
by five-year periods from 1980 to 1995  
(Annual averages)

Offences	1980-1984	1985-1989	1990-1994	1995
<i>Robbery</i>				
Montevideo	1 017	1 698	2 474	4 174
Interior	94	195	291	
Nationwide	1 101	1 893	2 765	
<i>Theft</i>				
Montevideo	12 862	27 120	26 170	
Interior	12 947	19 836	24 342	
Nationwide	25 809	46 956	50 512	
<i>Homicide</i>				
Montevideo	52	67	91	
Interior	87	90	111	
Nationwide	139	157	202	

Source: Prepared by the author on the basis of figures from the Ministry of the Interior of Uruguay. Figures for 1995: *El País*, 1996b.

crime figures reflect a marked increase in the incidence of violence. It should be borne in mind in this connection that the probability that offences will be officially reported to the police increases with the degree of violence involved, whereas the probability that minor thefts will be reported goes down as the population realize that the time spent in reporting the offence is not matched by a reasonable chance of recovering the losses suffered.<sup>11</sup>

<sup>11</sup> Specialists in crime statistics have emphasized the under-registration of some offences due both to skews connected with the reporting of offences itself and to skews connected with the bodies responsible for combatting crime. For example, if there is a decline in public confidence in the efficiency of the police or the legal system, there will be a corresponding decline in the reporting of certain offences, especially those which are less serious. On the other hand, the increase in the number of insurance policies against robbery encourages the reporting of such offences, because such reporting is an obligatory requirement for obtaining compensation. Sexual offences may or may not be reported, depending on the severity of the sexual stigmas involved and the degree of understanding and sympathy for the victims displayed by the police, judges and public opinion. On the part of the bodies responsible for combatting crime, there is a strong bias towards the registration of offences committed by the poorer social segments, but there is a tendency towards the under-registration of offences which are typically committed by the middle and upper classes (fraud, dishonesty in general, influence-peddling, corruption, and acts of vandalism committed by young people from those classes). For a detailed analysis of the methodological problems involved in the study of delinquency, see Hirschi and Selvin, 1967.

## IV

### Criminal behaviour, poverty and marginality

There are no empirical studies in Uruguay which allow a connection to be detected between variations in different types of offences and changes in different aspects of the situation of the population. The simplest and most widely-held theory is that offences are committed by those who find it hard to obtain the desired objects by legitimate means. This idea focuses attention on the structure of opportunities to which the various segments of society have access in order to attain their culturally acceptable objectives. A first deduction drawn from this is that, in view of their greater difficulties in obtaining what they want by legitimate means, poor people will commit more crimes than the non-poor. If this is so, then the evolution of criminal offences should be related to the evolution of poverty. This does not seem to have been the case in recent Uruguayan history, however. Thus, for example, while the indexes of urban poverty displayed a downward trend between 1989 and 1994 –from 22.3% to 12.8% (INE, 1996)– this was not so in the case of the various indicators of delinquency. Thus, robberies increased from 1,968 to 3,189, while cases of theft went down from 49,045 to 47,967, yet homicides increased from 198 to 222.

A second deduction is that it is necessary, within the overall segment of the poor, to distinguish a marginal sector which has serious problems in integrating into society through the normal channels and hence tends to be linked with delinquency. Before analysing the available evidence in order to try to test the validity of such a link, we should clarify the concept of marginality used in this article and, in view of the history of that term in the region, mention the differences between the “old” and “new” forms of marginality.

#### 1. Old and new marginality: general features

One way of bringing out the special features of the “new” marginality is to distinguish it from the marginality of the population groups who, from the 1950s onward and in most of the countries of the region, moved on a large scale from rural areas to the cities, where they settled under makeshift conditions on the

outskirts. Despite their situation of poverty, many such migrants saw this move as a rise in the social scale in at least two senses: first, because of the excitement of winning urban citizenship which, quite apart from its symbolic value, meant gaining real access to much more varied consumer goods than those available in rural areas and also to health and education services and housing and recreational infrastructure which were practically beyond their reach in the rural environment, and second, because these large-scale population transfers took place at a time of expanding domestic markets which, stimulated by import substitution, were at that time capable of absorbing labour and keeping open important avenues of social mobility.

The marginality of the 1990s seems to be marked by other characteristics, however. Firstly, it is defined more with respect to the labour market and the occupational structure than to the geographical location of the place of residence, although it must be acknowledged that the makeshift settlements on the outskirts of the cities continue to form its hard core. Secondly, the population of these settlements is now mainly of urban origin: that is to say, the memory of a poverty-stricken rural past is no longer a suitable framework for evaluating their present situation. This statement is corroborated by the results of a recent study on makeshift settlements in Montevideo (Cecilio, 1995): even as far back as 1984, 93.5% of the residents of these settlements had been born in urban areas, and three out of every four had been born in Montevideo itself. Moreover, while a strong element in the growth of the marginal settlements of the 1960s was the lure of the cities, the settlements of the 1990s seem rather to reflect processes of expulsion from the cities, for in 1995 nearly six out of every ten heads of household in makeshift settlements around Montevideo stated that their previous dwelling had been a house or apartment (Cecilio, 1995, p. 103).

Thirdly, it should be noted that whereas one of the features of the 1960s was the broadening of the avenues of social mobility, what stands out in the 1990s is their narrowing. The traditional channels of mobility are fading away rapidly, but alternative avenues are

opening up only slowly. This is one of the effects of the globalization of economies, their greater openness, and big changes in the production of goods and services in search of greater international competitiveness. In their quest for such competitiveness, firms cut their workforces, incorporate technology, and change their hiring criteria, thus raising problems of employment instability for larger and larger segments of the labour force. It should be noted that the lack of a working community that serves as a stable reference group means that the world of productive employment is deprived of that space which, over the centuries, was one of the main places where the identities of workers were formed.

As Uruguay has not experienced the heavy population growth, rapid large-scale migrations from rural areas, or the acute rural-urban differences and ethnic discrimination which have marked other countries of the region, the degree of integration of Uruguayan urban society was not greatly affected by the forms of incorporation of rural migrants which were a salient feature of the old form of marginality. This situation makes Uruguay a particularly suitable context for observing the new forms of marginality, whose features are neither superimposed nor obscured by the effects of forms of marginality with different causes and consequences.

## 2. Poverty and marginal poverty

As a social position, marginality is the result of the combined effect of three elements: cultural goals, access to the means of attaining those goals, and the personal capacities of the individuals occupying that position.<sup>12</sup>

The goals legitimated by the prevailing culture define the lifestyles that most of the population aspire to. In societies with rigid class distinctions, as also in highly structured, relatively isolated local communities, subcultures may be formed whose goals are different from those prevailing in society as a whole. This is not the case in Uruguay, however. On the one hand,

the equalitarian ideology of the country, the ethnic homogeneity of its population and the absence of "feudal" components in its history prevented the establishment of rigid class barriers. On the other hand, the rapid recent expansion of the mass media has finally dissolved the already feeble frontiers of local communities. It can therefore be said that there are no cultural barriers which can justify the existence of segments of the population cut off from the dominant lifestyles.

The availability of means of attaining cultural goals depends fundamentally on the economy's capacity to absorb labour in productive jobs, and this depends ultimately on a combination of style of development and growth rate. Within this general framework, however, the structure of opportunities available in each stage of people's life cycles is defined by the access to the institutions which, together, make possible a type of education and training in keeping with the requirements of the labour market, the main channel of social mobility being the educational system.

The marginal poor are distinguished from the rest of the poor by their smaller capacity to make use of the existing structure of opportunities, whether by organizing themselves to meet the population's demands for goods and services, using the various means of access to public services and credit, or making the fullest possible use of the possibilities offered by the educational system or the opportunities of the labour market.<sup>13</sup> Their lifestyles reflect the absence of any project aimed at incorporation in society at large. Their attitudes and forms of behaviour likewise reflect a low level of self-esteem and a lack of expectations about the possibility of significantly improving their low levels of well-being through their own efforts.<sup>14</sup>

Each individual's capacities are the result of the combination of his various assets: his biological assets (freedom from disabilities; state of health); his knowledge (level and quality of education received, working experience); his social assets (contacts and ability to

<sup>12</sup> This concept grossly simplifies the wealth of meanings of the notion of marginality, of course. In the late 1960s there was an extensive debate on this subject from different points of view—including a critical assessment of capitalism from the Marxist standpoint—by Roger Vekemans, José Nun, Fernando Henrique Cardoso, Aníbal Quijano, Gino Germani and others. For a good summary of this debate, in an issue completely devoted to the subject of marginality, see *Revista Latinoamericana de Sociología*, 1969, vol. V, No. 2.

<sup>13</sup> Taking a similar approach, Irarrázaval (1995) coordinated a study in Chile which distinguishes between the capable and the incapable poor by analysing indicators of the relative economic and social success of families sharing similar economic constraints. The capable poor were those who registered positive results for a number of indicators measuring the efforts made to succeed in the world.

<sup>14</sup> Individual self-esteem is usually a consequence of the sign (positive or negative) and level of structuring of the messages that the individual receives from significant people around him in the course of his life in response to his actions.

mobilize the goodwill of others for his benefit); his material goods (fixed and movable capital); his cultural qualities (beliefs, work ethic, etc.), and his motivational assets (achievements, self-esteem). Each of these assets is formed and matures at specific ages

and has a different degree of importance at different moments in the individual's life cycle. Thus, the main assets of children and adolescents are their families, because it is through them that their other assets are fostered and consolidated.

## V

### Marginality and the family

#### 1. The family and the formation of the children's capacities

The form and composition of families are important elements for predicting how children will succeed at school, for those who live with only one of their parents or whose parents have only a common-law union lag behind at school to a significantly greater extent than the rest of the children.<sup>15</sup> A number of studies carried out in Uruguay reveal the effects of the family on other aspects of childhood and adolescence. Thus, for example, children born out of wedlock (illegitimate children) register a much higher rate of infant mortality than the rest, and those who do not live with both their biological parents show signs of greater damage in the various dimensions of psychomotor development (ECLAC, 1991; Universidad de la República, Facultad de Medicina, Departamento de Psicología Médica, 1996).

The formation and composition of the family have also proved to be a good means for predicting future criminal forms of behaviour. Thus, for example, it was found that over 70% of all the young people in juvenile detention centres in the United States come from households where one of the parents is absent (Dafoe Whitehead, 1993, p. 77).

<sup>15</sup> This assertion is corroborated by the results of a number of studies. With regard to Uruguay, see Filgueira (1996) and also ECLAC (1987 and 1990b). In the United States, the Department of Health and Human Services carried out a very extensive study on the subject among over 60,000 children. J. Wilson summarizes its conclusions in the following words: "At all income levels except the highest (over US\$ 50,000 per year), for both sexes, and for whites, blacks and hispanics alike, children who lived with a mother who was divorced or had never been married registered markedly worse performances than those living in families where both parents were present. Compared with children who lived with both their biological parents, children from single-parent families were twice as likely to be expelled or suspended from school, to suffer from emotional problems or problems of conduct, and to have problems with their schoolmates. They were also much more likely to display antisocial forms of conduct" (Wilson, 1994).

#### 2. Family background of the minors confined in the Instituto Nacional del Menor (INAME).

In order to investigate this relationship in Uruguay, data were studied from the Child Information System of INAME, whose archives provide a wealth of information for studying from the very beginning the most immediate determining factors underlying antisocial forms of conduct. The data referred to 2,133 children and adolescents of both sexes whose cause of entry (socially unacceptable conduct and offences against the law) could be interpreted as forms of behaviour which depart from accepted standards and bear witness to severely damaged links with society.<sup>16</sup> The majority (81.5%) of these children and adolescents were confined in INAME or foster homes. The study covered the period 1990-1995.

There is ample evidence to show that complete, unbroken families have a greater capacity of socialization than those where one of the biological parents is absent. The study by Filgueira mentioned earlier confirms that this capacity is weakened by the absence of one of the biological parents, even when some other person takes their place. Thus, in our definition, marginality is mainly a problem of the capacities to make use of the structure of opportunities existing in a society, and if the assets that form such capacities in children and adolescents are provided mainly by the family, then it is reasonable to assume that children brought up in incomplete or broken homes will have a

<sup>16</sup> The number of cases of minors sent to INAME for socially unacceptable conduct are broken down as follows: begging, vagrancy, running away from home, consumption of drugs, prostitution and vandalism; vagrancy and running away from home account for 84% of the total. The cases of minors sent to INAME for offences against the law comprise theft, robbery, wounding, homicide, drug trafficking, rape and attempted theft; about 70% of the cases correspond to theft and robbery.

greater propensity for marginality than those from families which are intact, especially in the case of the poorer sectors.<sup>17</sup>

Of the minors studied, only one out of every three (31.2%) was living in a complete family (with both biological parents) at the time of his entry into an institution (a similar result to that registered for juvenile detention centres in the United States). Of the children who were not living with both their biological parents at the time of their detention, 63.8% were living with their mother, 30.8% with a stepfather or stepmother, and the remaining 5.4% were not living with any of their parents.

Although this result might seem to indicate that minors who do not have a complete family are more likely to commit offences or engage in socially unacceptable forms of conduct, there is not enough proof to assert that there is a causal relation between these two variables. Both could be determined by a third variable, such as poverty. The information provided by the INAME registers does not permit a distinction to be made between the effects of the family structure and the effects of poverty, as it does not include data on the characteristics of the detainees' homes which allow them to be compared with those of poor households in general. Nor does the Permanent Household Survey allow the family profile of minors in poor households to be compared with that of the minors in INAME, since it does not distinguish the parents in terms of their biological relationship with the persons in the household who figure as children of the head of family.

In order to try to isolate the effect of the type of family from the effects of situations of poverty, insofar as they affect the marginality of minors, we reexamined the data from a study made by the ECLAC Montevideo Office on the family characteristics of a

sample of children in public schools. The situations of those children were then compared with those of the minors analysed in INAME (table 6). The results show that, independently of the seriousness of the economic shortcomings of the household, the family profile of the minors in INAME is totally different from that of the other children. Thus, among the latter, 67.3% of those in a situation of indigence, 79.4% of those who were poor but not indigent, and 83.9% of the non-poor lived with both their biological parents, in sharp contrast with the situation of the minors in INAME. The most important single characteristic of the latter is the absence of the father. Consequently, even though the average age of the minors in INAME was around 15 years (compared with 10 or 11 years in the case of the children studied in the public schools), it is reasonable to conclude that the INAME minors come from households with family characteristics that are significantly different from those of poor and indigent Uruguayan households as a whole. Instead, both this information and the opinions of persons well acquainted with the functioning of INAME point to a profile of households in a situation of marginal poverty, one of the most important features of which is the incomplete and unstable nature of the family.

Formally, the fact that the parents are not married when a child is born make that child illegitimate. This situation, which affects 45% of the minors studied in INAME, increases the risk that the father will be absent from the family group (table 7).<sup>18</sup>

The rapid rise in the qualifications demanded from young people for their incorporation into the modern sector of the economy further heightens the marginalizing effect of incomplete and unstable families, highlighting the disadvantage of not enjoying the support of a complete family, for lengthening the period of education and training means prolonging the material, emotional and intellectual support activities and the formation of work habits and discipline in which the family is irreplaceable. Children and young people from families which do not possess these assets, because they are unstable or incomplete, will be in a much weaker position than others to take advantage of the opportunities that exist.

<sup>17</sup> The presence of the father is vital for providing or strengthening certain assets of children: i) as an identity-forging model, especially for boys; ii) as an agent for conserving and creating habits of discipline and transmitting experience of life; iii) as a means of material support, since the absence of the father's contribution considerably reduces the household's income, especially in view of the fact that women earn 20% to 50% less than men; and iv) as a source of social capital, inasmuch as the absence of the father means the loss of a line of contact with male networks of relations, both at work and in politics, and also because if the connection with the networks of relatives that the father could provide is broken, this significantly reduces the potential family links.

<sup>18</sup> Charles Murray (1993) suggests that illegitimacy should be considered as one of the most important signs of marginality and social disintegration.

TABLE 6

**Uruguay: Family background of fourth-grade schoolchildren  
as a whole and of minors detained in the National Minors' Institute (INAME)**

Family group	Schoolchildren <sup>a</sup>			Minors in INAME <sup>b</sup>
	Indigent	Non-indigent poor	Non-poor	Total
Mother only	7.1	5.2	6.5	43.9
Stepfather or stepmother	4.4	3.4	3.2	21.2
Both biological parents	67.3	79.4	83.9	31.2
Others	9.7	10.3	4.1	3.7

*Source:* For schoolchildren, Encuesta para un Diagnóstico de la Educación Básica en Uruguay, ECLAC Office in Montevideo, 1990. For minors in INAME, prepared by the author on the basis of data from the SIPI files of INAME, 1990-1995.

<sup>a</sup> Fourth-grade pupils of public schools in Montevideo and Tacuarembó.

<sup>b</sup> Minors detained in INAME for offences or socially unacceptable conduct.

TABLE 7

**Uruguay: Minors detained in the National Minors' Institute (INAME)  
for offences or socially unacceptable conduct, by family  
background and birth status, 1990-1995**  
(Percentages)

Presence of parents in family group	Birth status					
	Of total number of minors studied			Of total number of minors in each category		
	Legitimate	Illegitimate	Total	Legitimate	Illegitimate	Total
Mother only	20.9	23.0	43.9	38.1	51.0	43.9
Mother and father	21.2	10.0	31.2	38.4	22.5	31.2
Stepfather or stepmother	10.0	11.2	21.2	18.3	24.8	21.2
Others	2.9	0.8	3.7	5.2	1.7	3.7
<b>Total</b>	<b>55.0</b>	<b>45.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
			(2 133)	(1 172)	(961)	(2 133)

*Source:* Prepared by the author on the basis of the SIPI files of INAME.

### 3. Families where the father is absent

The family characteristics of the minors in INAME give very important pointers to some features of the new marginality and draw attention to the changes which have taken place in the family. If there is indeed a tendency in Uruguayan society towards greater instability and breakups of couples and an increase in the proportion of illegitimate births and children who do not live with both of their biological parents, then unless there are substantial improvements in the general economic and social situation of the lower urban strata we may expect a growing incidence of marginal behaviour.

If we review recent trends in the number of illegitimate births (table 8), we see that whereas in 1975

one out of every five children was born out of wedlock, in 1993 this proportion was one in every three. This process has speeded up in the last decade, since whereas in the period 1975-1984 illegitimacy grew by 14%, it increased by some 50% between 1984 and 1993. This acceleration was observed in all age groups.

If, as the background of the minors detained in INAME seems to suggest, illegitimacy is associated with family structures which favour the emergence of problems of conduct and offences against the law, then the social consequences of the considerable increase in the proportion of illegitimate births observed over the last decade in Uruguay are a matter for serious concern.

It would seem obvious, then, that in order to monitor the evolution of the problems connected with marginality we must follow up very closely the statis-

TABLE 8  
Uruguay: Rates of illegitimate births

Year	1. In Montevideo, 1975, 1984 and 1993	
	Rates of illegitimacy (%)	
1975	20.9	
1984	23.8	
1993	34.5	
	2. Nationwide, 1961 and 1988	
	Rates of illegitimacy (%)	
Age of mother	1961	1988
15-19	25.7	47.9
20-24	15.5	30.5
25-29	11.5	20.9
30-34	11.7	21.2

Source: Prepared by the author on the basis of data from the *Boletín de Estadísticas Vitales* of the National Statistical Institute (INE) and also, for Montevideo, on the basis of data from the Division of Statistics of the Ministry of Public Health.

tics on changes in the form and composition of families. Official sources of statistics, however, only show a very tiny part of the most important changes affecting families: the remainder—especially those connected with family units within households and reconstituted or reassembled families—are hidden from our analysis. Even so, the visible tip of this iceberg is sufficient to show that illegitimacy is increasing, as also is the proportion of common-law unions or cohabitation in the total number of households, especially young ones (table 9). As regards the question of female heads of family units, this is made more difficult to detect because of the tendency of many mothers in this situation to seek refuge in their households of origin.

In view of the situation reflected by the above-mentioned tendencies, those responsible for the formulation of social policy in Uruguay should try to find a quick answer to the following question: what are the conditions that favour this increase in the rates of illegitimate births, common-law unions and family units with absent parents? It is no easy matter, of course, to assess the relative weight of each of the many conditions that contribute to the increase in these phenomena, but there are at least a couple of factors that cannot be left out when seeking to explain the changes in the manner of forming families. These are the cultural changes relating to sexuality and the reluctance of young men to take on long-term responsibilities for the maintenance of a family.

TABLE 9  
Montevideo and urban areas in the interior of Uruguay: Young people between 15 and 29 living in common-law unions, as a percentage of the total number of young couples, by number of years of schooling, 1984, 1989 and 1994 (Percentages)

Year	Years of schooling	Montevideo	Urban areas in the interior	Total urban areas
1984	Nine or less	17.9	16.1	17.0
	Ten or more	4.8	4.5	4.6
	<b>Total</b>	<b>12.6</b>	<b>12.7</b>	<b>12.7</b>
1989	Nine or less	22.6	23.5	23.0
	Ten or more	6.1	7.2	6.5
	<b>Total</b>	<b>14.6</b>	<b>18.5</b>	<b>16.7</b>
1994	Nine or less	30.8	30.0	30.4
	Ten or more	14.8	13.2	14.2
	<b>Total</b>	<b>22.7</b>	<b>24.3</b>	<b>23.6</b>

Source: Prepared by the author on the basis of data from the Permanent Household Survey of NE.

#### a) *Changes in sexuality*

We are witnessing a rapid loosening of the standards governing sexual behaviour. Among the reasons for this are the widespread dissemination of birth control techniques and the consequent increase in the possibility of separating reproduction from sexuality; the increased participation of women in the labour market and their consequently greater economic independence, and finally, the deterioration of primary institutions such as the family and the local community and the consequent weakening of their capacity to control and punish forms of behaviour.

This combination of factors has undoubtedly contributed to the marked lowering of the age of sexual initiation and the increase in adolescent pregnancies. This latter phenomenon might seem a little surprising, because the increasingly high educational standards of women and the growing availability of birth control information raised hopes that the opposite might be the case.

A great many early pregnancies (considered to be those occurring before the age of 20) represent important links in the chain of processes that lead to marginality. The rates of illegitimate births among these mothers are higher than in the other age groups and have been growing rapidly and steadily over the last thirty years in Uruguay (table 10). The increase in the general rate of illegitimacy is partly explained by a



TABLE 10

## Uruguay: Evolution of rates of illegitimate births, by age of mother

Age of mother	1961	1966	1971	1976	1981	1985	1993
(1) Up to 19 years	26.5	23.4	30.3	31.1	41.7	45.4	63.2
(2) Total	18.1	19.1	21.7	22.6	25.3	26.5	34.5
Ratio (1)/(2)	1.44	1.23	1.40	1.38	1.65	1.71	1.83

Source: Prepared by the author on the basis of data from the vital statistics of the INE; for 1993, data from the Division of Statistics of the Ministry of Public Health of Uruguay for Montevideo, which are usually 10% below the nationwide rates.

parallel increase in the share of total births accounted for by adolescent mothers (see the last line of table 10).

The association between adolescent motherhood and marginality does not end with the illegitimacy of the children born in such circumstances, however. A recent study by the National Institute for the Family and Women gives the following results:

i) The partners of early mothers are more unstable than those of other mothers, and this is reflected in a higher percentage of common-law unions and divorced and separated women. These conclusions corroborate the findings of other studies carried out in Uruguay which are cited by the author of that study.<sup>19</sup>

ii) Most early mothers drop out of the educational system, thus not only reducing their possibilities of self-realization by limiting their employment opportunities and cutting themselves off from the important socialization environments provided by educational establishments but also inhibiting the development of one of the most important assets they can pass on to their children.

iii) The studies on adolescent mothers give a variety of reasons for this behaviour. The general impression is that in their social environment poor adolescents find a positive response to motherhood. It would appear that, unlike young men, these women suffer from a lack of alternative roles that represent a minimum of social recognition, and their only option for gaining some such recognition is motherhood. In this context of desperation about

their opportunities for self-realization, romantic fantasies and craving for affection may be seen as ways of giving their lives some meaning.

b) *Some causes of young men's reluctance to form new households*

The second important factor connected with the increase in illegitimacy and loose cohabitation among young people from the poor strata is the reluctance of the men to take on the main responsibility for the economic maintenance of a family.<sup>20</sup> This reluctance is in keeping both with the positive association between nuptial tendencies and real wages and with studies which show that the higher their income, the greater is the propensity of men to get married (Figueira, 1996). From the point of view of the possibilities of self-realization, this reduced propensity of young men to get married may have a rational economic basis which should be taken into account.

According to data from the Montevideo Permanent Household Survey for 1994, about one in every three (34.5%) young men between 20 and 30 years of age who worked more than 20 hours per week was in a position to maintain a minimal family (wife and young child) above the poverty line (table 11). This means that their labour generated income equal to two and a half times the poverty line for that year.

When these data are broken down by level of education, the following facts are observed. Among those who had only completed the basic educational

<sup>19</sup> Uruguay, Ministerio de Educación y Cultura, Instituto Nacional de la Familia y la Mujer, 1995 (study directed by María Elena Laurnaga. The studies cited which corroborate these findings may be found in Instituto Nacional de Alimentación (INDA), 1989.

<sup>20</sup> This responsibility is particularly important for poor young men, who have shown themselves in public opinion surveys to be in much stronger agreement than other young people with the traditional image of the division of labour between the sexes, whereby men participate in the labour market and women are responsible for the domestic tasks.

TABLE 11  
**Montevideo: Capacity to maintain a family displayed by employed persons with incomes equal to or greater than 2.5 times the poverty line who are between 20 and 29 years of age and work more than 20 hours per week, 1994 (Percentages)**

Number of years of schooling	Capacity to maintain a family			
	Not-capable	Capable	Total	
Up to 5 years	77.4	22.6	100	(53)
6 years	78.7	21.3	100	(300)
7 years	78.3	21.7	100	(115)
8 years	77.0	23.0	100	(243)
9 years	69.8	30.2	100	(334)
10 years	64.6	35.4	100	(582)
11 years	62.1	37.9	100	(322)
12 years	64.6	35.4	100	(82)
13 years	62.7	37.3	100	(102)
14 years	58.1	41.9	100	(148)
15 years	53.9	46.1	100	(154)
16 years	55.1	44.9	100	(127)
17 years or more	30.2	69.8	100	(116)
<b>Total</b>	<b>65.5</b>	<b>34.5</b>	<b>100</b>	<b>(2 678)</b>

Source: Prepared by the author on the basis of data from the Permanent Household Survey of Montevideo of the INE.

cycle (nine years' formal schooling), less than one in three (30.2%) reached the income level in question. The situation was not very different for those who had reached school leaving certificate level (35.2%). Only among the 5% of young people who had reached the level of 17 years' formal schooling was there a majority with incomes equal to at least two and a half times the poverty line. In other words, for most young employed men with less than 17 years' schooling, setting up a family meant sinking below the poverty line (unless they were able to obtain an extra income).<sup>21</sup>

<sup>21</sup> The reluctance of young men of low educational level to set up a family in the current labour market conditions should be interpreted in the light of the importance assigned in the lower strata to the traditional division of labour between the sexes, whereby the man would be the only breadwinner in the household. Thus, when asked whether they agreed or disagreed with the statement "A woman's duty is to look after the children and the home, while a man's duty is to bring in money", the percentages of agreement were broken down as follows according to the educational level of those interviewed: Incomplete primary education, 63%; Up to third year of secondary cycle, 61%; Up to sixth year of secondary cycle, 22%; University studies, 9%. See *El Observador*, 1995.

These findings are corroborated by the relationship between the stages in a family's life cycle and the likelihood of sinking into poverty (table 12). The first line of the table shows the households with heads under the age of 30 which consist only of the couple and represent no more than 1.6% of the households in Montevideo. The first point to note is that the proportion of young childless couples in the total number of households is very low, indicating that the beginning of cohabitation is strongly associated with the birth of the first child. The second point is that there are practically no poor households in this segment.

The next category, however—households consisting of the couple and at least one child between 0 and 4 years—accounts for nearly 11% of all households. It may be noted that approximately 30% of these households are poor: more than twice the poverty index for Montevideo in that year (12.4%). As families progress to subsequent stages in their life cycles, there is an increasing probability that some of the children will bring income into the household and that other institutions will share the children's care and socialization with the parents. With more free time, there is also a greater probability that the spouse will supplement the income of the head of household. As a result of all this, there is a substantial reduction in the incidence of poverty. The data in the table show that the changes in the economic situation of the household with the different stages in the family life cycle are also observed in non-nuclear (extended and composite) households.

In order to analyse the incidence of poverty according to the level of education of the head of household, we studied only the stages in the family life cycles of nuclear households (table 13). Two groups were distinguished: heads of household who only managed to complete the basic cycle at the most, and those who progressed beyond the basic cycle.

Uncertainty about the capacity to generate income inhibits plans to form a family, and the absence of such plans militates against long-term commitments. Young men—especially those who only managed to complete the basic cycle of education—only need to look around them to realize that if they decide to start a new household they run a serious risk of remaining or becoming poor. Backed up by the experience of their immediate environment, this expectation naturally makes them reluctant to take on the commitment of forming a family. Thus, the structurally conditioned weakness lying at the origin of families from the lower strata adversely affects the likelihood that the new generations will enjoy the material, emotional and

TABLE 12

**Montevideo: Proportion of poor families,  
according to stage of life cycle of family, 1994**

Stage of life cycle of family	Percentage of families in a state of poverty	Percentage of total number of families
<b>Nuclear families</b>		
No children, heads between 15 and 29	0.7	1.6
With children between 0 and 4	30.6	10.7
With children between 5 and 14	20.8	15.7
With children between 15 and 24	6.1	12.0
Others	4.1	13.8
With head aged 65 or more	4.3	8.9
<b>Non-nuclear families</b>		
No children of own, but including other minors	38.3	1.0
No children of own, no other minors	4.9	7.2
With own children between 0 and 4	35.7	1.6
With own children between 5 and 14	28.0	3.3
With own children over 15 and other minors between 0 and 4	31.0	2.3
With own children over 15 and other minors between 5 and 14	22.6	1.9
With own children over 15 and no other minors	7.7	4.1
Other non-nuclear families (single-person families)	2.5	15.7
<b>Total</b>	<b>12.4</b>	<b>100.0 (9 447 families)</b>

Source: Prepared by the author on the basis of data from the Household Survey of the INE.

TABLE 13

**Montevideo: Incidence of poverty in nuclear households, by stage in  
life cycle of family and educational level of head of household, 1994  
(Percentages)**

Stage in family life cycle	Educational level of head of household		
	Up to 9 yrs	10 years or more schooling	Total
With children between 0 and 4	51.4	8.9	30.6
With children between 5 and 14	31.4	5.5	20.8
With children between 15 and 24	9.7	1.0	6.1
With no children under 25 and with head aged under 65	6.1	0.6	4.3
With no children under 25 and with head aged over 65	5.1	—	4.1
<b>Total households</b>	<b>17.2</b>	<b>3.1</b>	<b>12.4</b>

Source: Prepared by the author on the basis of data from the Permanent Household Survey of Montevideo of the INE.

normative support that complete, intact families could give them.

But of course economic rationality is not the only reason why young men from the lower urban strata are reluctant to take on family responsibilities. Another reason is the loss of substance of the role of head of household associated with the weakening of his power in the family, his representational functions in the public sphere, his capacity to pass on skills that will be

useful to his children in the labour market, and, above all, the weakening of his function as the main or only breadwinner of the household.<sup>22</sup>

<sup>22</sup> In another study, the present author has tried to describe the loss of substance of the role of head of household, as seen by the young men of the lower urban strata (Kaztman, 1992).

## VI

### Social segmentation processes

Finally, we will highlight some processes of segmentation which contribute to the increase in marginality in Uruguayan society. The main source of marginality is the lack of relatively stable productive jobs which incorporate scientific and technical knowledge, provide various benefits of labour security, and generate sufficient income to maintain a medium-sized family at a socially acceptable level of dignity. This subject has been extensively dealt with in specialized Latin American publications under such terms as "structural heterogeneity", "marginality" and, more recently, "exclusion", and it forms the backdrop for the following analysis.<sup>23</sup>

In this section, segmentation will be examined as a process involving the formation of social frontiers and reduction of the opportunities for interaction among people of different economic and social origins. Its main consequence is weakening of the degree of integration of society, and its main mechanism is segregation in the fields of housing and education.

#### 1. Housing segregation

Makeshift settlements, taken together, may be viewed as one of the poles of a process of housing segregation. It has been estimated that the number of dwellings in makeshift settlements in Montevideo rose from 2,541 in 1984 to 4,835 in 1990 and 7,013 in 1994: i.e., it trebled in ten years and its growth rate speeded up from 1990 on (Cecilio, 1995). There were no significant changes between 1984 and 1994 in the age structure of the people living in these settlements (table 14). The proportion of children is much higher than in Uruguay as a whole: according to the 1985 census children under 10 represented 17.1% of the population of Montevideo, but one year earlier the corresponding figure for makeshift settlements was 33.5%.

<sup>23</sup> For an extensive analysis of these matters, see *Revista Latinoamericana de Sociología*, 1969. The concept of social exclusion has been used in various publications of the International Labour Organisation (ILO) as a means for analysing employment problems in the industrialized countries, but it is only recently that the problem of relative advantages has been tackled in order to understand the current Latin American situation (see Barros, De los Ríos and Torche, 1996).

As newspapers and magazines have been warning in recent months, some makeshift settlements in Montevideo are turning into ghettos.<sup>24</sup> As the sociologist Castagnola says in a recent article in the magazine *Tres*, "The Montevideo ghettos are very recently established neighbourhoods where shortcomings abound and poverty lives cheek by jowl with delinquency" (Castagnola, 1996, p. 68).

The ghettos are fertile ground for the progressive deterioration of the social capital of the poor. This social capital comprises patterns of harmonious coexistence, mutual confidence, and systems of mutual aid which mean that each family can respond to crisis situations with the aid of others. In the ghettos, however, the situation does not seem to permit this. Firstly, makeshift settlements are increasingly isolated from the outside world: the newspapers often report on cases where neither the police nor ambulances risk going into them. Secondly, the press also prints statements by people who cannot leave their houses and are afraid of leaving their children alone: something which reflects a breakdown in the most basic standards of coexistence in the ghetto.<sup>25</sup> Thirdly, those who can migrate to other areas—who are usually precisely those who have the greatest capacity to influence the decisions of the public authorities—do leave and thus further deplete the community's resources. The deterioration of social capital in the urban ghettos is therefore reflected in at least three dimensions: their growing isolation from the rest of society, the depletion of

<sup>24</sup> The study on "Makeshift settlements in Montevideo", carried out by the Datos consultancy firm for the Ministry of Housing, Territorial Planning and the Environment, tries to classify settlements by their level of integration into society as a whole, using as a criterion for this the level of primary school attendance of the children living in them. This criterion seems quite suitable, as in Uruguay failure of a child to go to school indicates a clear break with socially accepted patterns of behaviour. Using this criterion, the study found that in 35% of the settlements all the children attend school regularly, in 58% most but not all of the children do so, and the remaining 7% of the settlements are divided between those where only a minority of the children go to school and those where none of them do so.

<sup>25</sup> For some examples of these cases, see *El Observador* (1996), and articles on two young inhabitants of the Borro quarter in the weekly magazine *Búsqueda* (1996b and c).

TABLE 14

**Montevideo: Structure of population of  
makeshift settlements, by sex and age group, 1984-1994**  
(Percentages)

Age groups	Male		Female		Total	
	1984	1994	1984	1994	1984	1994
Up to 10 years	32	33.1	36	34.0	35	33.5
11 to 18	18	19.7	15	20.9	16	20.3
19 to 40	30	31.0	33	33.3	31	32.2
41 to 65	17	14.1	13	10.5	15	12.3
66 and over	3	2.1	3	1.3	3	1.7
<b>Total</b>	<b>100</b>	<b>100.0</b>	<b>100</b>	<b>100.0</b>	<b>100</b>	<b>100.0</b>

Source: Cecilio, 1995.

the remaining reserves of confidence among neighbours, and the continual departure of those who do have some say in public matters.

The increasingly uniform conditions of precarious existence among the households living in the same settlement; the feeble and often conflictive contact with people in the same situation; the absence in the immediate environment of any moral authorities who can reprimand forms of conduct that depart from those prescribed by the more general values of society; and the perception that legitimate ways of attaining the goals set by society are out of reach are all factors that contribute to a progressive weakening of the presence of rules and values. This normative vacuum may favour the emergence of leaders who propose a social order framed within a subculture of marginality and legitimize patterns of conduct which are different, and often opposed, to those of society as a whole. The ideas of such leaders involve both costs and benefits for the community of the ghetto. The biggest cost is that the functioning of the community must mould itself to the demands of criminal projects which convert it into a centre of distribution and sale of drugs (as in the slums of Rio de Janeiro), a hideout for criminals, a scrapyard for stolen cars, etc. The benefits are a more orderly form of coexistence, some degree of protection, and the possibility –by taking part in these activities– of obtaining incomes that would otherwise be very hard to get, especially for young people. The loyalties thus generated ensure complicity with the illegal activities engaged in by the new leaders.

As already noted, however, the spread of ghettos is merely an extreme example of a general process of housing segregation which is taking place in all the

cities and derives from the spread of a market-based mentality, one of the effects of which is the loss of everyday contact between people of different economic and social backgrounds. The degree of isolation becomes even greater when, in addition to housing segregation, there is segregation in recreational, health and educational services.

## 2. Segmentation in education

The pronouncements made at Presidential summit meetings in recent years would appear to indicate that those bearing the highest responsibility for public policies are now acknowledging that equity in the early years of life should form part of the core values of the models guiding development in Latin America and that concentrating educational resources on children from homes of low socio-cultural level is one of the most efficient ways of breaking the mechanisms responsible for the reproduction of poverty and social segmentation. Paradoxically, however, at the same time that these worthy principles are being enounced, many societies in the region are witnessing an unprecedented process of stratification of educational circuits.<sup>26</sup> It seems obvious that the educational system

<sup>26</sup> This is so much so that in some countries of the region the awareness that such circuits exist is causing many parents to go through periods of intense anxiety, trying to ensure that children of three or four years of age get into particular kindergartens (which even impose entrance examinations), because entry into such establishments will subsequently allow the children to continue in an educational circuit of schools and colleges with high-quality teaching staff and equipment, thereby in turn opening the doors of the best universities for them.

can hardly help to lift the social burden of poverty and inequality, and offset the growing segmentation in the field of employment, if it is segmented itself. This is undoubtedly one of the main current social problems in many Latin American countries.

In this respect, it should be borne in mind that except for the periods of compulsory military service—in countries where there is such an obligation and it really is universally applied—there are few institutions through which all citizens must pass and which give people of different social origins the opportunity of interacting with each other for a substantial length of time on bases other than employment contracts or trade in goods and services. The educational system is undoubtedly the main—and often the only—institutional environment which can act as a melting pot where poor children and adolescents have a chance to maintain daily relations and develop common codes and bonds of solidarity and affection, on terms of equality, with their peers from other strata. In this respect, the more the composition of the student body of each establishment resembles that of the national community as a whole, the greater the contribution that the period of school life will be able to make to the enrichment of the stock of social capital. In contrast, the greater the segmentation among educational establishments, the greater the probability that the members of a given social stratum will only come face to face with members of other social strata in the labour market, where such relations will already be confined within the hierarchical patterns governing the organization of the world of work.<sup>27</sup>

If this is not so—that is to say, if the rich go to rich colleges, the middle class go to middle class colleges and the poor go to schools for the poor—there is not much that the educational system will be able to do to promote social integration and avoid marginality, no matter how much it tries to improve the educational opportunities of those who have least resources.<sup>28</sup> This is why it is important to emphasize not only the contribution to equity that the educational system can make through greater equality of opportunity, but also the contribution it can make to social integration by promoting interaction on an equal footing among those who are not equal.

<sup>27</sup> This does not appear to have been the case in Uruguay, where, through the universal application of the idea of general public schools, the educational system has played a very important role in the achievement of a level of social integration which even today continues to be a distinctive feature of the country in the regional context.

<sup>28</sup> This is particularly true of societies where the dominant values explicitly reject class barriers.

By facilitating such interaction, education can promote a more equitable distribution of social capital. A student's social capital consists of his legitimate expectations that others will help him in the future. The value of this capital depends on the number of people willing to provide such help, the resources that those people can mobilize, and the degree of obligation they feel towards him (Flap and Graaf, 1986). Daily interaction in the same educational establishment can produce such effects because:

i) it generates a feeling of belonging to the same community, with shared identities and common goals, as well as positive attitudes recognizing other persons as having rights too and feelings of moral obligation extending to fellow-students of different social, religious, ethnic or national origins. In terms of forming citizenship, the more representative of the national community the student body of each establishment is, the greater the importance of this experience;

ii) it allows students of a given origin to broaden and deepen their knowledge of the world by enriching it with the life experiences, cultural codes, habits and customs of students of other origins;

iii) it opens up possibilities for competing on merit in a context where it is supposed that there are no influences deriving from a student's economic and social situation. It is in fact a favourable context for building self-esteem;

iv) above all, it allows students with few resources to establish links of reciprocity and mutual obligations and relations of confidence and loyalty with other students from better-off homes. These contacts can be extremely useful for entering the labour market on favourable terms, because the more influential students—those with easier access to the attractive jobs—are directly acquainted with the merits of their less influential school-mates and have obligations to them which derive from their shared background. Believing that merit alone will help social mobility is a fallacy that is only fulfilled in very unusual situations. Social contacts, with everything they imply, have great significance at both the personal and the social level for achieving the full utilization of human capital. Furthermore, inasmuch as contacts generate reasonable optimism about the possibility of obtaining jobs in keeping with the educational level reached, this means that they will give people greater motivation to invest in the development of their human capital;

v) it gives students' parents, regardless of their economic situation, a chance to interact with other parents to solve common problems. In this respect, the

migration of the better-off students to private education means the loss of a substantial source of support for raising the level of public schools.

In view of the unequal capacity of parents from different economic and social strata to pay for their children's studies, an indicator of educational segmentation is the differentiation between free public education and paid private instruction.<sup>29</sup> In Uruguay, this differentiation has been gaining importance in recent years. The great majority of the present middle-class parents in Uruguay were educated in public schools, but a certain proportion of them send their children to private schools. Most probably, they had personal experience of the virtues of the integrating function of public schools, have made efforts to ensure that such schools maintain an acceptable level of quality, and have only decided to send their children to paid private schools because of the evident deterioration of the public school system.

Information prepared on the basis of the Permanent Household Survey (table 15) allows us to follow up the evolution of the relative weights of private and paying primary and secondary education in urban Uruguay, as well as their effects on the probability of personal interaction between students of different economic and social origin in educational establishments.<sup>30</sup>

At the level of the urban areas of the whole country, paying education has only quite a low incidence: less than one in every five students in 1994.

There are substantial differences between Montevideo and the urban areas in the interior, however. Thus, in the capital the ratio is slightly more than one in every three students, but in the interior it is only about one in every sixteen.

In Montevideo, the proportion of students paying for their studies grew slowly but steadily between 1984 and 1994 at all levels of education. In urban areas

in the interior, in contrast, the very incipient privatization of education does not show a clear trend: it rose in 1989 but went down in 1994.

If we look at the data in the light of the income of the students' households, we see that in Montevideo in 1994 only one out of every four students from the upper stratum attended public schools at the level of primary education or the basic cycle of secondary education. A larger proportion did attend public schools at the level of the second cycle of secondary education ("Bachillerato"). In these strata, the privatization of education increased more rapidly in the period 1989-1994. Although it is still only incipient, there is a clear tendency in Montevideo towards segmentation of the educational system. In urban areas in the interior, in contrast, despite the increase in the proportion of private education, up to 1994 the great majority of the better-off students continued to attend public schools.

Table 15 also shows a transfer of students from the private basic secondary cycle to the public second cycle (bachillerato). However, this does not seem to increase the possibilities of personal interaction between adolescents of different economic and social origin. The proportion of students dropping out of school is larger in the lower strata, so that the greatest opportunities for personal interaction between students of different economic and social origin are in primary education and the basic cycle of secondary education. Indeed, as may be seen from table 16, less than half the poorer young people between 16 and 18—the age-group in which most of the students in the second cycle of secondary education are concentrated—attend any educational establishments.<sup>31</sup>

The tendency towards the privatization of education is a phenomenon that is affecting the vast majority of the countries of the region. The more marked segmentation by classes is, the harder it is to reverse it. In Uruguay, however, the relatively high ideological weight that public education seems to have in the minds of the generation that is now sending its children to school holds out hopes that the eventual success of the educational reforms now being proposed may check or even reverse the privatization process.

It is worth noting, on the one hand, that the privatization of education is merely a reflection of social

<sup>29</sup> Free private schools are not taken into account because, according to the data of the Permanent Household Survey, they only serve less than 3% of the total urban student body.

<sup>30</sup> The differentiation between free and paying education weakens the integrating function if it means a division in terms of the levels of household income. In order to study this point, we divided students into three groups according to the per capita income of their households: the 30% of households with the lowest incomes were termed the lower stratum, the next 40% were classified as the middle stratum, and the 30% with the highest incomes were termed the upper stratum. The aim of the exercise was to obtain a first approximation to the changes over time in the probability of personal interaction between students of different economic and social origin.

<sup>31</sup> This table also shows that whereas the participation of poorer young people in the second cycle of secondary education went down slightly in the period under consideration, the opposite was true of young people from the upper income stratum.

TABLE 15

**Montevideo and urban areas of the interior of Uruguay:  
Students attending private educational establishments, by level  
of education and income bracket, 1984, 1989 and 1994  
(Percentages)**

Level of education	Primary			Basic secondary			Bachillerato <sup>a</sup>		
	1984	1989	1994	1984	1989	1994	1984	1989	1994
<b>Income bracket</b>									
<i>Montevideo</i>									
Low	6.7	8.7	11.1	8.7	8.4	11.0	2.3	11.0	6.4
Middle	22.0	32.8	44.9	23.0	26.8	32.1	16.2	18.9	25.4
High	56.5	62.7	73.6	51.9	58.1	78.3	40.2	40.2	58.4
<b>Total</b>	<b>20.2</b>	<b>22.6</b>	<b>29.0</b>	<b>24.8</b>	<b>26.2</b>	<b>29.3</b>	<b>22.3</b>	<b>24.3</b>	<b>29.7</b>
<i>Urban areas of the interior</i>									
Low	2.1	3.2	2.6	1.5	1.9	1.9	-	1.6	-
Middle	7.3	12.2	11.1	5.1	7.7	7.4	2.0	4.2	2.5
High	18.3	24.6	26.6	13.0	18.8	18.1	1.1	5.9	8.6
<b>Total</b>	<b>6.7</b>	<b>8.2</b>	<b>7.7</b>	<b>5.8</b>	<b>7.7</b>	<b>6.5</b>	<b>1.2</b>	<b>4.0</b>	<b>3.2</b>

Source: Prepared by the author on the basis of the Permanent Household Surveys of the INE.

<sup>a</sup> Higher secondary cycle.

TABLE 16

**Montevideo and urban areas of the interior of Uruguay:  
Population between 16 and 18 years of age not attending  
educational establishments, by income bracket, 1984, 1989 and 1994  
(Percentages)**

Income bracket	Montevideo			Urban areas of the interior		
	Low	Middle	High	Low	Middle	High
<b>Year</b>						
1984	51.1	26.6	15.4	60.4	39.1	30.1
1989	51.6	28.3	14.4	56.8	44.0	27.6
1994	53.1	26.9	11.3	58.0	43.1	27.1

Source: Prepared by the author on the basis of the Permanent Household Surveys of the INE.

segmentation and the heterogeneity of the quality of the available educational opportunities, while on the other, any attempt to determine the exact magnitude of the problem must also analyse other forms of differentiation, both among private establishments and among public and free schools. The tendency towards housing segregation in Montevideo already gives grounds for presuming that the public sector may be reproducing this segmentation. Undoubtedly, mechanisms are at work in that sector which tend to concentrate the most experienced teachers, the fullest infrastructure and the best teaching aids in the establishments attended by students from the higher strata, while the most inexperienced staff, the most inadequate installations and the

most rudimentary teaching equipment are to be found in rural areas or the marginal settlements of the cities (ECLAC, 1990b, 1992 and 1994).

Since parents show a natural tendency to send their children to the schools which they consider to be best both because of the quality of the education provided and because they agree with the philosophy behind it, any attempt to mix children and adolescents from different social strata becomes a political problem. In these circumstances, educational action to promote social cohesion must maintain the delicate balance involved in, on the one hand, fulfilling the State's duty to strengthen the mechanisms of social integration and, on the other, respecting parents'



right to send their children to the establishments which will give them the best possible education. Restoring the prestige of public schools and making the services they have to offer more attractive is one of the solutions to this problem, although certainly not the only one. Whatever the solution finally adopted, it will undoubtedly call for extra investments in public education and decisions on the sectoral redistribution of

expenditure. In view of the fact that as the pace of the incorporation of technological change speeds up the hub of social integration will lie more and more in the educational system, the costs assumed in order to strengthen this integrating function must be contrasted with the considerable losses that society will suffer as a result of the growing stratification of educational circuits.

## VII

### Conclusions

#### 1. Summary of the conceptual and methodological framework

There are many different dimensions of marginality, and the available knowledge is insufficient for proposing a global answer to the problem. The aim of the present article is to suggest some guidelines for blocking some major paths to future marginality. To this end, the immediate causes of marginality in urban poverty have been explored: that is to say, the conditions in which the behaviour of a segment of the poor begins to depart from socially acceptable patterns. An extreme sign of such a departure is criminal behaviour.

Like most social phenomena, marginality is due to a number of factors, whose effects mutually strengthen each other in a cyclical manner. The scheme used for explaining marginality has been centered on the imbalance between legitimate goals, the structures of opportunities, and the different capacities for making use of legitimate means for attaining such goals. Emphasis has been placed on the processes which are affecting the formation of these capacities in the lower urban strata.

Within the sequence of events leading to marginality, particular attention has been paid to the consequences of the tension between the structure of opportunities and the formation of skills and capacities, which affects poor adolescents and young people with particular force. On the one hand, the levels of qualifications demanded from young people in order to get a productive job are increasingly high, so that they are generally obliged to postpone their entry into the labour market and stay longer in educational institutions. On the other hand, there is a progressive weakening of the family which significantly reduces its capacity to keep on providing for a considerable period of time the mate-

rial, emotional, cultural, symbolic and social assets, the store of knowledge, and the habits of discipline which would help young people to extend and enrich their training through the existing channels. This disparity between the structure of production and that of the family is an important source of marginality. Furthermore, some changes in the structure of society, especially the tendencies towards the social isolation of the poor linked with housing segregation and the segmentation of services (particularly education) help to consolidate subcultural patterns of marginality.

#### 2. Summary of the findings

Opinion surveys reveal that Uruguayans have the impression that crime is increasing. In a significant proportion of cases, they have this impression because they themselves, relatives or friends have been victims of some crime. The percentage of people who say that they have little or no confidence in the police and the judicial system is also significant. It is hardly surprising, then, that many Uruguayans display feelings of insecurity and behave in a manner induced by fear of crime and violence. Although the mass media may be over-magnifying the dimension of crime in the minds of the public, the information provided by crime statistics, the number of experiences of having been a victim registered in opinion surveys, and the relatively low level of confidence in the bodies responsible for controlling delinquency do justify an increased feeling of insecurity.

The increase in crime is not linked, at least in the period under consideration, with variations in the poverty index. In other words, the number of cases of theft and robbery have increased despite the reduction in the proportion of households whose income does not cover the cost of a basic shopping basket of consumption items.

A decline in poverty may be accompanied by a rise in aspirations, either because the general consumption standards of the society in question have risen, or because the exposure of the poor to those standards has increased. Both of these things may be taking place in Uruguay, since the effects of the growing globalization and penetration of the mass media into people's homes work in this direction.<sup>32</sup> For many young people from the lower urban strata, exposure to the glittering world displayed by the publicity in those media increases their feelings of frustration, and delinquency may seem to be the only way of satisfying their desires.

Another possible explanation points to the fact that the increased demand for gaining access to the legitimate channels of social mobility has not been accompanied by increases in the formation of capacities for making use of those channels. The information presented in the present study indicates that it is this latter explanation which accounts most convincingly for marginal forms of behaviour among poor urban young people.

Among the data presented are those concerning the home background of the minors confined in INAME for delinquency or socially unacceptable conduct. Half of these minors were born out of wedlock, and only a quarter of them live in households where both their biological parents are present. The substantial increase in the rates of illegitimate births and common-law unions registered among young people (especially those of low educational level) over the last fifteen years gives grounds for supposing that changes in the forms of establishment and the stability of poor families must be among the most important sources of future marginality.

The growing tendency towards the formation of incomplete and unstable households in the lower urban strata implies a progressive weakening of the family and, hence, of its capacity to provide the assets that poor children and adolescents need to acquire in order to make use of the structure of opportunities that

exists in society. The difficulties in forming stable families appear to be due to a combination of cultural changes affecting sexuality and the reluctance of young men to take on the commitments involved in forming and maintaining a household. Thus, the data show, on the one hand, that there has been a lowering of the age of sexual initiation and an increase in the proportion of births accounted for by adolescent mothers, while on the other hand very high levels of educational achievements are required in order to obtain the income needed to enable a young man to maintain a minimal family.

Finally, the data presented on the increase in housing segregation and the segmentation of education highlight the progressive social isolation of the poor. The lack of suitable models and the growing disparity perceived between efforts and achievements give rise to a context favouring the development of a subculture of marginality.

### 3. Action guidelines

The mechanisms that lead people to depart from socially accepted patterns of conduct begin to operate in earliest childhood and are consolidated throughout the subsequent cycles in a person's life. In this sense, we may speak of "paths to marginality". All social integration policies seek to block those paths and create conditions favouring the restoration of people's links with society. For this purpose, the actions taken must be based on a diagnostic study which identifies the mechanisms operating at different times in people's lives, evaluates the relative impact of each of these mechanisms on the propensity to engage in marginal forms of conduct, and selects the most crucial points of intervention in the light of the costs and benefits of each action. Only a comprehensive view of the mechanisms at work will make possible the rational selection of the most effective and efficient options.<sup>33</sup>

<sup>32</sup> No information is available on the increased exposure of the poor to the messages of global society fomenting increased consumption. A rough indicator of this exposure would be the percentage of households with television sets. Household surveys began to collect this information too recently (1991) to permit significant comparisons, but a very rough sign of changes in general consumption patterns is provided by the combination of the increase in global consumption and the changes in the proportion of foodstuffs in that consumption. Thus, while consumption increased by 18% between 1982 and 1994, the proportion of foodstuffs in that consumption went down from 31% to 28%.

<sup>33</sup> The determining factors of marginality analysed in the article seem to operate relatively independently of political and economic factors. The fact that such conditioning factors have not been analysed here does not mean that their influence in the generation of

marginality has been ignored. Thus, for example, it cannot be denied that the return of democracy to Uruguay and the consequent restoration of citizens' rights have created a favourable setting for the action of social integration mechanisms, nor can we overlook the importance of the resources generated by the sustained economic growth of the country in the struggle against poverty and marginality and in society's capacity to create spaces that facilitate the action of integrative forces. It is just as clear, however, that problems of marginality and social integration are arising once again even in countries with a long and successful history of industrialization and with old-established and stable democratic regimes, which would seem to suggest the action of factors which are more complex than mere economic growth rates or the consolidation of democracy, and which are relatively independent of those variables.

Although the weakening of the primary institutions (the family and the community) would appear to be behind the signs of deterioration in the fabric of Uruguayan society, social policies do not focus their attention on problems relating to the formation and stability of the family. If the effectiveness and efficiency of such policies are to be improved, this oversight must be corrected.

An essential first step is to tackle the problem of the statistical invisibility of these matters. Published data on illegitimate births in Uruguay only extend to 1989. Furthermore, nothing is known about the proportion of children who do not live with both their biological parents, despite the evidence assembled in developed countries on the important effects of reconstituted families on the children. Nor are there statistics which make it possible to assess the proportion of family units which, for various reasons, have not managed to set up independent households. It is therefore essential to strengthen the availability of vital statistics and make some small changes in household survey and census questionnaires.

A second important field of action is to make the public aware that any institutional option specifically designed to make up for shortcomings in families will be more difficult, more costly and relatively less efficient than efforts to strengthen the family. It is also important to understand that the longer the training period needed to enable young people to meet the new demands of the labour market, the higher the cost of such options will be, since it seems clear that there is no substitute for the family as a source of the material, psychological and emotional support and the habits of discipline and other qualities demanded by the new patterns of social integration.

A third field of action is the prevention of adolescent pregnancies. The data presented in this article suggest that it is very difficult to avoid an accumulation of disadvantages throughout later life when the starting point is so unfavourable and that the time when a family is set up is one of the crucial points for action. In view of the growing proportion of adolescent pregnancies and their role in the corresponding increase in the rates of illegitimacy, it seems essential to create conditions that favour postponement of the age of first pregnancy. This points, among other things, to the need to take measures in the field of sex education, imparting knowledge that makes it possible to control reproduction and ensure that children will be born when they are really wanted, as well as giving a

fuller and more complete understanding of the responsibilities of motherhood and fatherhood.

It is also urgently necessary to reduce the close links that currently exist between the formation of a family and a situation of poverty, especially in the case of young people of low educational level. Setting up a family in a situation not marked by poverty should be a goal within the reach of more young people. Achieving such a goal depends on the creation of opportunities for productive employment, the easing of the demands posed for obtaining such employment, the type and coverage of benefits associated with father or motherhood (family allowances, maternity and paternity leave, etc.) and the possibility of using services that make work compatible with the raising of children. It also depends very particularly on housing policies, because the hope of obtaining a dwelling gives a sense of meaning and direction to a couple's efforts, since they know that possession of a dwelling is a form of protection against economically hard times and thus reduces the vulnerability of the family.

In addition to being within reach, however, the family must be seen as a desirable goal, and in order to secure this it is necessary above all to promote social recognition of its importance. Traditional societies celebrated marriage rituals that involved the entire local community and thus showed the importance they assigned to this institution. These rites have been weakened and in some cases have lost all meaning. The responsible authorities should take steps to give register office ceremonies a due sense of dignity.

The other primary institution which nourishes the social capital of persons and their families is the local community. The strengthening of community links should be an ever-present feature of the design of sectoral social policies. Among the various options for implementing such policies, preference should be given to those which promote dialogue, mutual dependence, stronger links of solidarity, and the execution of joint undertakings. This will serve to strengthen the systems of mutual aid and confidence. The closer-knit the social fabric of a community is, the greater will be its capacity to ensure fulfilment of standards of behaviour more effectively and efficiently than State bureaucracies and specialized control bodies. Decentralization policies help to strengthen local communities insofar as they increase the latter's opportunities to participate in the definition and application of programmes that directly affect the living conditions of the potential beneficiaries, thus increasing the capacity of persons

and groups to identify themselves with collective goals and improve their situation through joint efforts.

The processes of housing segregation and segmentation of services lead to the progressive isolation of the poor, thereby increasing the likelihood of marginal forms of behaviour which may turn into subcultures. Once such subcultures are established, there is a gradual loss of the codes of communication shared with "integrated" society, and prejudices and stereotypes build up in both social segments which widen gaps and gradually reduce the opportunities for forms of interaction that go beyond the labour market or the pur-

chase and sale of goods and services. In contrast, regular interaction on equal terms restores and strengthens the shared codes of communication. Integration policies should therefore give priority to the generation of such areas of interaction.

The foregoing considerations should be borne in mind in town planning, in policies on the location of dwellings, and in the concepts underlying the design of public services, especially education. The more the present tendency towards housing segregation and segmentation of services advances, the greater the social cost of combatting its effects will be.

(Original: Spanish)

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# Trade policy within *the context of the* World Trade Organization

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This study looks at the main obligations arising from the World Trade Organization and their repercussions on the design of trade policy. First of all, the study analyses the content of the world trade system and the problems it raises, and highlights the fact that, as the number of questions considered expands and an ever-increasing number of policies are brought under international scrutiny, the delicate balance between trade policy and negotiations must be adjusted more and more exactly. It is pointed out that the commitments entered into within the context of the WTO indicate the direction but not the depth of trade reforms in Latin America. Closer analysis of the obligations arising from the WTO shows that they offer substantial leeway. The new international rules will have different effects in the long and short term with regard to the leeway available in the domestic market, compared with the external market, and in the region as a whole compared with each country taken separately.

# I

## Introduction

A necessary condition for growth today is the achievement of competitiveness and a more dynamic presence in international markets. Because of this condition and the changes which have taken place in international markets, there has been a fundamental turnaround in the trade strategies of the countries of the region, and the same has occurred with their international negotiating strategies.

Many governments of the region consider that, if properly applied, some of the limitations on economic policies indicated to in the course of the international negotiations could be useful for overcoming longstanding shortcomings in public policies. Thus, for example, the agreements of the World Trade Organization (WTO) oblige countries to display greater transparency and predictability in many areas of trade policy (Rodrik, 1995). They oblige countries, for example, to give advance notification of changes in their rules regarding their import systems and subsidy programmes. At the same time, the processes of consolidation of the tariff universe help increase the credibility and predictability of reform and deregulation programmes.

In broader terms, the WTO provides the possibility of assuring the direction (although not the degree) of trade reforms. The economic authorities can do this through consolidation processes, safeguard agreements, subsidies, etc. In other words, the WTO can be used as a multilateral anchor of economic policy, useful for indicating to the private sector what the new rules are and taking care of the possible political pressures that a change of course might cause.

The WTO is different from the new regional agreements such as the North American Free Trade Agreement (NAFTA) and the European Union, which involve greater policy harmonization. The WTO gives the economic authorities considerable latitude. Unlike NAFTA, in which a private individual can set in motion

the system for the settlement of disputes, it does not give rise to any obligations or rights for private individuals.

In the area of services, for example, NAFTA provides for the liberalization of all services, with very few exceptions; the WTO, in contrast, following the past practice of GATT regarding goods, liberalizes only the services offered as a result of the negotiations effected. Consequently, in the WTO there is the possibility of maintaining discretionality simply by not enrolling a services sector within the structure of the General Agreement on Trade in Services (GATS). Even in the consolidated sectors, the main commitment is non-discrimination between different suppliers. Provision of the same treatment as that accorded to a country's nationals is not obligatory, but is a matter for negotiation. In the course of the negotiations, national treatment is only arranged for a few sectors, none of which include all the forms of this benefit. The GATS also permits the revocation of this commitment by negotiation with the countries affected.

The aim of the present study is to analyze the main obligations involved in the WTO and their repercussions on trade policy design. Section II deals with the content of the trade system and the problems raised in general terms. The WTO agreements have a dual significance. On the one hand, they represent a new trade programme in its broad lines, while on the other hand they indicate the possible formulas that could be applied to promote future trade negotiations. The analysis highlights the way in which, as the number of questions considered increases and an increasing number of policies are brought under international scrutiny, each time it becomes necessary to adjust the delicate balance between trade policy and trade negotiations more precisely.

Section III moves on from a general description to a more detailed analysis. First it describes the changes in special and in differential treatment. It then looks at an example of deep harmonization: the case of intellectual property rights. Finally, it considers trade measures proper, subsidies and safeguard measures. In all these cases, the costs of the new system and the leeway left open are studied.

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Any errors or omissions are, of course, the sole responsibility of the author.



Section IV shows how the general and specific questions analyzed in the preceding sections come together. Some institutional repercussions of WTO for the countries of the region are described. Finally, the implications that the new international

rules are likely to have are analyzed from three standpoints: in the long and short term; with regard to the domestic and external leeway they leave open; and their implications for the region as a whole and each country separately.

## II

### Progress in regulation under the new international trade system

The programme of international trade negotiations has become increasingly broad as trade integration has become deeper, or, what amounts to the same thing, as the old programme of superficial integration has been completed. Robert Lawrence (1993) defined "shallow integration" as the reduction of border barriers, including the reduction of tariffs and quantitative restrictions. The concepts of shallow integration and deep integration are equivalent to the concepts of negative and positive integration in the traditional theory of Customs Unions (Johnson, Wonnacot and Shibata, 1986).

The Uruguay Round marked the end of the negotiations centered on trade policy as applied at the national border level. As tariffs went down to lower and lower levels, it was natural that trans-border instruments should assume growing importance. As a result of this process, and as the different economic systems came into closer contact with each other, the question of disparities between regulations and their effects on trade have been acquiring increasing importance.

A turning point has thus been reached in economic integration, in which questions relating to public policies have increasingly become a matter for negotiation. The Uruguay Round marked an important step forward in this direction, since it went far beyond negotiation on border measures (Tussie, 1994), by incorporating into the negotiations such matters as intellectual property rights, investment measures and the provision of services.

This evolution changed the whole concept of trade policy, which is now increasingly all-embracing. It now includes a mass of domestic policy measures and instruments of each country which were previously outside the scope of international negotiations. By eliminating the outer layer of protection, govern-

ments are now obliged to account for their measures in a larger number of spheres. A set of measures which would previously have been considered as having only indirect effect on trade policy are now seen as distorting trade. According to the World Bank Manual, non-tariff barriers are considered to be all public regulations and government practices which introduce unequal treatment between domestic goods and foreign products which are identical or similar to them. To use a broader definition, they represent "the most important obstacle to the growth of international trade" (Olechowski, 1989, p. 121).

In short, as trade integration has become deeper, the range of public policies which are considered as having a possible effect on trade relations has become wider. Thus, the conventional distinction between trade policy and economic policy has been wiped out, obliging governments to discuss a growing number of domestic policies with their trading partners.

The inclusion of domestic policy matters in international discussions is not aimed solely at avoiding the appearance of substitutes for the tariffs abolished in the past. It also means broadening the field of the WTO's competence and potential scrutiny. "The long process of reduction of trade barriers could thus be compared to the draining of a lake which finally reveals mountain peaks, or, more prosaically, to the task of peeling an onion" (Kahler, 1993, p. 8).

In the past, increasing trade openness usually only applied in practice to items of the tariff nomenclature. The interested parties exchanged concessions regarding particular products, without questioning domestic rules. The only domestic commitment was to give national treatment to products once they had crossed the border and the tariff had been collected. Today,

however, the negotiations deal less and less with products subject to the principle of national treatment and more and more with the policies determining conditions for competition.

It is considered that the conditions for competition are affected when inter-country costs differ by more than a certain amount: a threshold which is hard to define precisely but is considered as a standard by the country (or countries) defining the terms of the negotiations. This difference in costs may be affected by subsidies, policies designed to protect intellectual property, labour standards or environmental regulations. When the differences in costs between countries are considerable, there will be pressure to avoid or reduce the competition between their regulations. In the Uruguay Round, these pressures were felt particularly strongly when discussing the question of intellectual property. Although in the negotiations on services and trade-related investment measures (known as TRIMS) the idea was to seek some harmonization, this did not lead to a reduction in competition between regulations.

The pursuit of the harmonization of regulations can take place to different degrees: shallow harmonization (or negative harmonization according to Johnson, Wonnacot and Shibata, 1986), or deeper harmonization (termed positive harmonization in the traditional terminology). Shallow harmonization means that the harmonization is only of a corrective or preventive nature, to prevent damage to a process of openness compromised by the effect of non-tariff barriers. In this sense, the Uruguay Round tried to specify the circumstances in which countervailing or anti-dumping tariffs, technical or sanitary regulations

or customs procedures could be applied, in an attempt to prevent these measures from being used as tariff substitutes.

In deep or positive harmonization, in contrast, efforts are made to apply common policies in certain fields. The problem is: what domestic policies is each country willing to place on the negotiating table? —a problem which already arose in the Uruguay Round negotiations on intellectual property rights and which will be of crucial importance in the definition of the programme of environmental and labour standards. If such negotiation becomes a condition for gaining access to markets, then instead of deep harmonization we will be facing a risk of fragmentation or “imperial harmonization” (Lawrence, 1993).

This tendency towards the convergence of economic policies has two effects. On the one hand, the consolidation of certain policies within the framework of the WTO serves to mark the general course of economic reforms and legitimizes the direction taken by economic policy. On the other hand, if taken beyond certain limits, it could become an obstacle to continued outward-oriented growth. International obligations gradually reduce the leeway for active participation in international trade. Freedom of action has been limited compared with the past, though it has not disappeared completely.

The new trade negotiations must fit within these limits. On the one hand, there is the need to maintain a certain amount of leeway for the application of active development policies; on the other, there is the need to strengthen external solvency, for which purpose there may be advantages in adopting self-imposed restrictions instead of seeking unlimited leeway for action.

### III

## The new WTO rules and the degrees of freedom they allow

#### 1. The nature of special and differential treatment

Special and differential treatment was conceived as a means of making up for differences between national income levels. It was applied in two ways: as a form of protection for economic development, including bal-

ance of payments problems, and as a way of gaining preferential access to international markets. The first way is provided for in Article XVIII of GATT-1947. The second way was put into practice through the Generalized System of Preferences (GSP). The two ways were fused in the Enabling Clause adopted at the Tokyo Round of multilateral negotiations, which

marked the high point of special and differential treatment. The GSP was never a contractual obligation, however, so that access to preferential forms of treatment was always granted discretionally by the industrialized countries.

The Uruguay Round marked a turning-point in the evolution of special and differential treatment and its underlying philosophy. The developing countries were more willing to enter into commitments, and they pressured the relatively more developed countries to renounce the benefits they received from special and differential treatment.

Two major categories of countries have been established: the developing countries, and the least developed countries (47 countries, as identified by the United Nations), plus the low-income countries (those with a per capita GDP under US\$ 1,000).<sup>1</sup> Under the new agreements, the least developed countries usually have a period of grace for fully assuming all the obligations agreed upon, while the low-income countries are allowed to fulfill the obligations less strictly (ECLAC, 1994 and Weston, 1995).

Special and differential treatment takes the following forms:

a) postponement of the fulfillment of some of the obligations contained in the agreements,

b) exemptions from the fulfillment of some obligations for the least developed countries. For example, they are exempted from the commitments on the reduction of subsidies for agriculture (Article 16 of the Agreement on Agriculture),

c) *de minimis* arrangements apply where the volume of exports is only small and the amounts of subsidy or dumping are also small,

d) flexible application of procedures. In cases of dispute settlement, when these have been brought by developing countries, account will be taken not only of the trade affected but also of its repercussions on the economy of the country concerned.

Some degree of differential treatment has also been maintained with regard to consolidated tariffs. The countries of the region have consolidated all their tariffs, with ceilings of between 30% and 35%. This level is higher than those offered by the developed countries.

In short, special and differential treatment only amounts to the granting of longer periods of adaptation to international rules and minor concessions to mitigate the effects of the adjustments that the countries of

the region must make to comply with the higher standards imposed on them by the new obligations. In matters of intellectual property, special and differential treatment has been seriously reduced.

## 2. Intellectual property

The Agreement on Intellectual Property, known as the TRIPS Agreement, is the best example of deep or positive harmonization. The result of this harmonization is extra-territorial protection of intellectual property rights and the progressive integration of this Agreement into the body of international economic law (Reichman, 1997). Before the Uruguay Round, only the principle of national treatment had to be fulfilled in matters of intellectual property. This principle obliges the countries to comply with some rules with regard to the form of protection granted, but they still remain free to decide what sectors to include and the levels of protection to grant. This approach is similar to that of a European Union directive: it lays down minimum standards for government action. The countries of the region are seriously prejudiced by the extension of patents to almost all fields of technology. The only exception granted to the developing countries is a longer period for the fulfillment of obligations.

As net importers of technology, the countries of the region had different preferences regarding patentability, depending on the sector involved and the learning possibilities it offered. In some cases they preferred to purchase technology abroad; in others, they preferred to obtain it by copying. The pharmaceutical industry was that which was most often excluded. The case of medicines has been one of the most hotly disputed, because this is a sector with high research and development costs but with process technology which is potentially accessible and is of key importance for health policies.

The TRIPS Agreement introduced the obligation to harmonize standards for six types of intellectual property: copyright, registered trademarks, geographical indications, industrial designs, patents and layout-designs of integrated circuits. Directives were also laid down on the adoption or rules to enforce intellectual property rights. The main obligation imposed on holders of patents is that of full disclosure of the information contained in the invention. The TRIPS Agreement does not demand local use of the invention, however (Article 27).

In general terms, it could be said that the Agreement provides for two different types of intellectual

<sup>1</sup> This group includes Bolivia, Guyana, Honduras, Nicaragua and Haiti.

property. Literary and artistic works, computer programmes and databases form part of the first of these categories. They are granted protection for 50 years. In a sense, registered trademarks also come within this group, as they are protected for an almost indefinite period, subject only to the condition that the holders of the trademark must continue to supply the domestic market.

The second category essentially covers industrial patents. Any innovation which complies with the conditions of novelty, inventive activity and capability of industrial application is patentable. Patents must be granted for a term of 20 years. In the field of biotechnology, patents cover microorganisms and artificially produced new plant varieties, but exclude essentially biological procedures for the production of plants and animals and the resulting plants and animals themselves. The provisions of the agreement in the area of biotechnology will be reviewed in 1999.

In order to comply with the provisions of the Agreement, the countries of the region will have to make substantial changes in their own intellectual property regimes. With regard to patents in particular, all the countries of the region will have to extend protection to pharmaceutical and chemical products, which are currently generally excluded from patents systems. Furthermore, countries which already have some legislation on intellectual property will have to make it compatible with the Agreement. Chile, for example, already has a patent system which provides for a validity of 15 years, but it will have to adjust this to comply with the period of 20 years laid down in the TRIPS Agreement. Other countries have exceptions to the period of 20 years which are not provided for in the Agreement, while some of them use a different date for determining the beginning of the patent protection (Primo Braga, 1995). The countries of the region which previously applied requirements for local manufacture in order to promote the establishment of production plants will have to grant patents for products even if they are not manufactured in the country.

With regard to copyright, the TRIPS Agreement classifies software under literary works. Most of the countries of the region do not have any protection at all for software. A few of them do have such protection, but through legal means different from those of copyright. The same is true of the protection of plant varieties, which the Agreement says must be effected through patents and/or a *sui generis* system. Most of the countries of the region exclude this type of protec-

tion, and only three of them (Argentina, Chile and Peru) have systems of their own (Ramassotto, 1997). For its part, Mexico undertook to introduce protection for new artificially produced plant varieties and to comply with the obligations of the Union for the Protection of Plant Varieties (UPOV) within two years of the signing of NAFTA (Primo Braga, 1995).

These examples show that the region must make substantial reforms in its legislation in order to comply with the standards laid down in the TRIPS Agreement. Ensuring compliance with intellectual property standards will perhaps to be one of the hardest tasks for the countries, as they have few administrative resources and their judicial systems are not entirely efficient.

However, the Agreement contains six more areas in which the countries retain quite significant degrees of freedom:

i) There are transitional and grace periods. The purpose of the transitional period is to give affected sectors the time they need to adapt to the new rules that will be applied when the law on intellectual property is adopted. Article 65 of the TRIPS Agreement provides for a total transitional period of as much as 10 years for the entry into force of the standards laid down in it:

- subparagraph 1 lays down that all members have a grace period of one year from 1 January 1995, which is the date of the entry into force of the WTO Agreement;

- subparagraph 2 provides that developing countries can postpone the application of the measures laid down in the Agreement for a further 4 years;

- subparagraph 4 provides that developing countries which are obliged by the Agreement to extend product patent protection to areas of technology not hitherto thus protectable in their territory (the pharmaceutical sector in most countries of the region) can opt to postpone the application of the provisions of the TRIPS Agreement for another 5 years.

The periods of transition are the same for both the developing countries and the least developed countries.<sup>2</sup>

ii) Under certain conditions, obligatory licences can be invoked (Article 31). "Adequate remuneration" must be given, and the licences can only be granted for reasons connected with public health; nutrition or

<sup>2</sup> The least developed countries do not enjoy any special exemption except a vague commitment by the developed countries to further the transfer of technology (Article 66): a commitment which does not extend to the developing countries (Article 66.2).

other public interests in national emergencies; public non-commercial use; the correction of anti-competitive practices, or when the holder of the patent refuses to grant a licence on "reasonable commercial terms and conditions".

iii) Patents are not retroactive. Retroactive protection refers to products with patent applications pending, products which are under development, or products not yet on sale in countries which are in the course of transition to stricter patent laws when the legislation is approved. Thus, patents will only be granted in respect of applications presented after the entry into force of the Agreement.

iv) Articles 40 and 41 seek to avoid the creation of artificial barriers to entry. Members are authorized to specify in their national legislation the patenting practices or conditions which "constitute an abuse of intellectual property rights having an adverse effect on competition".

v) The final text of the TRIPS Agreement does not contain a full or coherent interpretation regarding parallel imports. On the one hand, the TRIPS Agreement grants exclusive rights to the patent owner (Article 28). The holder of the rights to a product or procedure can prevent other persons from, without his consent, making, using, offering for sale, selling or importing for these purposes the patented product or any product obtained directly through the patented process. It could be deduced from this article that parallel imports of the patented product are not permitted.

In other articles, however, the Agreement seems to contradict itself on this point. For example, it includes the concept of the exhaustion of patent rights (Article 6). According to the legal definition of exhaustion of rights, the holder of an intellectual property right is the only person authorized to place the protected object on the market and receive compensation on that occasion only. Once the product has been placed on the market, however, the product "flies with its own wings", and the holder of the rights cannot seek fresh compensation or prohibit the protected object from continuing to circulate on the market. Exhaustion of rights permits the free circulation of goods. Without this legal provision, a third person in the marketing chain would always be subject to the obligation to pay compensation to the holder of the patent. Adoption of the principle of exhaustion of rights could be interpreted as accepting the idea of parallel imports: the possibility that a licensee can import an object legally acquired in another market.

In this respect, therefore, national legislations remain free to define the rules on exhaustion that they deem appropriate. Thus, for example, whereas the Chilean and Mexican legislation prohibits parallel imports, the legislation approved by the Argentine Congress in October 1995 permits them. Under the law currently in force in Brazil, imports from voluntary licensees of the patent holder are permitted.

vi) Since the Agreement forms an integral part of the WTO, which has established comprehensive machinery for the settlement of disputes, it will henceforth be legitimate to take reprisals against non-fulfilment in this field which restricts access to the goods market involved.

The use of trade sanctions has transferred a principle of the United States Trade Law into international law, albeit in a mitigated form. Under the WTO, reprisals are a last resort: the third in a three-step procedure under the new dispute settlement machinery.

In theory, justified reprisals give the countries of the region the possibility of using them to deny protection to the intellectual property of a developed country which illegally or unilaterally prevents their goods from having access to its market (Reichman, 1997). In practice, this possibility is limited by the possibility of side payments provided for under the Generalized System of Preferences (GSP) or the hemispheric negotiations currently underway. Although the Agreement settled the main differences on this question in favour of innovating countries, this has not put an end to bilateral and plurilateral pressures, mainly originating from the United States. These pressures arise above all in connection with the possible margins of leeway referred to earlier. There have even been threats of trade sanctions, especially exclusion from the benefits of the Generalized System of Preferences not consolidated in the WTO, and, hence, the imposition of conditions on access to markets whose possibilities of being defended in the WTO are uncertain.

In Argentina, for example, the legislation under consideration had to be amended several times to adapt it to the United States' suggestions. This resulted in long haggling between the Legislature and the Executive and to uneasiness among the legislators on account of the intervention of the United States Embassy at key points in the negotiations. The Bill was put to the vote three times because the Executive vetoed it in part and continued to request amendments.

The effort to secure its approval was the longest and the most complex legislative action in the two-year period from 1995 to 1996. Finally, in early 1997 the United States announced the removal of Argentina from the GSP.

### 3. Subsidies

The Agreement on Subsidies and Countervailing Measures is an example of negative harmonization, as it only covers trade measures proper. It is the longest text adopted by the WTO, reflecting the current importance of this issue and the discrepancies aroused by an active policy of seeking access to foreign markets. Economic authorities will gradually have to abandon some government promotion policies and adapt the systems they use for countervailing measures. The result is some restriction of the leeway for such countervailing measures.

Article 27 of the new Agreement recognizes that subsidies may play an important role in economic development programmes (previously incorporated in Article 14 of the Tokyo Round Code); but apart from this general endorsement, restrictions have been imposed on subsidy programmes of the size, variety and intensity displayed by those applied by Taiwan and Korea at the beginning of their outward-oriented industrialization.

The Agreement contains two "trigger" clauses which are quite restrictive in terms of the graduation of the countries of the region. Firstly, the developing countries will be graduated when they reach a level of export competitiveness defined as a share of at least 3.25 per cent in world trade for a given product for two consecutive calendar years. A product is defined as a (four-digit) section heading of the Harmonized System Nomenclature. When there is a high level of aggregation, this makes the probability of reaching the threshold more remote.

Secondly, a very strict indicator has been established: all countries with a per capita GDP over US\$ 1,000 must assume the same obligations. Five countries are excepted from this in the region, either because they have a lower per capita GDP or because they have been identified by the United Nations as a least developed country: Haiti (least developed), and Bolivia, the Dominican Republic, Guatemala and Guyana (per capita GDP below US\$ 1,000).

The agreement goes far beyond the previous Tokyo Round Code on various matters which are of

importance for development policies. For the first time, a definition has been reached of the concept of a subsidy, although it is still too generic. Thus, a subsidy is defined as any form of financial contribution by a government or income or price support mechanism which gives some kind of advantage to companies or branches of production. The disciplines provided for in the Agreement only apply to specific subsidies granted to particular companies, industries or groups or companies. With the aim of establishing an order of subsidies (and hence of the circumstances in which countervailing measures can be taken), subsidies are classified in three groups: prohibited, actionable and non-actionable.

Subsidies contingent upon the use of domestic inputs or inputs explicitly destined for exports are prohibited.<sup>3</sup> The developing countries must eliminate the first-named in five years and the second in eight years, which may be extended to ten years by the Committee on Subsidies and Countervailing Measures set up to supervise the Agreement. Applications in respect of countervailing measures may be presented during the transitional period, however. The least-developed countries listed in Annex VII of the Agreement are exempted from this prohibition, provided their per capita GDP is not over US\$ 1,000.

Non-actionable subsidies cannot be the subject of countervailing measures. These subsidies are those of a general nature which do not have a direct impact on prices: for example, those applied to activities such as basic research and development, pre-competitive development, assistance to disadvantaged areas, or assistance to comply with new environmental regulations or standards. These subsidies are permitted within certain limits, although any country can complain to the WTO if it considers that a subsidy which is in principle non-actionable is doing it harm.

Actionable subsidies are all specific subsidies (that is to say, those granted only for certain industries or companies) which influence export prices.

<sup>3</sup> It should not be forgotten that temporary importation (duty-free importation of goods, parts or components for subsequent export) and drawback arrangements (reimbursement of duties paid on imported inputs used in exports) are not considered as subsidies, nor are they prohibited. The maximum periods of time for claiming drawbacks are not regulated at the international level, so that each country can make its rules in this respect as loose or severe as it sees fit. In the United States, for example, drawbacks can be obtained up to five years after the importation of the goods in question.

They can give rise to countervailing measures if it is shown that they are having harmful effects on national production. The Agreement lays down quite a restrictive procedure for determining whether there is serious prejudice and calculating the level of the subsidy. It is generally assumed, however, that there is serious prejudice when subsidies exceed 5% of the value exported. When a developed country wishes to take action against a country of the region, it must provide proof of the harm suffered. This gives the countries of the region more leeway than the developed countries in the case of countervailing measures, because the burden of proof is reversed for the developed countries and they are responsible for proving that they are not causing harm.

The Agreement also includes other exceptions for countries of the region in the rules on special and differential treatment, which could be beneficial for small or new exporters.

The *de minimis* provision included in the free trade agreement between Canada and the United States and subsequently transferred to the WTO means that any investigation for the application of a countervailing tax against a country of the region will be closed if the subsidy involved is only small. In order to benefit from this clause contained in Article 27.9, the level of subsidy granted by a developing country must not exceed 2% of the unit value of the product (3% in the case of the countries listed in Annex VII). The *de minimis* provision also applies if the export in question accounts for less than 4% of the total volume of imports of the product, provided that all the developing countries together do not account for more than 9% of imports of that product.<sup>4</sup> Another clause in the Agreement which also permits some leeway is that which provides that countervailing duties will not be applied in respect of condonation of debts or direct subsidies applied in order to cover the social costs connected with privatization programmes,

provided that both the programme and the subsidy are limited in time and that the programme results in the true privatization of the company in question. This provision could serve to encourage subsidies connected with the inflow of foreign direct investment in connection with privatization processes.

The limitations on the countries from which the main import flows come, and which already have a highly visible presence in world markets, offer another opportunity. These countries cannot introduce new subsidies and will have to eliminate their present export subsidies within a period of ten years. For the countries of the region which are at an earlier stage in the development of their exports, this measure has positive effects on two fronts. On external markets, it leaves open a certain space for increasing their shares. Furthermore, as small exporters, their own freedom of action is broader. The *de minimis* provision (in its sense of staying under 4% of the total volume of imports of the product concerned) also gives some scope for growth. On the domestic market, the legitimate possibility of checking to some extent the activities of the countries which are most active in international trade heightens the sustainability of the developing countries' own openness. The countries of the region must now complement their openness and deregulation processes with the adoption of flexible mechanisms compatible with the WTO for the application of countervailing duties (as well as effective safeguard mechanisms) in order to sustain the trade reforms which have been made.

In short, the WTO leaves open some possibilities for applying sound policies to forestall countervailing measures. The countries must now concentrate their subsidy policies on correcting obvious market flaws or situations where there are big hidden costs. The market suffers from serious flaws with regard to the dissemination of information on outside markets, and especially on foreign consumer preferences, marketing channels, changes in design, compliance with technical standards, environmental labeling and quality requirements. There are no restrictions on market studies (and the acquisition of information on foreign markets in general) financed by governments through their export promotion departments. In these aspects, there are important possibilities to be explored, as is already being done by PROCHILE in Chile, EXPORTAR in Argentina, and PROEXPORT in Colombia (ECLAC, 1995).

<sup>4</sup> This clause means that countries must avoid giving support to products in which the exports of the developing countries are heavily concentrated, which are normally considered sensitive products on international markets. In order to avoid crossing this threshold it will be necessary to have information on the shares of the competing countries in each market. The regional organizations could play a leading role in centralizing and circulating the necessary information, in order to avoid subsidies which are counterproductive or subsidies on goods with little export future.

By way of pre-competitive support, the public sector can and should provide ample support to reduce the entry cost that the private sector must pay in order to introduce the international quality management standards developed by the International Organization for Standardization (ISO). The private sector will need increasing support in this area for the acquisition of the goods it needs to obtain more quality certificates. ISO certification is a master key for gaining access to international markets. Without it, export firms have to carry out long and costly formalities in order to sell their products. As well as facilitating access to markets, compliance with ISO standards helps to reduce hidden costs within only a couple of years (Sykes, 1995).

There are also possibilities in the area of direct support. Thus, for example, consideration could be given to the establishment of a system for returning indirect taxes both in respect of products actually exported and vital inputs and components. It is permissible to use any mechanism that places exporters on an equal footing with their international competitors and gives them access to international interest rates, and it is even permissible to give a certain degree of subsidy in conformity with the guidelines of the corresponding OECD agreement.

Subject to compliance with the requirements of transparency and notification, subsidies can be granted to ensure that industrial processes comply more fully with environmental requirements, as long as they are limited to 20% of the cost of adaptation and represent a one-time, non-recurrent measure. It is well known that this type of restructuring helps to improve the efficiency of enterprises.

Finally, a support programme can be established for infant exports, with modest and temporary export subsidies which can be eliminated when the exports reach a certain level (fixed in terms of their value or their percentage of total export income) and thus cease to be of an infant nature. Such subsidies are not completely permissible in the case of countries with a per capita GDP of over US\$ 1,000, but they should nevertheless be borne in mind, as they could be considered as pre-competitive measures. Moreover, as long as these lines of exports are small and keep their market share under 4%, they will not be subject to countervailing measures (unless the total market share of the developing countries exceeds 9%).

With respect to this same category of infant exports (or exports which can be kept below levels that

would give rise to countervailing measures), consideration could be given to the introduction of subsidies for all companies which, together, export products coming under a given tariff heading in amounts which are below a predetermined ceiling to be decided by each country. Since such a subsidy would be granted to all companies, it could not be classed as a specific subsidy and there is therefore no reason why it should be prohibited. Chile, for example, operates the "simplified export drawback system", which consists of the reimbursement of up to 10% of the value of goods exported as partial repayment of taxes entering into the cost of the corresponding inputs, provided that the annual amount exported exceeds a certain level.<sup>5</sup> This type of support can be defended under the *de minimis* provisions.

In addition to the active utilization of this leeway for adopting measures to gain access to international markets, there are other positive elements in the reduction of the degree of discretionality of countervailing action. The use of this clause has a further three limitations. First, there is the "sunset" clause, whereby all countervailing duties must be eliminated within five years, except when the investigating authorities determine, on the basis of a new investigation, that the expiry of the duty would be likely to lead to continuation or recurrence of subsidization and injury to domestic producers. Second, a single company alone can no longer make an application for the adoption of countervailing measures; such an application can only be made by or on behalf of the group of domestic producers of the good in question. An application for countervailing measures will be considered to be made by domestic producers "if it is supported by those domestic producers whose collective output constitutes more than 50 per cent of the total production of the like product produced by that portion of the domestic industry expressing either support or opposition to the application" (Article 11.4). Third, for the first time the procedures give all the interested parties the right to present evidence (not only domestic producers, but also importers, consumers and industrial users of intermediate products).

<sup>5</sup> For more details see ECLAC, 1995.



In order to take full advantage of these possibilities, the countries of the region must give increasing consideration to the establishment of active contacts with consumers' associations or intermediate users of their export products, as an integral part of their export strategies. Within this field, consideration should be given to the possibility of establishing joint information and liaison offices with these associations, under the auspices of the regional organizations. This could be a very important element for supporting export growth and reducing the vulnerability of market access.

Notwithstanding these opportunities for greater freedom of action, however, it should be borne in mind that in bilateral negotiations many countries of the region have committed themselves not to introduce new subsidies and to gradually eliminate their existing subsidy programmes, so that the introduction of new programmes could give rise to protests at the bilateral level. Furthermore, conflicts of jurisdiction have already occurred with regard to investigations begun before the WTO came into force but completed later. In other words, the Agreement is not retroactive. Subsidies granted in the past may be subject to countervailing measures under the looser rules of the Tokyo Round Code. It should also be borne in mind that in the United States subsidies are actionable for 15 years from the date they are granted.

As importers, the countries of the region must adapt their legislation to the stricter and more precise conditions of these commitments, which reduce the leeway for discretionary administrative decisions and increase the need to give decision-making processes greater transparency (Guimares and Naidin, 1994). Perhaps the greatest advantage of the commitments assumed lies in the possibility provided for acting as an important anchor for the regional integration processes underway, which could otherwise be subject to advances and setbacks and to the uncertainty from which they suffered in the 1960s.

Whatever the limitations involved in these commitments, however, the stage of the indiscriminate massive application of fiscal incentives for exports is over. Quite apart from the weight of the fiscal restrictions which exist in most of the countries of the region, there are other reasons too which explain this evolution. Firstly, the trade policies of the countries of the region have reduced or even done away with their traditional anti-export bias and with the incentives used in other periods with the aim of offsetting the

harmful effects of the restrictive trade practices of transnational enterprises reluctant to produce goods for competing on international markets. The rapid process of globalization and the increasing tendency to orient foreign direct investment towards external markets also make it less necessary (and in some cases superfluous) to support exports through fiscal transfers. In this respect, the Agreement legitimizes price agreements as a means of solving and sometimes interrupting investigations on subsidies. The authorities of the region should be alert to this possibility, for if price compensation proves successful there can be no doubt that the need for subsidies disappears and it would therefore be highly advisable to end unnecessary transfers to exporters.

Today, competition in respect of incentives takes place mostly in connection with the race to influence decisions on the orientation of investment flows (UNCTAD, 1995). The Uruguay Round made only very timid progress in this field. The TRIPS Agreement only contains two obligations: to eliminate incentives aimed at increasing the degree of national integration or maintaining a positive foreign exchange balance (Sauvé, 1995).

#### 4. Safeguards: Articles XVIII.b and XIX

The safeguard measure most used by the developing countries in order to defend their markets has been the use of article XVIII.b. This article (added to GATT in 1955) has given the developing countries significant leeway for imposing quantitative restrictions with the declared object of protecting their balance of payments and maintaining an adequate level of reserves.<sup>6</sup> In the past, this exception was used not only for this purpose, but also in order to apply import substitution programmes without any major obstacles or opposition.

The understanding reached at the Uruguay Round does not involve new obligatory commitments, nor does it reduce this leeway significantly. Import quotas have not been prohibited. Subject to negotiation, the developing countries are authorized to use tariffs to

<sup>6</sup> It is well known that quantitative restrictions have distortionary effects, but in view of the delayed effect of tariff increases on the balance of payments, quotas have more often been used instead (Stewart, 1989).

deal with balance of payments problems. At the same time, they undertake to give due notification of the measures and consult with the Committee on Balance-of-Payments Restrictions. Thus, the degrees of freedom retained under the WTO can be quite important in the future.

In view of the precarious financial situation and the ever-present threat of external crises, these degrees of freedom to defend the balance of payments are essential in order to retain a capacity for immediate reaction to adverse effects. The consolidation of tariffs at higher levels than those previously applied also permits temporary balance-of-payments protection without the need for compensation. In the present international economic environment, however, it is much more difficult to use this exception to protect the domestic market, as frequently happened in the past.

A good example of the new restrictions on the use of this means is the resistance encountered by the motor vehicle quotas imposed by Brazil because of its growing trade deficit in June 1995. South Korea, the United States and Canada all came out against this measure. These countries threatened to demand compensation on the grounds that Brazil's reserves were too high to justify such a quota under the exception provided for in article XVIII.b, since they amounted to US\$ 47 billion: enough to finance 12 months of imports. Although two-thirds of those reserves were of a short-term nature, this precedent shows the difficulties that will be encountered in trying to justify quotas which do not have the clear objective of defending the balance of payments.

The use of safeguards (article XIX of GATT) has had a stormy history in the GATT negotiations. The safeguards clause in the 1947 GATT Agreement were designed to act as a safety valve, by permitting countries to apply temporary tariff surcharges in the case of import booms. Thus, under article XIX, higher tariffs could be temporarily imposed on the basis of the most favoured nation clause. Article XIX has rarely been invoked, however, because of its requirement that countries must comply with the most favoured nation principle and must give compensation to the exporters affected.

At the Uruguay Round, a pragmatic consensus emerged in favour of selectively legitimizing import quotas and relaxing the obligation to pay compensation. The new Agreement prohibits the developed

countries from imposing new grey area measures and proposes the elimination of all the existing measures within a period of four years, except for one specific measure per importing country, which must be eliminated by 31 December 1999. Likewise, all safeguard measures adopted under article XIX must be eliminated within a period of eight years from the time of their first application or five years after the date of entry into force of the WTO Agreement, whichever comes later. Moreover, all the measures are subject to a "sunset clause", which lays down a maximum duration of eight years provided the authorities confirm that the measure continues to be necessary and that they can show that an adjustment is being made. At all events, after one year the measure must be gradually liberalized throughout its period of application.

The Agreement also contains *de minimis* provisions, like those regarding the imposition of countervailing (and anti-dumping) tariffs for developing countries. It lays down that safeguard measures shall not be applied to a developing country when its share in the total imports of a product is less than 3% and when the imports from the developing countries together do not exceed 9% of the value of total imports of the product.

The Agreement is a compromise solution. Although it sanctions selectivity, maximum periods have been established for the application of safeguard measures and procedures have been laid down for determining the damage caused. In any case, security of access will not necessarily be improved, since the adjustment of the mechanisms for applying safeguards will cause the diversion of protective measures in the direction of more intensive use of anti-dumping tariffs, the rules for which were only specified in terms of procedures.<sup>7</sup> The relative ease of resorting to anti-dumping tariffs, together with the non-consolidation of the Generalized System of Preferences, represents the weakest link in terms of access to international markets.

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<sup>7</sup> As is well known, anti-dumping and countervailing measures have proliferated in recent years in spite of the negotiations underway in the Uruguay Round. Anti-dumping legislation is the trade measure most actively used. In proportion as the Latin American countries have liberalized their economies, they have also increasingly resorted to anti-dumping and countervailing tariffs. This could be counterproductive, as intra-regional trade is an important stimulus for growth (Tussie, 1996).

## IV

### The need for both anchors and leeway: how these objectives come together in the WTO

The international trade discussions are tending towards the achievement of growing harmonization in the long term. The clearest example in the case of the Uruguay Round is the result of the negotiations on trade-related intellectual property measures (TRIPS). The debate on questions of labour rights and the environment is following the same path, but less rapidly. The harmonization of regulations, for its part, is undoubtedly a slow and difficult process, at least at the multilateral level.

In the meantime, the meshes of the net have been widened in the short term: the WTO has left considerable room for discretionality, especially in the domestic market, although the leeway is no longer unlimited, as it was at the height of the period of special and differential treatment. There is still room for some degree of freedom of domestic action in the consolidation of tariffs above the levels previously in force and some looseness (or possible differences of interpretation) with respect to the obligations arising under article XVIII.b.

Comparatively speaking, this leeway in the domestic market is greater than that obtained with regard to measures to secure access to international markets. Initially, the *de minimis* provisions provide some freedom of action for small exporters, but in the long run they will act as a brake on external trade, especially for sectors of that trade which are sensitive or not very dynamic.

Although the *de minimis* provision ensures some opportunities for small exporters individually, it does not do the same for the countries as a whole. The total volume of exports of a given product of the developing countries can very easily exceed the 9% threshold laid down in the Agreements on safeguards and subsidies. Finally, there may well be a resurgence of anti-dumping measures and a general trend towards protective measures in this respect, since in relative terms these are the measures least regulated by the WTO.

On the other hand, the WTO can be used as a general anchor for economic policy. It can serve, for example, to ensure the transparency of incentive policies or improve their targeting, by effectively directing them towards infant export sectors which will not give rise to a reaction in external markets. Thus, the multilateral framework can

be used to avoid a situation where incentives are channeled mainly to highly concentrated sectors with strong lobbying capacity (and even with greater access to international financial markets).

It must be remembered that the linkage between trade policy and trade negotiations is nowadays an increasingly delicate matter, since there may be tension between the export development needs of each country and the tendency towards policy convergence implicit in the new trade system. In order to adapt itself to the new international commitments, the State must have the necessary institutional capacity. It must carry out the reconstruction of institutions needed to permit the application of policy instruments which, although more complex, may be closer to the optimum solutions (Hoekman, 1995).

Since the Uruguay Round, instruments which were hitherto normally part of each country's domestic policy have become central issues for negotiation. Some of the agreements reached involve obligations which go to the very heart of each government's internal management and will be subject to future international scrutiny. The adaptation of national legislation to the TRIPS rules, for example, led in Argentina to a struggle between the Executive, which was negotiating the international agreements, and the Legislature, which was responsible for reforming the laws. The Legislature became an actor in this process, seeking to interpret the various points of the Agreement and legislate on them without always having sufficient information. The amounts of leeway, grey areas or different possible interpretations which exist mean that the Legislature may take initiatives which result in friction with the Executive. In other words, the adaptation of legislation calls for a great deal of domestic political negotiation. A struggle between the different powers may be counterproductive, leading to political and economic instability instead of achieving the modernization and progress which it was hoped that incorporation into the international trade system would bring (Rodrik, 1995).

The Uruguay Round means a whole new set of obligations for the countries of the region. Thus, being

members of the WTO means having to fulfill a dozen collateral agreements with extensive notification requirements. The commitment to give due notification includes the need to inform the WTO of the introduction of import restrictions to protect the balance of payments (or any changes in those restrictions or in the agreed programme for their elimination). The agreements also call for annual notification of changes in legislation and rules. In the case of tariffs, the information required must include details of the type of measure used, the criterion adopted for applying it, the products affected, and its effects on trade.

The notification requirements also extend to the introduction or modification of sectoral incentives, even though exceptions to the commitment to reduce them may have been agreed. It is also necessary to notify changes in sanitary measures and cases of the adoption of standards differing from those internationally agreed. With regard to subsidy regimes, notification must be given of the form of the subsidy (such as loans, tax concessions, etc.); the degree of subsidy per unit, or at least the total or annual amount budgeted for granting the subsidy (including, if possible, the average subsidy per unit in the previous year); the policy objective of the subsidy; its duration; and statistical data permitting an assessment of its trade effects (Agreement on Subsidies and Countervailing Measures, article 25).

Few countries of the region currently have the institutional structure needed to satisfy the notification requirements. Their officials do not always have the technical and administrative training needed to comply with the scrutiny at the microeconomic and subnational level provided for in the new international rules. At the same time, in the context of the progress made towards greater openness, there are already indications that there will be growing domestic demand for the application of countervailing or anti-dumping tariffs. The institutional machinery for dealing with these demands must be adapted to the international requirements for the determination of damage in order to be able to provide proof of dumping or of subsidies and their levels. It will also be necessary to establish facilities for negotiation in order to reconcile the interests involved.

An important innovation in the WTO has been the establishment of a credible Dispute Settlement Body (DSB). The DSB, which has greatly increased powers, will deal with all disputes arising out of the agreements

contained in the Final Act. Its establishment represents the most important contribution of the Uruguay Round in terms of giving the multilateral trade system greater security and predictability. The DSB will establish special panels, adopt reports, supervise the application of resolutions and recommendations and authorize the suspension of concessions. This is a significant improvement compared with GATT, where the settlement of differences was split up between the GATT Council and the committees set up to administer the Tokyo Round Codes.

Two new aspects distinguish the DSB machinery from previous practice. From now on, there must be consensus on motions against the establishment of special panels or the adoption of their reports, whereas under the previous system there had to be a consensus before a positive decision could be taken. Under the new system, the disputing parties cannot block decisions that go against them for long. Secondly, the decisions of a panel can be appealed to the appellate body.

The establishment of the DSB has not changed the manner of determining possible compensation or penalties: the size of these continues to be subject to the discretionality of the parties in dispute. Furthermore, the DSB has no power to take initiatives itself. Nevertheless, there is an improvement in the automatic nature of the procedures, and it has thus become easier to seek compensation or penalties in the case of trade disputes. The DSB opens up the possibility of a credible multilateral negotiating body, so that increasing use of the dispute settlement system may be expected. As the countries of the region must bear in mind the possibility both that they may be bringing actions and that they may be sued themselves more frequently than in the past, they must become aware of the need to prepare themselves for this.<sup>8</sup>

In short, the new trade policy must be accompanied by an ongoing improvement of negotiating strategies. For this purpose, it is essential that the countries of the region should be aware of the increasing degrees of professionalism required at all levels, and not only in the Executive, which has traditionally been respon-

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<sup>8</sup> All the countries of the region which have appeared before the DSB as defendants (Venezuela, Chile, Peru and Costa Rica) have received favourable decisions. Brazil and Argentina are among the defendants in disputes which are still underway (Tussie and Vásquez, 1996).

sible for international economic negotiations. Deep integration calls for the growing participation of the other powers of the State: the Legislature, because of its responsibility for translating international rules into

national legislation, and the Judiciary, for settling possible differences between the powers and also between private individuals, as a result of the application of the new rules.

## V

### Final observations

The WTO calls for the fulfillment of various tasks at both the domestic and the external levels. At the domestic level, the challenge lies in changes in procedures, the growing need for information and the improvement of transparency. Sectoral agreements and agreements on specific issues involve the need for the notification of changes, for which the government authorities must be prepared. The WTO's Trade Policy Review Mechanism will also require the ongoing follow-up and periodic review of the trade policies in force.

This mechanism could be used to improve the interested parties' access to information at the national level and increase the transparency of trade policy. The need to centralize information could further the creation of a special body at the national level for monitoring trade policy. The function of this body would be to prepare and publish a regular report on the effects and incidence of the trade and investment policies adopted (Hoekman, 1995).<sup>9</sup> In this way, for example, efforts could be made to ensure that the subsidies granted do not give rise to a demand for countervailing measures, for which purpose it would be necessary to check their compatibility with the lists of permissible and actionable subsidies or, alternatively, ensure that subsidies remain within the *de minimis* provisions, both with regard to the value of the product and its share in the export market.

At the external level, the concept of graduation still remains to be defined and reformulated. The Uruguay Round agreements were excessively strict, with the establishment of a cutoff line for all countries with a per capita GDP over US\$ 1,000. The traditional bi-

nary division between developed and developing countries is undoubtedly already generally accepted, but the concept of infant industries remains in effect and the threat of precarious financial situations cannot be discounted. The establishment of a system of verification under the auspices of the WTO for the formulation of graduation criteria should therefore be proposed. It will be necessary to reach agreement on whether a country should be graduated with regard to all questions at the same time or, on the contrary, a step-by-step approach should be taken, proceeding issue by issue and sector by sector. It will also be necessary to agree on the authority which is to decide the point or moment at which a country "graduates" from special and differential treatment. It would be of benefit for the countries of the region if a system of supervision were established to ensure that the concessions and periods of transition granted by the agreements are not used to swing the balance in one or another direction at key moments in the negotiations.

In short, the discussions on international trade are tending towards the achievement of growing harmonization in the long term. It may be that they have been over-ambitious, however. In the short term, certain amounts of leeway have been retained in the domestic market. Although these degrees of freedom are no longer unlimited, as they were at the height of the era of special and differential treatment, they nevertheless exist and are by no means insignificant. This leeway is smaller, however, with regard to access to the international market than it is in the case of the domestic market. The *de minimis* provisions may initially serve to provide small exporters with greater leeway, but in the final analysis they may be an external constraint on export growth, especially in sectors of the international market which are sensitive or not very dynamic.

International undertakings form a frame of reference in which trade policies must operate. The WTO

<sup>9</sup> Mexico, for example, has already taken steps to consolidate its promotion policy by merging the Fund for Exports of Manufactures (FOMEX) with the Mexican Foreign Trade Institute (IMCE), under the National Foreign Trade Bank (BANCOMEXT).

still permits a significant degrees of discretionality, however. At its height, the concept of special and differential treatment provided ample leeway for import substitution policies, without necessarily being a determining factor either in their depth or their intensity, and the same is happening today with the WTO, which points the way for the process of greater trade openness but does not determine its intensity or rate. It should be noted that within the consolidated tariff levels there is still a by no means negligible amount of leeway for the effective protection of activities in line with each country's own priorities.

In terms of general market access strategy, it will be necessary to replace the traditional physical transfers with State support for activities which are marked by heavy externalities or generic activities which enjoy greater freedom from countervailing or anti-dumping measures. An example of this is the support that the State must provide so that the export sector can adapt to the standards and specifications of export

markets. With regard to access to international markets, contacts with associations of consumers, importers and intermediate users will give growing benefits, since the new system of applications for countervailing measures gives these groups the right to put forward their point of view. The countries of the region should establish joint information and liaison offices with those associations. In the future, these access management activities will bear increasing fruits, especially if they are carried out jointly by countries of the region with common interests. It should be borne in mind that the *de minimis* provisions are more restrictive for the developing countries as a whole than for the individual countries.

These broad parameters should shape the design of trade policies. Changes in production patterns will depend mainly on national-level policy options, together with the possible entrainment effect of the growth of international markets.

(Original: Spanish)

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# Trade and environment: *green light* or red light?

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One aspect of globalization that Latin American and Caribbean countries will have to confront is the increase in trade restrictions on environmental grounds. Not by chance, the first dispute judged by the new Appellate Body of the World Trade Organization that began to function in February 1996 was an environmental dispute involving the United States and Latin American countries. Two trends—more open economies and rapid growth in international trade, on the one hand, and, on the other, the broader acknowledgement of “environmental responsibilities” by the international community, as expressed in a number of new multilateral environmental agreements—have brought to the forefront two questions: are trade restrictions an effective instrument for implementing environmental policy? and to what extent are environmental restrictions changing international trade and competitiveness? Policy-makers are in fact replying to these questions in contradictory ways, as empirical studies to assess the impact of environment-related trade measures and trade-related environmental measures are only beginning.

# I

## The goal and the instrument: trade or environment?

The interaction between environmental policy and international trade has brought up two questions that policymakers have been facing and on which they have been taking decisions, without having the chance to wait for the answers that academics and their research might provide. One question starts with the environment, the other starts with trade:

1) Can environmental goals be reached through rules for international trade or, in other terms, are trade rules an adequate instrument for reaching environmental goals?

2) Are international trade flows and competitiveness being significantly changed by increasing environmental restrictions of diverse origin?

Those who reply to the first question with a decided "yes" in general hope to propagate and magnify "good care of the environment" through the progressive "greening" of international trade. Those who reply positively to the second question, in contrast, foresee increasing restrictions on international trade, coming from various sources, such as the environmental awareness of consumers in certain countries, trade clauses in international environmental agreements, campaigns driven by large international non-governmental organizations, interests of industries that have acquired a competitive edge in "environmental goods", or attempts by other industries or activities to take advantage of environmental arguments for protectionist purposes: in short, "red lights" in international trade, imposed on real or alleged environmental grounds. From the latter angle, the concern is no longer whether trade is a useful instrument of environmental policy, but "how to compete" given rising environmental requirements in international trade.

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These questions are not symmetrical. Even if one were to obtain ample evidence that trade bans and restrictions bear no relationship to their stated environmental goals—as seems to be the case, *inter alia*, with the relationship between elephant poaching and the ivory trade ban<sup>1</sup>—trade restrictions on environmental grounds could still be *de facto* influencing competitiveness and trade flows. Both are, in principle, empirical questions. A number of trade bans and restrictions have been established with environmental aims, and it should be possible to examine whether the particular environmental aim (to protect dolphins or marine turtles through a ban on the importation of tunafish or shrimp, or to reduce air pollution through a ban on the importation of a certain gasoline mix) was attained in each instance and whether that result was due to the use of the trade instrument in question and not to other causes. The attainment of a stated specific environmental goal does not necessarily mean, however, that such a result is the best for overall environmental prudence, since reduced exports and less development could well have had, in the end, a relatively larger negative impact on the environment. On the other hand, it is at least possible to estimate the impact of specific environmental measures on trade flows (the reduction achieved in a given country's exports of tuna fish, or gasoline, or ivory) and, in its turn, the consequences of that reduced trade for employment and the overall development of the country. Thus, in those cases where a trade measure was taken by a country in order to reach an environmental goal within that same country, the environmental benefit at one end can be compared with the reduction of exports at the other end and, further, with the impact of less exports on the country's development.

Formulating the questions in this way makes possible some assessment of the benefits and damages for the parties in a dispute, although only to a very limited

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<sup>1</sup> There is an amazing number of environmentalist studies showing that the ivory trade ban, even though it reduced international trade in ivory, has not helped the conservation of elephants. See Adams and McShane, 1992.

extent.<sup>2</sup> But even if we had many examples to add to this, this would of course not answer the “aggregate” question as to whether the international trading system or international trade is a cause of environmental deterioration, globally or in individual countries, as a few environmentalists continue to argue. As David Pearce, a leading environmental economist, has concluded, it is hard to demonstrate that the environmental degradation accompanying free trade is truly brought about by trade rather than some other factor, and that the loss of human well-being it represents is larger than the loss ensuing from less trade: “No-one has yet calculated the monetary value of the environmental losses from international trade. Environmentalists can thus argue that the losses are very large relative to the ‘gains from trade’. We simply do not know” (Pearce, 1994, p. 35).

Given the “state of the art” of the economic valuation of environmental goods and damages, it is not too far-fetched to posit that we will never know the exact figures in this comparison. Following this same line of reasoning, this would mean that there is no sound basis for the allegation that the present export-oriented development strategy of Latin America and the Caribbean is in general damaging the environment. Even though we can try and put numbers to the value of *n* turtles saved, as compared to the slower economic development of a country subject to a ban on its shrimp exports, the methodology available for such valuation

will never result in precise numbers and can only provide a range of estimates. Even so, the valuation is worth trying, and rough estimates of trade-offs are a less risky basis for policy-making than the presumption of some environmentalists that the value of something that cannot be measured exactly is therefore infinite.

After reviewing a considerable number of empirical studies, Markandya (1994, pp. 10-22) raises these same questions from a slightly different angle, namely, whether trade liberalization conflicts with “sustainable development” and whether policies aimed at “sustainable development” will restrict international trade. His conclusion is that “the evidence on both questions is mixed”, and that one way or the other it is not significant.<sup>3</sup>

At all events, policy-makers cannot afford to wait for all the measurements which should be attempted. In a sense, asking whether free trade is good or bad for the environment has as much concrete meaning as asking whether it would be better to live on Mars to protect the environment on Earth. Export-oriented development strategies and integration into the world economy are being pursued everywhere in the developed and, more dramatically, in the developing world, and it is hard to find anyone willing to reopen this debate in order to defend, on environmental grounds, the advantages and/or feasibility of inward-oriented development strategies.

## II

### The international context

The two questions on the interaction of trade and environment are actually being answered in a context where two main trends are at work: on the one side, globalization, which, even if it is not only economic, is driven by global economic integration and a rapid increase in international trade; on the other side, a broader acknowledgement of “environmental respon-

sibilities” of societies and governments and the recognition of the need for international cooperation to meet those responsibilities. Agenda 21: Programme of Action for Sustainable Development, and the Rio Declaration on Environment and Development,<sup>4</sup> as well as an increasing number of multilateral environmental agreements (MEAs), are as important benchmarks in

<sup>2</sup> No-one has ever calculated scientifically how much “sustainable development” was “lost” by Mexico, Venezuela and Colombia because of the tunafish embargo imposed by the U.S. since 1991, and how much “environmental protection” for the world’s dolphins was “gained” in exchange. How many of the 25,000 jobs in Mexican tuna production were lost or shifted to environmentally damaging activities? Some say that the only difference between the Asian Pacific and Indian Ocean tuna and the Latin American tuna that it replaced was that it was far away from the eyes of U.S. environmentalists.

<sup>3</sup> In his review, Markandya draws, among others, on case studies prepared in the framework of the UNCTAD/UNDP Research Programme on Trade and the Environment in which he participated. He is among those who have dismissed rather too easily the issue of the costs imposed on developing countries by new environmental restrictions in their export markets.

<sup>4</sup> Adopted at the United Nations Conference on Environment and Development, held at Rio de Janeiro in June 1992.

this context as the Final Act of the Uruguay Round approved in Marrakesh.

Since 1950 the volume of world merchandise trade has been growing faster than world output. It is true that during this period of over forty years the trade elasticity of world output has varied. It was very low between the mid-1970s and the mid-1980s, but has been much higher in the 1990s. In 1995 trade growth was almost three times as fast as output growth. Despite some narrowing of the difference, it still grew almost twice as fast as output in 1996, and the difference is expected to remain approximately the same in 1997.

These trends cannot be attributed only to the various GATT trade liberalization rounds that started in 1950 and culminated with the Uruguay Round. Other factors have been studied, such as technological changes that have reduced communication and transport costs, or the higher degree of industrialization that has brought product development, specialization and growing inter-industry trade. But the point to be emphasized here is that government policies have also played an important role, by liberalizing trade and building a rules-based system of international trade. Governments have taken part in eight GATT Rounds, and as a result the average import tariffs of industrial countries on manufactures have come down to less than 4% (ECLAC, 1996, p. 134). It is also true, however,

that the tariffs of the industrial countries on the products of greatest interest to developing countries (in particular textiles, leather and footwear, and agricultural products) are much higher – again as the result of policies and differences in bargaining power. Furthermore – and even more important for the subject under discussion here – non-tariff barriers and “grey area” measures (real or alleged environmental protection included) are nowadays at the core of development concerns and World Trade Organization activities (Agosin and Tussie, eds., 1993).

The Latin American and Caribbean countries not only reflect these trends, but also helped to define them. In the period immediately before the Uruguay Round, Latin American countries joined the GATT in growing numbers and virtually all are now members of the World Trade Organization. Latin American governments had a strong participation in the Uruguay Round, with a small but highly visible and skilled group of negotiators.<sup>5</sup> A complex web of subregional trade and economic integration agreements in Latin America and the Caribbean, and the major steps towards trade liberalization and integration being taken by the countries of MERCOSUR in South America, are further evidence of a very strong policy option in favour of trade liberalization and integration into the world economy.

### III

#### Trade as an instrument

The effectiveness of trade as an instrument of environmental policy is far from established.<sup>6</sup> Yet international trade is being increasingly used as an instrument of environmental policy, at different levels, unilaterally or multilaterally, sometimes on a voluntary basis, as with ecolabels or some of the clauses in multilateral environmental agreements (MEAs), but sometimes imposed on individual countries. It was no accident that the first case that the new WTO Appellate Body had to report on was a dispute over “environment and trade”. Venezuela, later joined by Brazil, had requested in 1995 the establishment of a WTO panel to examine their claim that United States rules for gasoline, following the rules established by the US Environmental Protection Agency to implement the US Clean Air Act, applied to imported gasoline standards that dif-

fered from those applied to the domestic product. The report of that panel, presented to the WTO Dispute Settlement Body in February 1996, in fact concluded that the US gasoline standards were not consistent with the internationally agreed trade rules, in that they violated Article III of GATT, the “national treatment” provision retained in the WTO agreements, which requires that goods imported from members must be treated no less favourably than the equivalent domestically-produced goods, in respect to all legislation.

<sup>5</sup> The names of the late Leopoldo Tettamanti from Argentina, Rubens Ricupero, Georges A. Maciel and the late Paulo Nogueira Batista from Brazil, Patricio Leiva from Chile, Felipe Jaramillo from Colombia, and Julio Lacarte from Uruguay, come easily to mind.

<sup>6</sup> For a thorough examination of the pros and cons, see Low, (ed.), 1992. See also Pearce, 1994, and Markandya, 1994.

Moreover, the panel considered that the U.S. gasoline standards under consideration could not be justified under the GATT Article XX exceptions admitted in paragraphs (b) (measures "necessary to protect human, animal or plant life or health"), (d) (measures to secure compliance with laws or regulations which are inconsistent with GATT agreements) and (g) (measures "relating to the conservation of exhaustible resources if such measures are made effective in conjunction with restrictions on domestic production or consumption"). The United States appealed to the WTO Appellate Body in the same month of February 1996, and almost one year later, in January 1997, the Appellate Body judged that in fact the US policy was incompatible with WTO rules in that it treated Venezuelan and Brazilian gasoline less favourably than domestic gasoline.

Strictly speaking, the gasoline dispute in the WTO was not an environmental case: the dispute was not over the environmental goals pursued by the country which discriminated against imports, and there was no discussion on whether those goals were being reached in the best way, or even whether they were being reached at all. The dispute was over the use of trade as an instrument to reach those goals. According to the report of the panel of experts, WTO members are free to set their own environmental objectives, but trade discrimination is not an accepted instrument for pursuing them.

Regional and subregional trade agreements in Latin America and the Caribbean have of late tended to include protocols regarding environmental aims to be pursued in their trade (or despite their trade), and some have even included negotiations aiming at, if not

harmonization, at least some degree of compatibilization of environmental rules and regulations of the partners in order to establish a fair basis for competition among their productive sectors. Here, the concern is to identify potential differences of interest and prevent future disputes.

Though unilateral trade actions with environmental purposes, or even environmental directives linked to regional integration schemes, may be the most publicized cases, especially when the parties involved make use of the dispute settlement mechanism of the World Trade Organization, a far more important area deserving study is the present or potential impact of trade clauses in a growing number of multilateral environmental agreements (MEAs). Some of these clauses are not compatible with WTO rules because they discriminate between countries, while some of them provide for protection of the environment in a country other than the one imposing the measure, thus constituting an "extraterritorial" dimension that is also incompatible with free trade principles. However, trade measures called for by multilateral environmental agreements derive legitimacy from their stated goal of protecting the "common heritage of humanity" and are less likely to be disputed in WTO than those adopted unilaterally and invoking domestic laws (such as the U.S. Clean Air Act, the U.S. Marine Mammal Protection Act, or U.S. federal turtle protection laws). A considerable body of multilateral environmental agreements has been built up in recent years, so that it will become harder to claim that unilateral action is justified because of the absence of multilateral rules.

## IV

### Trying to enforce multilateral environmental agreements

There are by now hundreds of multilateral environmental agreements (MEAs) of different geographical coverage—worldwide, regional or subregional—and addressing sometimes very specific problems. The United Nations Environment Programme (UNEP) maintains a register of such agreements (UNEP, 1996). Some of them have trade clauses which are supposed to help implement their environmental or "sustainable

development" goals, and some of them, without having specific trade clauses, could nevertheless affect trade flows. As these MEAs are relatively new, there is not much empirical investigation to assess whether they have (or could have) any significant impact on international trade. The most important of the MEAs with trade implications will be briefly examined, to illustrate some differences between the international

trade regime and environmental regimes.<sup>7</sup> This brief review of MEAs will lead us to a broad comparison of the international trade and environmental regimes.

### 1. Reducing hazardous wastes

Ultimately, the goal of the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal (1989) is to change patterns of consumption and production so as to minimize the hazardous wastes generated in production processes. To that end, it establishes a series of restrictions on their transport. The Convention has been ratified by 105 countries, including most of the Latin American and Caribbean nations.

The Convention allows the contracting parties to take drastic measures, such as to prohibit completely imports and exports of certain categories of wastes included in Annex I or approved as Annex I following recommendations of the Technical Working Group linked to the Convention. Besides the categories of wastes to be controlled, there are certain categories allowed in international trade under specific conditions, which include obtaining the "prior informed consent" (PIC procedure) of the importing country. Notification procedures have been established, and the parties must prohibit exports to a country that does not permit that specific import or a country which has not given consent in writing. For wastes characterized as hazardous according to the procedures of the Convention, movement between parties and non-parties is forbidden, except when there are bilateral and multilateral agreements that provide the same degree of environmental protection as the Convention.

The most recent development regarding transboundary movement of hazardous wastes is a consensus decision of the parties to the Convention to introduce an amendment that totally forbids developed countries (in effect, the OECD countries) to transport hazardous wastes for recycling in developing countries. Up to now, very few countries have ratified this amendment, which was supposed to come into force by January 1998. Governments were waiting for clarification from the Technical Working Group of the Convention regarding which materials for recycling were to be covered by the new amendment.

In February 1997 the Technical Working Group recommended new lists of wastes characterized as hazardous according to Article 1, paragraph 1a of the Convention (list A), of wastes not considered hazardous according to the same article (list B) (UNEP, 1997a), and of wastes to be placed on a list C (a sort of waiting list of residues to be considered for inclusion in A or B) (UNEP, 1997b). But of course these are only recommendations to the Conference of Parties to the Convention (COP).

There are other uncertainties, too. One refers to the WTO rules regarding trade in products to be recycled. And what happens when a country joins OECD? Does it lose the right to trade with its neighbours outside OECD and gain the right to trade with developed countries, which, according to the amendment, maintain their right to trade among themselves?

The Technical Working Group of the Convention had recommended at the end of 1995 that certain categories of waste to be recycled, consisting of metal and metal compounds in non-dispersible form, should be excluded from the restrictions as long as such waste was handled according to certain rules and it did not include wastes covered by the Convention or components that would render it hazardous. The recyclable wastes to be excluded were: precious metals (excluding mercury), iron and steel scrap, copper scrap, and a number of other types of metal scrap, including nickel, aluminium, zinc, tin, tungsten, molybdenum and manganese. This recommendation was confirmed at the last meeting of the Technical Working Group, in February 1997.

This discussion of the Technical Group illustrates one of the difficulties the Convention has to deal with, namely, the shadowy line between what is a product and what is waste. Another general difficulty is to reach agreement of what is "hazardous" and warrants inclusion in the list of "hazardous wastes" (UNEP, 1997b). In its Annex III, the Convention lists and defines "hazardous characteristics": explosive, flammable, liable to spontaneous combustion, poisonous, infectious, corrosive, toxic, ecotoxic, etc. But what is hazardous changes from one material to another. In each one it depends on the dose and on the corresponding response, on the time of exposure, and, in the case of composite materials, everything changes once more depending on the synergies involved. Most importantly, hazardousness depends on the existence (or inexistence) of adequate technology for handling and recycling and the capacity to manage "hazardous wastes" in an environmentally safe manner.

<sup>7</sup> The assistance provided by Carmen Artigas (Environment and Development Division, ECLAC) in the analysis of international environmental agreements is gratefully acknowledged.

If there is to be any hope of effective control of transboundary movements of hazardous wastes and avoidance of illegal transport, it will also be necessary to standardize nomenclatures. The nomenclature used in relation to the Basel Convention, based on the United Nations list of dangerous products, does not coincide either with the United Nations Standard International Trade Classification or with the Customs Cooperation Council's Nomenclature for the Classification of Goods in Customs Tariffs (the so-called Brussels Tariff Nomenclature used by trade authorities).<sup>8</sup> Effective implementation is further complicated by the multiplicity of "chemical safety" instruments, among them the International Code of Conduct on the Distribution and Use of Pesticides, of the United Nations Food and Agriculture Organization, or the London Guidelines for the Exchange of Information on Chemicals in International Trade, which seeks to ban or restrict certain chemicals and introduce PIC procedures for many others. Last but not least, lack of adequate technology and technical capacity, especially in the developing country signatories of the Convention, is a further impediment. As a capacity-building measure, the Latin American and Caribbean countries are at present considering the creation of a network of Regional Centres to provide training and technical support for national implementation of the Convention and for the transfer of technology for sound management of dangerous wastes (ECLAC, 1995).

Another problem related to the issue of hazardous wastes that the Basel Convention is trying to handle is the question of how to treat "domestically prohibited goods" in international trade. This is a broad category, covering in particular pharmaceuticals, consumer goods, chemical products, cosmetics and foodstuffs whose sale is not allowed on the domestic market, which have not obtained a legal permit for such sale, or whose permit is no longer valid. It may also cover machinery and equipment or inputs which are prohibited in the exporting country due to health or safety risks. Discussions on this issue continue in the Trade and Environment Committee of WTO.

<sup>8</sup> An illustration of these uncertainties is the case of some containers loaded with selenium which the Chilean health authorities considered to be hazardous waste (under the Convention that Chile has ratified) but which the Supreme Court of Chile in November 1994 declared to be a commercial product entering the country under valid rules ("Corporación Minera y Química Cormiquin SA con Servicio de Salud del Ambiente", Rol ingreso Corte 2552-94).

## 2. Biodiversity

Among the numerous agreements and consultation mechanisms and platforms regarding nature conservation, the Convention on International Trade of Endangered Species of Wild Fauna and Flora (CITES) is the oldest one using explicitly and mostly "trade related environmental measures" (TREMs). The CITES convention, which has 134 signatories, was adopted in Washington in 1973, and amended in 1979 and in 1983. It prohibits trade in species threatened with extinction and regulates trade in species that could become endangered, and its conference of the parties to the Convention (COP) regularly approves, by a two-thirds majority, scientific criteria, inclusions and exclusions in Appendix I, the list of all species threatened with extinction, in respect of which "particularly strict regulation" or trade bans are required, in Appendix II, the list of species not currently threatened with extinction, but whose survival justifies trade restrictions, and Appendix III, which covers other species needing the cooperation of the Parties. In order to implement the Convention, countries have to impose restrictions on imports or exports, depending on the geographical location of the fauna or flora in question.

Trade with countries that have not signed the Convention is in principle subject to the same rules as those applied to signatories. The European Union has in fact approved rules for the application of CITES in Europe that are more rigorous than the rules of the Convention itself and has included species not listed by it. An instrument which has aims related to CITES is a new Convention on Migratory Species, under the auspices of which some regional agreements have been adopted, as for example on the conservation of cetaceans of the Baltic and North Seas, of bats in Europe, and of African-Eurasian waterbirds. In these cases, however, there is less emphasis on trade measures.

The CITES Secretariat in Geneva monitors infractions and reports implementation problems to the COP. The IX COP, which met in Fort Lauderdale, U.S.A. in 1994, unanimously approved new criteria for the listing of endangered species and reviewed infractions, recent examples of which include the discovery of a crate containing a gorilla and a chimpanzee at the Kigali (Rwanda) airport, containers with ivory sculptures in Brussels, and the skin of a serpent in a postal packet sent from Argentina to Denmark (CITES, 1994). Animal protection gets a lot of publicity, and CITES has a glossy quarterly (*CITES/C&M International Maga-*

zine), but given the limited volume and nature of the trade covered, CITES is not at the core of the concerns on the compatibility between trade regimes and the environment.

Although it does not contain explicit trade clauses, the implementation of the Convention on Biological Diversity could have much greater importance in international trade. This Convention was presented for signature at the United Nations Conference on Environment and Development in 1992 and by now, with the notable exception of the United States, almost all countries have signed and/or ratified it: a total of 163 nations at the end of 1996, including most of the Latin American and Caribbean countries.

Its main goals are the conservation and sustainable use of biodiversity and the equitable distribution of the benefits thereof, or, as formulated in its article 1, "... the conservation of biological diversity, the sustainable use of its components and the fair and equitable sharing of the benefits arising out of the utilization of genetic resources, including by appropriate access to genetic resources and by appropriate transfer of relevant technologies, taking into account all rights over those resources and technologies, and by appropriate funding". To that end, the countries have agreed to a whole list of measures for in-situ and ex-situ conservation, for identifying and monitoring biodiversity, and for integrating biodiversity conservation and use into relevant sectoral policies and programmes.

The Convention considers the conservation of biodiversity to be "a common concern of humankind" but reaffirms national sovereignty of States over their biodiversity, and it operates at three levels: genes, species and ecosystems.

Under the Convention, each party promises to facilitate access to its genetic resources, "on mutually agreed terms" and subject to prior informed consent: the well-known PIC procedures of several other MEAs. An unresolved point of discussion is how to compensate developing countries for the global use of the biodiversity originating in their territory. For Latin America and the Caribbean, which are comparatively rich in biodiversity and are following a development path making intensive use of the export of natural resources, this is an important point. What is at stake here is the international use and pricing of biodiversity, which is known to be unevenly distributed worldwide and concentrated, at least at present, in the developing countries.

It has been claimed that biodiversity could become the new competitive advantage of developing countries (Feinsilver, 1996). That might depend on the

possibility of bargaining access to biodiversity resources against access to technology for their sustainable use (especially biotechnology). Since agreeing to the Convention on Biological Diversity, many developing countries have adopted regulations on access to and export of biological resources, in order not only to control them but also to capture the economic benefits thereof.

The most publicized practical experience is the 1991 agreement between Merck and the National Institute of Biodiversity of Costa Rica (INBio), for biodiversity prospection in Costa Rica and research on the possibility of obtaining and commercially exploiting pharmaceuticals based on the samples provided by INBio. INBio received initially one million U.S. dollars for identifying, collecting and extracting a number of plants and insects. The patents of invention deriving from these samples would belong to Merck, but INBio would have some rights in respect of the pharmaceutical products or agrochemicals produced on the basis of the samples provided.<sup>9</sup>

Another proposal that has been put forward is to study an acceptable international mechanism allowing countries that have biodiversity resources considered to be important for the rest of the world to charge for the "environmental services" provided to the other countries through that biodiversity (United Nations, 1997). Resources thus obtained could be used for the sustainable management of the biodiversity in question.

Other open questions related to the Convention are:

- i) "farmers rights", that is, rights stemming from past, present and future contributions by farmers in conserving, improving and making available plant genetic resources, which should guarantee them participation in the benefits resulting from plant breeding and other scientific methods applied to those resources;
- ii) access to *ex-situ* collections that did not result from decisions of the Convention;
- iii) how to face the possibility that new uniform plant varieties may displace the biodiversity of traditional varieties;
- iv) the impact of the agrochemicals which have made possible the expansion of agricultural production.

<sup>9</sup> Feinsilver (1996) gives an excellent analysis of Costa Rica's experience, of other cases of biodiversity prospection and the scientific and commercial use made of the samples obtained, and of the potential of such arrangements for developing countries.



the agrochemicals which have made possible the expansion of agricultural production.

Intellectual property issues loom large in the provisions on the transfer of technology (especially biotechnology), involving not only technology for the conservation and sustainable use of biodiversity, but also technology stemming from the use of genetic resources whose access is covered by the Convention. Compatibility with the intellectual property rules of the World Intellectual Property Organization (WIPO) and of the World Trade Organization (WTO) is an issue deserving examination. In principle, the WTO agreement on trade-related intellectual property rights does not prevent governments from limiting research on, and use of, technology, with the aim of protecting the environment. A registered patent guarantees that its owner can avoid its use by others (with exceptions), but does not guarantee to the owner the right to exploit the patent if it is found to be damaging or dangerous. Apart from biosafety issues, however, there is also the question of the appropriation of economic benefits through the commercial exploitation of patents of invention obtained on the basis of the biodiversity of countries that do not have the scientific and research capacity to exploit independently their own biodiversity.

### 3. Reducing global emissions of gases likely to increase the "greenhouse effect"

The latest MEA with trade implications is the 1994 United Nations Framework Convention on Climate Change. It too was opened for signature at the 1992 United Nations Conference on Environment and Development, and came into force in March 1994. By the end of 1996, it had 163 signatories. Its general objective is to protect the climate system against human-induced change, and for that purpose governments have committed themselves to a series of measures to obtain "stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. Such a level should be achieved within a timeframe sufficient to allow ecosystems to adapt naturally to climate change, to ensure that food production is not threatened and to enable economic development to proceed in a sustainable manner" (article 2). Moreover, "measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade" (article 3).

As in other major environmental conventions, this provides for a subsidiary scientific and technological advisory body to link the scientific assessments and information provided by competent international bodies with the policy-oriented needs of the conference of the parties to the convention. The relationship between that advisory body and the Intergovernmental Panel on Climate Change (IPCC) is unclear, but the IPCC confirmed, in its latest evaluation, the occurrence of global warming induced by human activities.<sup>10</sup>

The Framework Convention, like the first Conference of the Parties held in Berlin in 1995, insisted on "common but differentiated responsibilities", "respective capabilities" and "equity", for obvious reasons, as the main greenhouse emissions to be stabilized are carbon dioxide (CO<sub>2</sub>) emissions and their main sources are the energy and transport sectors. Most industrialized countries, including the European Union, Japan and the United States (the Annex I countries in the parlance of this Convention), had committed themselves to "the aim of returning individually or jointly to their 1990 levels of these anthropogenic emissions of carbon dioxide and other greenhouse gases" by the year 2000 (article 4). But these targets are not binding and by the first COP in Berlin in 1995, and again at the second COP in Geneva, in 1996, the specified time frames were being pushed further into the future.

Potentially, drastic measures on carbon dioxide emissions could affect international competitiveness and trade via the energy and transport sectors, as these sectors provide inputs to all production processes. However, despite highly respectable proponents (Cline, 1992) and a February 1997 call by 2,000 United States economists that included six Nobel laureates, an international carbon dioxide emission/energy use tax, that could affect trade in fuels, currently lacks the political support needed to turn it into a feasible proposition.

The international instrument being tried under the Framework Convention is "joint implementation", or "activities implemented jointly", now at a pilot stage, which could set the stage for the introduction of internationally tradeable emission certificates. At the origin of "joint implementation" was the idea that a country (branch of industry, company) could fulfil its

<sup>10</sup> At the last Conference of the Parties, in 1996, however, some parties disputed these conclusions, and there is no clear consensus among scientists, either, as is evident from Emsley, (ed.), 1996.

reduction obligations through a combination of internal reductions and external offsets (offsets meaning here emission reduction credits which, once formally certified, could be traded internationally).<sup>11</sup> This should act as an incentive for project sponsoring by industrialized countries and for the transfer of low-emission technologies to developing countries.

A number of "joint implementation" projects in the fields of energy efficiency, fuel switching, afforestation and reforestation are being planned or implemented in developing countries, especially in Latin America and the Caribbean (Belize, Costa Rica, Ecuador, Honduras, Mexico, Nicaragua), but in terms of the intended reduction in greenhouse gases emissions they are no more than a drop in the bucket (Zollinger and Dower, 1996). In this pilot stage, no system to give "emission reduction credits" to the sponsoring countries is in place. Before "credits" can be given and traded, a global verifiable limit to total emissions would have to be agreed upon, as well as a distribution of emission quotas in which richer countries and people would have to make (ecological) room for the poorer.

#### 4. Eliminating ozone-depleting substances

The 1985 Vienna Convention for the Protection of the Ozone Layer, its 1987 Montreal Protocol on Substances that Deplete the Ozone Layer, and subsequent adjustments aim at protecting the ozone layer and ultimately eliminating the production and consumption of substances that deplete it, starting with "precautionary measures to control equitably total global emissions of substances that deplete it"<sup>12</sup>, especially chlorofluorocarbons (CFCs). The Montreal Protocol, which now has 160 signatories,<sup>13</sup> envisages a gradual reduction in the production of controlled ozone-depleting substances—CFCs and a number of other substances—and developing countries that are below a certain level of production

of those substances have a ten-year phase-out period (which would be ending in 1999). The Protocol has linked to it a Technical and Economic Advisory Panel and a small multilateral trust fund, which has received about half a billion U.S. dollars since its establishment in 1991 and which provides concessional credits to help developing countries to cover costs linked to their implementation of the Protocol.

With regard to controlled ozone-depleting substances, the parties to the Protocol have agreed to ban imports from and exports to non-parties. This ban has been in place for CFCs and halons since the early 1990s, and despite the fact that it is not compatible with the non-discrimination principle in international trade, it has not been challenged in the WTO.

The industrialized countries are well on their way to the phase-out of CFCs and halons, and there is progress in other ozone-depleting substances as well. Under the Montreal Protocol, the industrialized countries were supposed to have banned halons by 1994 and CFCs and carbon tetrachloride by 1996. Those countries are to phase out methyl bromide by the year 2010, while the developing countries have agreed to freeze methyl bromide by the year 2002 at their average 1995-1998 levels. This must have been a hard decision, since this substance is used as a fumigant against pests in many export crops of developing countries. Exemptions will be permitted for certain trade-related applications (pre-shipment and quarantine) and for critical agricultural uses.

The United States has stopped producing CFCs for domestic consumption, except for a few essential uses, but it seems that this was essentially the result of domestic policy measures (Cook, 1996). There have also been advances in the developing countries, which are supposed to phase-out CFCs by the year 2010. No assessment has been made of whether trade bans played any important role in meeting the Montreal Protocol's phase-out requirements.

<sup>11</sup> See Simonis, 1996, p. 100.

<sup>12</sup> Preamble of the Montreal Protocol. Besides chlorofluorocarbons (CFCs) and halons, the Protocol and its amendments cover other controlled substances such as carbon tetrachloride, methyl chloroform, and methyl bromide. Hydrochlorofluorocarbons are classified as transitional substances, to which

less tight schedules apply. Products can be added as their ozone-depleting potential is established.

<sup>13</sup> Amendments to the Montreal Protocol were approved at subsequent COPs. As of the end of 1996, the 1990 London Amendment had been ratified by 111 countries, and the 1992 Copenhagen Amendment, by 62.

## V

# Comparing global environmental regimes and the international trade regime

Global environmental regimes and the international trade regime are different: they have different goals, different structures, and operate according to different principles, with different institutions and different instruments. One cannot be translated into the other.

Compared to the international trade regime, environmental regimes are far more complicated. The trade regime is based on a coherent theory showing that trade improves the well-being of exporters and importers alike. By contrast, environmental regimes, in particular the main MEAs ratified in connection with Agenda 21, promote "sustainable development": a vague concept for which there is broad political support but for which there is no formal definition within any given theoretical framework. The multiple definitions which exist are essentially variants of the original formula of the Brundtland Commission: "Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (World Commission on Environment and Development, 1987, p. 43).

There is more or less general consensus on the nexus between economic activity and the natural environment, and about the inseparable components of development: economic growth or selective growth of production, social development (focussed in developing countries on the fight against poverty and on equity), and environmental sustainability requiring conservation and a fair distribution of the use of ecological resources. Much has been said about these interlinkages, which were already stressed by Gro Harlem Brundtland in March 1987 in her "Chairman's Foreword" to the report of the independent commission established by the Secretary-General of the United Nations in late 1983 (World Commission on Environment and Development, 1987, pp. ix-xv). International organizations, in particular the United Nations, necessarily subscribe to "sustainable development" in the approach arising from the 1992 United Nations Conference on Environment and Development. But one does not have to probe too deeply to recognize the difficulties of the concept.

Sustainability of what?<sup>14</sup> Which should come first: human beings or the ecosystem? There is a whole gradation between anthropocentric and ecocentric approaches, for global as well as for local problems. Then there is the factor of scientific optimism or pessimism, as manifested in the assumptions on substitutability between natural resources themselves and between man-made and natural capital (both depending on technological advances).

Sustainability where? Different environmental problems have different geographic coverage. The damage seldom hits exactly where it originates. And geography also matters in the impact of policies.<sup>15</sup> How should we deal with common and shared resources? How should we distribute geographically those famous "common but differentiated responsibilities" of Principle 7 of the Rio Declaration? How should we establish the overall level of protection or use of the ecological environment and the division of the quotas for access and use of it?

Sustainability when? Improving the well-being of present generations without risking the ability of future generations to do the same is the broad consensus definition. But how much risk is acceptable in the assessment of intergenerational equity? And there is always the question of scientific uncertainty and sustainability. In the presence of uncertainty, what level

<sup>14</sup> Prof. Opschoor, Rector of the Institute of Social Studies of The Hague, who certainly cannot be accused of not being an environmentalist, gave a wonderful lecture on the fuzziness of the concept when answering the questions of what, where, when, and how much risk (Opschoor, 1996). I have drawn on his remarks.

<sup>15</sup> In terms of a formal model of natural resource extraction and use, assuming two countries—a home country and a foreign country—and adopting a "weak sustainability" concept, i.e., allowing for substitution between man-made and natural capital, Klepper and Staehler (1996) have shown that the unilateral introduction of "sustainability rules" in the home country leads to greater unsustainability in other countries. It should be noted that the "sustainability rules" used in the model are "exhaustible resources extraction rules" and that the model assumes perfectly competitive markets (and thus no interference in trade). Unless unsustainability abroad is no problem, the results of the model imply a condemnation of unilateral rules within one country for the protection of the environment.

of risk is acceptable? How dangerous is it, for instance, that the deadlines for greenhouse gases emission reductions are being postponed? What exactly are the deadlines that should be established for each programme of action dealing with environmental problems? And finally, linked to all the previous questions, how are we to measure "environmental capital" or "environmental services" and sustainability or the lack of it?

The old trade issues and the measurement of trade flows, by comparison, look simple. The system of rules for international trade has been built up over more than 50 years, based on the principles of non-discrimination, reciprocity and national treatment. In contrast, the principles and most of the existing rules for international environmental management and "sustainable development" are relatively new and are yet to become legally binding. And while the Uruguay Round negotiations strengthened the international trade disputes settlement machinery, there is no unified mechanism for settling disputes related to environmental damage and its mitigation.

It is true that over the years the coverage of the international trade regime has expanded and, besides trade in goods, has come to include services, trade-related investment measures and trade-related intellectual property rights. Environmental regimes, however—and in particular Agenda 21—might cover in principle anything under the sun. There is a vast range of environmental issues, even if we take account only of those with transnational implications: transboundary air and water contamination, sanitary standards for food trade, toxic chemicals, hazardous waste, ozone depletion, marine contamination from land-based sources, pollution from ships, overfishing, endangered species, loss of biological diversity, soil erosion, desertification, deforestation, climate change, and so on and so forth. Each of them involves a variety of domestic institutions, various levels of appropriate government action (from communal to international), quite a lot of jurisdictional overlaps and conflicts, and diverse international organizations. Moreover, each of these issues relates to different economic activities and interests, and does not affect all socio-economic groups and strata in the same way.

This number of issues is matched by an even larger number of instruments used to achieve results: voluntary agreements between governments and industries, regulations establishing emission standards, product standards, process standards, requirements for environmental assessment, monitoring and reporting, and rules for testing, packaging and labelling.

To these we must add the now rather fashionable emerging "economic instruments": taxes of various kinds (earmarked or not for environmental expenditures), pollution charges, deposit refund schemes, "green protocols" for credit (linking credit to environmental impact assessments), subsidies (given or eliminated), waste fees and levies, ecolabels in marketing, liability instruments, and tradeable permits (relating to the use of certain resources or to the emission of specific substances).

Then, there is the role of natural sciences. The trade regime deals only with economic relations and is not concerned with natural phenomena. MEAs are radically different. Even if they try to deal with social and economic relations, they only do so insofar as these relations result in changes in nature, diagnosed as damage. Although the impact of environmental degradation can often be perceived even without scientific preparation, natural scientists (including health specialists) have identified most environmental phenomena and are monitoring them closely.

It is not by chance that almost every one of the MEAs has attached to it a scientific body, to assess chemical, physical or meteorological processes, to classify toxic and hazardous products and wastes, and so on. Nevertheless, sometimes parties to the conventions ignore or even dispute the scientific advice of such panels.

To deal with scientific uncertainty, international environmental regimes are built on the precautionary principle, according to which "where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation" (as formulated in Principle 15 of the Rio Declaration on Environment and Development, 1992). The reference to "cost-effective measures" is a reminder that the precautionary approach is insufficient alone to guide decisions, and that the value of avoiding environmental damage cannot be assumed to be infinite. As environmental damage and policies to prevent it usually have "winners" and "losers", there will be no easy consensus about cost-effective measures. This is true at both the local and the international level.

This wide variety of trends has necessarily had to be embodied in the system of multilateral environmental negotiations. As a result, for now, enforcement and dispute settlement mechanisms in MEAs are extremely weak. Emphasis is given to voluntary commit-

ments and the exchange of information, as well as to procedural responses in domestic policies, such as the approval of "national strategies" in response to international environmental agreements. In fact, trade measures are about the only coercive instrument in MEAs.<sup>16</sup>

The growing number and variety of multilateral environmental agreements which exist, together with their rapid evolution through new protocols and amendments, is creating a web of ever more complex international environmental regimes. In the absence of international enforcement procedures and incentives, many countries—in particular developing countries, Latin America and the Caribbean included—have yet to build the institutions and technical capacity required for implementing and monitoring the agreements which they have been signing.

Given the linkages between the environmental issues MEAs are trying to address, compatibility between different environmental agreements, and especially coordination of the international and domestic institutions dealing with their implementation is assuming increasing importance in the international agenda. The United Nations Environment Programme (UNEP) provides administrative backstopping to various of the MEA secretariats, and while these tend to strive for more autonomy, UNEP has been calling for increased coordination among them. A more radical proposal has been that of creating a Global Environ-

mental Organization, or GEO, to pull together the multitude of international institutions that currently influence environmental policy, such as UNEP, the Global Environmental Facility, the secretariats of the various MEAs, and a host of other bodies. The original proponent of this approach, Daniel Esty, a senior official of the United States Environmental Protection Agency (EPA) has not suggested practical steps for putting together in one institution the responsibility for all global environmental negotiations, but he has argued that an institutional counterweight to WTO is needed (Esty, 1994).

Trade policy and environmental policy do interact in ways that are not yet well-known and sometimes at cross-purposes. As WTO Director-General Renato Ruggiero has summed up in very cautious terms "it is possible to envisage circumstances in which trade, unsupported by sound environmental policy, could involve damage to the environment—or, on the contrary, circumstances in which environmental regulations could harm legitimate trade" (Ruggiero, 1995). In each of these circumstances: which one should be adjusted? Policy-oriented research should give rational answers to this question. In pondering it, it would be wrong to forget that differences in levels of development and well-being among countries go together with differences in international bargaining power and in environmental priorities.

(Original: English)

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<sup>16</sup> For a very illuminating comparison between international environmental and trade regimes, see Von Moltke, 1996.

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# Nominal anchors and *macroeconomic* coordination *options in MERCOSUR*

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This study deals with the question of macroeconomic coordination in the context of MERCOSUR, analysing the contribution that different types of nominal anchors (monetary and exchange-rate) could make to the achievement of convergence of nominal indicators and sustained economic growth. The possible gains in terms of well-being associated with policy coordination are explored, in order to permit a rational evaluation of proposals for greater monetary coordination. An analysis is made of the problem of selecting the nominal anchor most suitable for serving as the basis for cooperative agreements, in an economy affected by real and monetary disturbances. In view of the structural differences that exist among the economies that make up MERCOSUR, it is concluded that a flexible form of macroeconomic coordination is needed in this regional bloc. Special attention is given, in the context of a centre-periphery monetary coordination model, to the problems of sustainability of an asymmetrical-type monetary coordination mechanism based on use of the exchange rate as a nominal anchor. A proposal is then set forth for a sustainable form of macroeconomic coordination under a flexible exchange-rate agreement based on a system of ranges of fluctuation backed up by nominal convergence criteria, structural reforms designed to make markets more flexible, and possible moderate controls on capital movements. The study ends with some considerations on the design of a strategy for the gradual abandonment by Argentina of the quasi currency board mechanism, in order to permit overall macroeconomic coordination in MERCOSUR.

# I

## Introduction

The consolidation of MERCOSUR as a viable economic integration project is increasingly highlighting the need to put into effect a well-designed programme of macro-economic coordination among the countries making up this regional bloc.<sup>1</sup> The Argentina economy, which was one of the most tightly closed economies in the world at the time of signing of the Treaty of Asunción, was the economy which subsequently registered the most significant progress in the process of opening up of trade to the exterior. A quick look at the details of this regional bloc's external trade shows that it still offers very large possibilities for intra-regional trade.<sup>2</sup> Although the smaller countries in MERCOSUR display heavy trade dependence on their larger partners, Argentina and Brazil have an explicit vocation for global trade.<sup>3</sup> The present strategy of external openness, which seems to serve the interests of all the parties in the trade agreement, is based on two main elements.

Firstly, the extension of MERCOSUR to other Latin American countries (as for example through the signing of complementation agreements aimed at creating a free trade area in the Southern Cone of Latin America which will be in full operation in the course of the next decade),<sup>4</sup> and secondly, the establishment of trade liberalization agreements with the European Union (like that signed in December 1995) and with the North American Free Trade Area (NAFTA) (developing the 4+1 Agreement signed with the United States in June 1991): that is to say, with groups of countries which represent MERCOSUR's main trading partners.

The establishment of the Customs Union on 1 January 1995 (whose list of exemptions left the capital goods, information technology and telecommunications sectors outside the common external tariff)<sup>5</sup> and the advances made in the establishment of a basic system of legal rules for MERCOSUR mark the end of

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<sup>1</sup> The dynamism of MERCOSUR is evidenced by the fact that trade among the countries in this regional bloc doubled in less than four years after the signing of the Treaty of Asunción in March 1991. Thus, MERCOSUR intra-regional trade increased from US\$ 3,639 million in 1990 to almost US\$ 13 billion in 1995. From 1992 onward, Argentina became the second most important market for Brazil after the United States, absorbing almost 9% of Brazilian exports in 1995. In turn, Brazil is the main purchaser of Argentine manufactures and primary products of agricultural origin. In the period 1991-1995, Brazil built up a trade surplus of some US\$ 4.8 billion with the rest of its partners in MERCOSUR, in spite of the significant deficits registered with Argentina in 1991 and 1995.

<sup>2</sup> The degree of openness of the Argentine economy rose from only 7% in 1991 to over 17% in 1995. Over the same period, the degree of openness of Brazil remained steady at around 15%, that of Uruguay fluctuated between 40% and 45%, while Paraguay continued to be the most open economy in the group, with an average index of nearly 80%. Approximately 30% of the total trade of the MERCOSUR countries is with the European Union, 20% with North America, and 12% with East Asia. Intra-regional trade is still below 20%, while trade with the rest of the Latin American countries accounts for only 10% of the total.

<sup>3</sup> Whereas in the case of Argentina this vocation is very recent and still not fully consolidated, Brazilian trade policy has been consciously guided by this principle for several decades past. At present,

Brazil directs around 30% of its exports to the European Union, while the United States absorbs a further 20-25% (the same as Latin America). Another important market is that of East Asia, to which Brazil directs between 15% and 20% of its total exports. This tradition may have favoured the interest in open regionalism that MERCOSUR seems to be displaying at present. In the case of Uruguay, almost 40% of its exports and 50% of its imports are with MERCOSUR, while Paraguay directs 45% of its exports to MERCOSUR and obtains 40% of its imports from its partners in that bloc.

<sup>4</sup> This is the case, for example, of the agreements signed with Chile and Bolivia and the summit meeting held in the Argentine city of San Luis on 25 June 1996. The expanded MERCOSUR has an overall GDP of over US\$ 900 billion and a potential market of over 200 million consumers, which makes it one of the biggest trade and financial areas in the world. In the near future, similar agreements could be reached with other Latin American countries (with rates of integration that take account of each country's special features). These initiatives represent MERCOSUR's concrete contribution to the achievement of a hemispheric free trade area, as proposed at the Miami summit meeting in December 1994.

<sup>5</sup> The goods subject to the common external tariff account for almost 85% of the total. Intra-regional trade in these goods is free of all tariff barriers. Capital goods are to converge towards a common external tariff of 14% by 1 January 2001 in the cases of Argentina and Brazil; Uruguay and Paraguay have five years longer to adapt their tariffs to the common external tariff by gradually increasing them. For the information technology and telecommunications sectors, the four countries are to establish a common external tariff of 16% by 1 January 2006. Finally, other goods such as sugar and textile products are subject to special trade regimes.



a first cycle in the process of incorporation of the member economies into the world market. The general objective of the next phase is the effective consolidation of the integration process, for which purpose it will be necessary to make great progress in i) deepening the process of external openness, ii) developing MERCOSUR as a strategic project aimed at changing production patterns and securing competitive linkages with the global economy (which will call for major progress in the coordination of microeconomic policies), and iii) effective and sustained coordination of macroeconomic policies. These three areas are clearly interdependent, so that failure in any one of them would impede achievement of the other objectives.

## II

### Gains in well-being through macroeconomic coordination

Without needing to resort to mercantilist theories (which do not take account of the negative externalities for the rest of the world when evaluating the effects of national policies on well-being, and which view international economic relations as a non-cooperative zero-sum game), there is nevertheless undoubtedly some economic justification for applying independent economic policies at the national level. Thus, in an economy fraught with nominal rigidities and uneven access to information, for example, the non-neutrality of short-term money makes an independent monetary policy an essential element of stabilization policies. Having acknowledged the possible existence of incentives for adopting non-cooperative forms of behaviour, however, it is necessary to consider in what circumstances macroeconomic cooperation would be desirable and at what level it should be carried out, and to identify the fundamental obstacles preventing cooperative agreement from being reached and maintained in time within a regional bloc which, like MERCOSUR, aims to become something more than a mere preferential agreement.

The economic justification for forming a true domestic market at the regional level lies fundamentally in the existence of public or collective goods—including the objectives of stabilization, income distribution and establishment of a suitable regulatory environ-

Microeconomic and macroeconomic policy coordination could be a powerful stimulus for growth in so far as it makes it easier to deepen the economic openness process and sustain it in time. The greater economic interdependence brought about by the preferential trade agreements will tend to strengthen the existence of significant externalities which will mean that independent decisions by each government in a large number of areas will be second-best solutions. Macroeconomic policy coordination would make it possible to avoid (or at least reduce) the distortions associated with the discretionary design by each country of its own monetary and fiscal policies for achieving independent national objectives in terms of domestic or external equilibrium.

ment—and the differences at the national level in the preferences regarding those goods (Whitman, 1977, p. 3). In this context, economic policy coordination would involve a significant change in national policies in response to a situation of international economic interdependence which makes the independent adoption of decisions by governments inefficient, because of the existence of externalities and international public goods.<sup>6</sup> The fact that the exchange rate represents a link of contact between economies (as well as its specific nature of a shared instrument) could explain the importance assumed in practice by exchange agreements involving the creation or expansion of currency areas. Market integration—the formation of an internal market or the establishment of an integrated economy—is achieved when (leaving aside transport costs) each type of product or factor of production is sold at a single price. The gains in efficiency associated with an integrated economy increase in

<sup>6</sup> See, in this respect, Crockett, 1989, p. 345. Peace, international cooperation, freedom to sail the seas, international courts of justice, the free-trade system, an international monetary system, the international financial system, and systems of weights and measures—including the keyboards and compatible operating systems of computers, mathematical theorems and reserve currencies—are everyday examples of international public goods.

proportion to the size of the internal market: from the point of view of international trade in goods and factors of production, the optimum economic area is the world, and any interference with the price formation mechanism (except for interventions aimed at eliminating market flaws) will represent a source of inefficiency in resource allocation. This result is not exactly reflected in the question of currency areas, however.<sup>7</sup>

Let us consider, by way of illustration, two countries whose monetary authorities try to minimize a loss function (defined conventionally in terms of objectives of inflation and unemployment) and are operating in the framework of a small open economy in which the prices of domestically produced goods are given in the short term. Explicit consideration of the well-being functions is necessary when the economic policy pursues more than one objective and when—as often happens—a given policy has positive effects on some objectives and negative effects on others. This conflict between objectives lies at the root of the problem of economic policy coordination.

In order to simplify the exposition, let us assume that there is perfect symmetry between the structures of the two countries, that capital mobility is perfect, and that the expectations regarding exchange-rate variation are static, while the fiscal variables are rigid in the short term, so that the repercussions of economic policies on the other country take place exclusively through variations in the level of the exchange rate. The Appendix at the end of this article describes the structure of the economy—equations [A.1] to [A.6]—and develops the essential features of the model.<sup>8</sup> Let us also assume now that the two countries are affected by a similar price disturbance which causes their infla-

tion rates to increase by the same amount. Within the context of our model, monetary policy can only influence the rate of inflation through the exchange rate, so that this instrument becomes the intermediate objective of anti-inflation policy in both countries. The non-cooperative Cournot-Nash solution is determined on the assumption that the monetary authorities of each country take the monetary policy decisions aimed at minimizing their loss function—described in equation [A.12]—on the supposition that the monetary policy of the other country is given (i.e., treating the money stock of the other country as a parameter).

The non-cooperative game must necessarily be settled with excessive monetary contraction in both countries. The main results are described in expressions [A.15] to [A.19]. Both monetary authorities compete to enhance their anti-inflation reputation (and the credibility of their monetary policy) by implementing contractionary monetary policies. But the monetary contraction does not succeed in modifying the short-term equilibrium rate of inflation of either country, since the Central Banks of both of them try to modify the same nominal variable in opposite directions, each offsetting the initial achievements of their rival through their intervention. The lack of coordination of monetary policies has negative real consequences for both countries: the policy of competitive currency appreciations will end up in an increase in real interest rates and a drop in production below the desired level in each country.<sup>9</sup>

These real costs can be avoided through a cooperative agreement between the two monetary authorities. The cooperative result is equivalent to that achieved when a joint monetary committee solves the problem of global optimization described in equation

<sup>7</sup> The theory of optimum currency areas suggests that, in proportion as the size of the currency area increases, so too do the gains deriving from exchange stability, although at a decreasing rate. At the same time, expanding the currency area increases the probability that there will be a larger number of asymmetrical disturbances and, consequently, the probability that losses of well-being will be increasingly frequent. Consequently, the optimum currency area is not the world: it is therefore possible to put forward an economic justification for the maintenance of a certain degree of what has wrongly been called—making ill use of a jargon with manifestly mercantilist overtones—monetary sovereignty.

<sup>8</sup> The studies by Hamada (1976 and 1979) are the basic reference material for analysis of the coordination problems that arise in the framework of different exchange-rate regimes. For an excellent introduction to the general problems of macroeconomic coordination, with application to the case of MERCOSUR, see the studies by Heyman and Navajas (1992) and Ferrer and Lavagna (1992).

<sup>9</sup> In order to simplify the exposition, in the Appendix we refrain from analysing the solution corresponding to the Stackelberg-Nash non-cooperative equilibrium. The Stackelberg-Nash solution means that the rate of variation of the exchange rate is different from zero, so that the interest rate arbitrage condition ( $i=i^*$ ) must be revised and the model solved under the new conditions. In this case, the leader uses the information available on the other country (materialized in his reaction function) in order to over-expand  $m$ , since he knows (in the light of the information provided by the reaction function of the follower) that the authorities of the other country will attempt to appreciate their currency through monetary contraction. Thus, the behaviour of the government which exercises the leadership position could make it possible to limit the global contraction suffered in the Cournot-Nash equilibrium.

[A.20]. In view of the conflict between the objectives of the two countries, the monetary committee will refrain from using the exchange rate as an intermediate objective of their anti-inflation policy. In effect, the resulting equilibrium means that the governments agree to accept the initial inflation rate and concentrate their efforts on reducing the variation in production around the full employment equilibrium (equations [A.21] and [A.22]), since in this case  $m = m^* = q = q^* = p_0$ . In the context of this static (single-period) game, the well-being achieved under the cooperative equilibrium is clearly greater than that obtained in the case of the Cournot-Nash equilibrium: the rate of inflation is similar in both cases, but the deviation of production is minimized (equal to zero) in the cooperative solution. In contrast, the non-cooperative Cournot-Nash equilibrium means that  $m = m^* < q = q^* = p_0$ , opening up the possibility of a gradual reduction in the inflation rate of the monetary area (if the adjustment costs are accepted).<sup>10</sup>

The initial cooperative agreement does not suffice of itself to change the structure of the economy (by making wages more flexible and reducing the degree

of wage indexing) enough to facilitate the process of reduction of inflation. If the monetary authorities persist in their desire to reduce the rate of inflation of both countries over time, it would be necessary to supplement the cooperative agreement—within the context of an essentially dynamic game—with additional nominal convergence criteria, since in our model the cooperation takes the form of an express agreement to maintain the initial inflation rate. It must also be borne in mind that nominal convergence is a necessary but not of itself sufficient condition for attaining real convergence. Macroeconomic coordination must therefore be strengthened by the application of structural reforms aimed at making markets more flexible (especially in the services sector and the labour market). In the final analysis, a satisfactory monetary agreement cannot be defined solely in terms of rules governing the exchange rate: the instruments used for maintaining the exchange commitment have repercussions both on the well-being of each country and on the stability of the system. Consequently, mere fixing of the exchange rate does not solve the general problem of the external effects.<sup>11</sup>

### III

## Macroeconomic coordination formulas

When authorities decide to cooperate by modifying their economic policies in a mutually beneficial manner in the light of the interdependence which exists between them, they must first of all agree how far the cooperation will extend. Absolute coordination would cover all levels of macroeconomic policy (including final objectives and the monetary, fiscal and other instruments available to each government). Coordination

must necessarily be based on the establishment of commitments for future economic policy actions, which leads us to pose two unavoidable questions: i) do governments have so much capacity to enter into un-

<sup>10</sup> This reduction in inflation depends on factors which are not specified in the simplified model but basically link the reduction in the product with the reduction in inflation rates. In order to analyse this question briefly, let us consider an expansion of the structure of the model by the incorporation of a price equation  $p = w$ , obtained on the assumption that companies determine their prices by establishing a margin over their mean variable costs, and a wage equation,  $w = \delta q + \phi y$  (where  $w$  represents the growth rate of wages, the parameter  $\delta$  reflects the degree of wage indexing, and the parameter  $\phi$  reflects the degree of wage flexibility of the economy). By substituting the wage equation in the price equation, we obtain the following expression,  $p = \delta q + \phi y$ , so that, in a dynamic context, temporary reduction of the product makes possible a decline in inflation in the long term.

<sup>11</sup> In similar conceptual environments Krugman (1990) and McKibbin and Sachs (1991) show that the comparison between cooperative and non-cooperative equilibrium, in terms of the resulting long-term gains in well-being, depends essentially on the objectives of governments and of those fixing wages, as well as the interactions between the two. Following the same line, Oudiz and Sachs (1986) point out that, in general, international coordination is less desirable in dynamic models than in static single-period models. These authors give an example which shows that cooperation may also be preferable in a dynamic context, because it makes it possible to eliminate the inconsistency over time which is typical of monetary policies in a non-cooperative regime, but this result is achieved on the assumption that the authorities have absolute capacity for entering into undertakings regarding future policy actions. The relative efficiency of non-cooperative solutions compared with the imposition of nominal convergence criteria aimed at controlling inflation within the context of a cooperative solution promoted by an exchange-rate agreement is an ambiguous question which depends on the conceptual context in which the analysis is carried out.

dertakings that they can guarantee consistent behaviour over time?, and ii) do governments have sufficient control capacity to modify the instruments used when this is necessary for preserving the cooperative agreement? The answer is obviously negative in both cases (even in an economic and monetary union, in view of the difficulties in coordinating fiscal policies). Consequently, macroeconomic coordination must necessarily be only partial, limited generally to aspects regarding the relative positions of the countries. This helps to explain the importance usually given to the balance of payments and the exchange rate in the theory and practice of such coordination.

The fact that the macroeconomic coordination is only partial means that some objectives are fixed independently (discretionally, or in line with domestic rules) and that some instruments will remain outside the negotiations. In practice, however, the degrees of freedom enjoyed by the authorities may be much less than the relativity of the agreements might suggest. Intertemporal restrictions create indissoluble links between monetary and fiscal policies, so that it is often necessary to establish a minimum degree of fiscal coordination (through convergence programmes that limit budget deficits, for example) in order to make the monetary coordination effective. Furthermore, the crucial problem of the consistency of policies over time suggests the need to supplement cooperation with broad institutional reforms in order to ensure the sustainability of the agreements.<sup>12</sup>

Inevitably, cooperation agreements take place in a climate of uncertainty. In these circumstances, the gains in well-being expected from the agreement may turn out to be losses of well-being when the programme has been executed, thus weakening the incentives for the governments to cooperate. This uncertainty stems from the existence of errors of information and from outside disturbances which affect the system, but there is also uncertainty with respect to the quality of the models used for the analysis, the real preferences (objectives and priorities) of the authorities, and the sustainability of the agreements. Macroeconomic coordination may be particularly beneficial in conditions of uncertainty (it

may reduce policy errors) if the cooperation makes it possible to internalize the effects and spread the risks among the participating countries instead of encouraging them to shift these problems to competitors.<sup>13</sup>

In its minimum expression, policy coordination means the exchange of information between the parties; the next level consists of negotiating the type of rules that the authorities undertake to follow; and finally, the authorities can adopt an agreement involving all aspects of common policy. Whatever the level of cooperation, in a dynamic context it is essential to put the reputation of the authorities on a sound basis in order to give the agreements credibility. The strategy adopted for placing the reputation on such a basis determines the effects of the policy on the level of well-being: the model in the previous section provides an example of how non-cooperative actions by each government to improve their reputation through the common instrument (the exchange rate) may end up by producing a net loss of well-being. This is probably one of the results most clearly established in the literature on macroeconomic coordination. Such coordination is often based on the selection of at least one intermediate target variable whose regulation will permit control of the final objectives (represented by goals in the areas of inflation and growth). In this context, it would be appropriate to define a nominal anchor as a nominal variable which the government decides to convert into the intermediate objective of the policy. Naturally, the prime condition for the policy to be effective is that it shall be aimed at the achievement of objectives which are within its reach. If the government (whether acting independently or within the context of a cooperative agreement) seeks to fix a real variable (such as the unemployment rate, the interest rate or the real exchange rate) at a level out of keeping with the market, it will not only fail to achieve its objectives but will inevitably lead the economy into a vicious circle which will end in an inflationary spiral.

The role of nominal anchor may be played either by monetary variables or by the exchange rate.<sup>14</sup> The use of a monetary anchor means that monetary policy

<sup>12</sup> For example, a country could make the obligation to maintain a balanced budget part of the Constitution, prohibiting the monetization of deficits in any circumstances and giving the Central Bank an independent status which makes it totally impervious to monetary policy decisions on budget imbalances.

<sup>13</sup> Empirical estimates of the gains in well-being from macroeconomic coordination vary widely because of differences in the reference models, in the objective functions used and in the assumptions on the credibility of policies. For a recent analysis of the literature on this question, see Currie, 1993.

<sup>14</sup> For a more detailed analysis of the role of the exchange rate as a nominal anchor, see the studies by Giovannini (1988), Quirk (1996) and Rodríguez Prada (1996).

fixes the price of a good or group of goods in terms of the country's currency (the most notable example of this is the Gold Standard), or, alternatively, that the intermediate objective of the monetary policy is the rate of change of a nominal value (the price level, a particular monetary aggregate, or nominal income). There are also many varieties of the use of the ex-

change rate as a nominal anchor: the monetary authorities can fix the level or rate of variation of the price of a country's currency in terms of a foreign reference currency, or they can establish a range of fluctuation around a fixed central parity, or they can intervene more or less frequently in currency markets to control the evolution of the exchange rate.<sup>15</sup>

## IV

### Selection of the nominal anchor

Selection of the nominal anchor which is to serve as the basis for macroeconomic coordination is a very complex process affected by such factors as the transparency of the nominal variable selected, the monetary authorities' capacity to control it, or the stability of the ratio between real income and the nominal variable which is to act as an intermediate objective. The nature of the disturbances affecting the system is also of crucial importance for determining the relatively optimum nature of a cooperative agreement. Adjusting an economy affected by a real disturbance of an asymmetrical nature requires a change in the relative prices of the goods and factors of the country with respect to the rest of the world, whatever the exchange-rate regime in force. If the structure of the economy gives rise to the non-neutrality of short-term money, making the nominal exchange rate more flexible will allow the necessary adjustments to take place more rapidly and with lower adjustment costs. If, in contrast, the disturbances are mostly of a nominal nature (for example, intense financial disturbances which cause erratic shifts in the demand for money), then flexibility of the nominal

exchange rate will give rise to excessive and unnecessary adjustments in relative prices, with potentially serious real adjustment costs.<sup>16</sup>

Exchange-rate flexibility will be desirable when asymmetrical real disturbances, whether transitory or permanent, predominate in each country. Asynchronous changes in the economic cycle are a good example of asymmetrical real disturbances of a transitory nature. Let us suppose, for example, that Brazil suffers a serious recession. The reduction in the level of production will give rise to an excess supply of money (as a result of the decline in demand for real balances) which will bring down interest rates, giving rise to an interest rate differential which is unfavourable to Brazil and will cause an incipient flow of capital abroad. If it were not tied by the exchange rate, the Real would go down enough to give rise to expectations of appreciation strong enough to restore arbitrage in international financial markets. Over time, the depreciation of the Real would have an automatic stabilizing function on the economy, by stimulating the production of tradeable goods and increasing aggregate demand through the growth of net exports.

Even if the asymmetrical real disturbance were of a permanent nature, the adjustment in the exchange rate could bring great benefits. Let us suppose, for example, that the Brazilian economy suffers from a structural crisis reflected in a decline in the industrial backbone on which the country has pinned its faith. Once again, with constant monetary rules, the gradual reduction in competitiveness would eventually bring about a reduction in real interest rates which would be

<sup>15</sup> On the other hand, the balance of payments can take the place of the exchange rate as the intermediate objective of economic policy, and the conflict between objectives may surge up again violently in a fixed-exchange-rate regime. Thus, for example, if each country has its own independent objective for the current account balance, the fixed-exchange-rate system would be bound—in the absence of sufficient fiscal or monetary correction—to suffer continual deflationary pressures, without achieving the individual objectives of attaining a current account surplus. In an alternative scenario, in which the countries are indifferent to the effects of their policies on their current account balances, they would tend to implement fiscal or monetary policies which would be too expansionary and would result in excessive current deficits.

<sup>16</sup> These results were obtained from a simple extrapolation (to the case of an open economy) of the classic study by Poole, 1970.

reflected in a decline in the opportunity cost of investments and in long-term indebtedness. The resulting interest rate differential would be a first incentive for a shift in international investment towards Brazil which would relieve the burden of the efforts to carry out the necessary industrial retooling.

In such an adverse situation of industrial crisis, however, perhaps more would be needed than the cheapening of credit in order to stimulate investment. It would also be necessary to generate a decline in the relative price of real Brazilian assets (especially capital goods, real estate and land) sufficiently great to attract the necessary foreign direct investment. It may be asked whether, in such a context, exchange-rate flexibility could make a useful contribution. With fixed exchange rates, the adjustment in relative prices would necessarily have to be effected through a drop in the nominal prices of these real assets. A significant reduction in the national currency value of real Brazilian assets, however, would bring down the value of the guarantees backing the credit provided by the financial system, thus endangering the solvency of financial institutions and, if the crisis were sufficiently serious, giving rise to intervention by the Central Bank as lender of last resort.

The depreciation of the Real would greatly facilitate the adjustment in these circumstances, since the necessary reduction in real terms in the prices of assets would be achieved largely through adjustment of the exchange rate. After this depreciation, the dollar prices of Brazilian assets would suffer a relatively severe fall, but their value in Reales would remain practically unchanged. In contrast, with a fixed exchange rate Brazil would need to resort to drastic deflation to bring about the same decline in the dollar prices of its assets. The foregoing analysis assumes that in the short term the purchasing power parity hypothesis is not satisfied, so that the variations in the nominal exchange rate are reflected, at least for several months, in the real ex-

change rate. In a situation of economic recession, this is usually the case.<sup>17</sup>

At the same time, it must be borne in mind that, as the experience of Argentina shows (even in countries starting out from a situation of hyperinflation and affected by a high degree of dollarization), fixing the exchange rate does not immediately bring with it the fixing of the general price index.<sup>18</sup> Even if the country succeeds in bringing inflation back to stable rates perfectly comparable with those existing in industrialized countries within a period of two or three years, the real appreciation in the currency can quickly give rise to big deficits on the external accounts.<sup>19</sup> In fact, the use of an exchange anchor in a context of free capital movements can give rise to quite intensive episodes of inflation. This phenomenon is due to the difficulty of applying an effective policy of sterilization of reserves in order to offset the expansionary effect exerted on the monetary figures by the capital flows attracted by the more stable environment created by the greater credibility of monetary policy. Sterilization of the reserves means increasing interest rates, which will give a fresh impulse to the inflow of capital, thus making monetary control more difficult.<sup>20</sup>

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<sup>17</sup> The nominal and real depreciations undergone, for example, by the pound sterling, the lira and the peseta after the crisis in the European Monetary System (EMS) in September 1992 are eloquent examples in this respect, especially bearing in mind that the downward convergence of inflation rates (especially in the non-tradeable goods sector) speeded up precisely after the devaluations.

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<sup>18</sup> In Argentina, cumulative inflation during the two years following the introduction of the Convertibility Plan (from April 1991 to May 1993), as measured by the consumer price index, increased by 46%, while in Brazil, in the two years following the introduction of the Plano Real (from July 1994 to June 1996), the cumulative increase in consumer prices was around 55%. For a brief analysis of the problems associated with stabilization after hyperinflation, with abundant references to Latin America, see Heyman (1992).

<sup>19</sup> For example, in 1996 Brazil had a trade deficit of some US\$ 5.5 billion (an unprecedented figure), while its current account deficit was over US\$ 24 billion (3.3% of GDP). Projections made at the beginning of 1997 estimated that in that year the trade deficit would be brought down to around US\$ 8 billion.

<sup>20</sup> By way of illustration, Estonia suffered from a transitory increase in the rate of inflation shortly after a drastic monetary reform (after leaving the rouble area and changing its Central Bank into a quasi currency board), and Egypt suffered from heavy inflationary pressures after the Gulf War.

## V

### Forms of macroeconomic coordination which could be applied in MERCOSUR

The economies making up MERCOSUR are too different from each other to make it feasible to practice strict coordination of their macroeconomic policies (the problem would be even greater in the case of a MERCOSUR expanded to include Chile and Bolivia). The optimum dimension of a regional bloc is that which ensures the optimum provision of public and collective goods, including the objectives of stabilization, income distribution and the legal and institutional environment (Cooper, 1976). Any project for coordinating economic policies in MERCOSUR must take account of the structural and institutional features of the regional bloc. The existence of unequal features which it would be very difficult to reverse in the short term (such as market size, level of industrialization, degree of openness, per capita income, degree of dollarization, etc.) prompts an instinctive rejection of excessively homogeneous solutions.<sup>21</sup>

Borrowing the Ricardian distinction between domestic trade and foreign trade (perfect mobility of factors within each country and total absence of such mobility between countries), Mundell (1961) showed that in an optimum monetary area the existence of a high degree of mobility of the factors of production (or the existence of sufficient wage flexibility) takes the place of exchange-rate variations as an adjustment instrument. The discontinuity in the degree of mobility of labour (not explained by Ricardo or by Mundell) could be partly attributed to language and cultural differences between societies (as well as to transport costs). In MERCOSUR, which is still at only an incipient phase of integration, the necessary intra-regional mobility of the factors of production is still very limited. Moreover, the degree of openness, average size and degree of diversification of the MERCOSUR economies

<sup>21</sup> In Argentina, over half the deposits in the financial system are denominated in dollars. Dollarization is difficult to reverse and seems to increase even in a context of apparent nominal convergence (a good example is the case of Bolivia, which has a degree of dollarization of the financial system of nearly 90% after more than a decade of macroeconomic stability).

does not allow occasional use of the exchange rate to be ruled out for restoring lost competitiveness.<sup>22</sup>

If the internal disturbances suffered by the regional bloc are relatively small compared with the external ones, the optimum policy would be to: i) promote the separation of risks by trying to isolate the region from the outside world through the application of trade barriers and exchange controls, and ii) strengthen the domestic market by adopting a common currency for the regional bloc. If the internal and external disturbances are of a similar magnitude but are not very closely correlated, the optimum policy would be to spread the risks through the economic and monetary integration of both sides. Finally, if the disturbances affecting the different regions of the monetary area have similar effects, the appropriate monetary policy would be the same in each region and nothing would be gained through greater flexibility of exchange rates. Many of the disturbances are specific (idiosyncratic) to each country, however, and even those of common origin will generally have asymmetrical effects because they affect different economic structures. If the disturbances are mostly of an asymmetrical nature, fixing exchange rates would mean making what would probably be a very great sacrifice by failing to apply a potentially beneficial monetary policy.<sup>23</sup> All in all, the

<sup>22</sup> As the degree of openness increases, flexibility of the exchange rate becomes less effective as a means of adjusting the current account balance to real disturbances in demand, since the variations in the nominal exchange rate will be transferred more rapidly to the prices of goods, thus limiting the adjustment of the real exchange rate (McKinnon, 1963). On the other hand, a high degree of diversification makes it less necessary to adjust the exchange rate to absorb specific disturbances in a sector of production (Kenen, 1969).

<sup>23</sup> Feldstein (1992), for example, has criticized the objective of European monetary union, claiming that the present European Union is not an optimum monetary area because the mobility of labour is only limited and the existence of asymmetrical disturbances continues to make exchange-rate adjustment necessary. For a different point of view which is radically in favour of monetary union, see Buitier (1995), who considers that the degree of real convergence is irrelevant for monetary union in as much as market rigidities (for example, wage rigidities) cannot be relieved by exchange-rate flexibility or monetary independence.

differences in the underlying economic structures of the countries making up MERCOSUR increase the probability that idiosyncratic disturbances will prevail and that disturbances will have asymmetrical effects even if they are of common origin.

In the specific case of MERCOSUR, the disturbances are asymmetrically distributed and the rates of adjustment vary from one country to another, making necessary occasional modification of the exchange-rate to reduce the cost of the adjustment process. Bayoumi and Eichengreen (1994) have shown that the exchange-rate tensions between Argentina and Brazil reflect the existence of differential demand disturbances and that the speed of adjustment of the production system to the disturbances is lower in the Brazilian economy, so that a monetary policy aimed specifically at stabilizing the bilateral exchange rate would tend to aggravate the costs of the adjustment. This result is further confirmed by the fact that disturbances of supply are only feebly correlated among the MERCOSUR countries (especially in the case of Uruguay and Paraguay).<sup>24</sup> Moreover, the supply disturbances in the case of Argentina and Chile are inversely correlated with those of the United States. This result makes it even more difficult to justify the long-term maintenance of a fixed exchange rate between the peso and the dollar and suggests the desirability of introducing a relatively more flexible exchange-rate system.

The establishment of an exchange-rate range represents an alternative (and provides an exit strategy in the context of a cooperative agreement) to the use of the exchange rate as a nominal anchor. A mechanism with predetermined ranges of fluctuation represents a non-linear compromise between a system of fixed exchange rates and a system of flexible rates. Basically, it consists of an exchange-rate regime which

makes it possible to take advantage of the leeway provided by freely fluctuating exchange rates, without sacrificing the monetary policy coordination provided by a system of fixed exchange rates.<sup>25</sup> In these models, the anticipation that there will be defensive interventions when the exchange rate hits the limits of the range gives rise to substantial non-linearities which are reflected in the curve of the typical trajectory—an S-shaped curve—followed by the exchange rate within the range. The essential feature is the stabilizing nature of the system (so that changes in the fundamental macroeconomic variables have less effect on the exchange rate in a system of ranges of variation than in a system of fully flexible rates).

The difficulties in calculating the equilibrium exchange rate themselves represent an additional argument in favour of a system of ranges of fluctuation. The central parity can be periodically revised with the aim of avoiding prolonged departure from the long-term equilibrium exchange rate.<sup>26</sup> If the agents have full confidence in the government's capacity to keep the exchange rate within the range, this type of exchange-rate mechanism has clear stabilizing properties. In a situation of uncertainty, however, when the probability that there may be a realignment exceeds a certain level, the stabilizing properties of the range are abruptly changed and the mechanism of ranges of fluctuation becomes intrinsically unstable, encouraging speculative attacks. Generally speaking, in a climate of uncertainty an increase in the frequency of exchange-rate realignments and in the width of the range increases the risks run by speculators and consequently helps to restore the credibility of the exchange-rate mechanism.

<sup>24</sup> The same study shows that NAFTA does not display suitable conditions for unification of the exchange rate either, since there is a significant inverse correlation between the supply disturbances of the United States and those of Canada and Mexico. Furthermore, the demand disturbances affecting the United States and Mexico display a strong negative correlation, whereas the correlation between the United States and Canada is very slightly positive.

<sup>25</sup> The seminal model developed by Krugman (1988) showed in a very elegant manner the way this exchange-rate system could stabilize the nominal exchange rate within a given range, thereby rationalizing the use of exchange-rate mechanisms such as that employed in the European Monetary System. This model is based on a simple monetary model for determining the exchange rate which involves a number of extremely restrictive assumptions: complete flexibility of prices; perfect credibility of the range; defence of the range through infinitesimal marginal interventions, and a specification of the macroeconomic bases which is excessively simple, but technically useful for finding an explicit solution to the model.

<sup>26</sup> Williamson and Miller (1987) coined the term "target zone" to denote a mechanism of ranges of fluctuation defined around the real exchange rate which they considered should serve as the basis for macroeconomic coordination among the countries of the Group of Seven.



# VI

## A centre-periphery monetary coordination model

As may be deduced from the analysis made in the previous section, even a summary examination of the characteristics of MERCOSUR is enough to reject out of hand the idea of basing macroeconomic coordination among that bloc's member countries on a strict system of fixed exchange rates. It must be acknowledged, however, that institutional factors heighten the role of the U.S. dollar in all the MERCOSUR economies, and especially in Argentina, where the April 1991 Convertibility Act (Law No. 23.928) turned the Central Bank into a quasi currency board (which backs the monetary base with convertible currencies and accepts unrestricted convertibility of the national currency with the external reference currency) and fixed an exchange rate of one peso per U.S. dollar.<sup>27</sup> At the same time, the fears of the repercussions of a change of system on the financial markets has given rise to the perception in broad sectors of Argentine society that the costs of abandoning the convertibility system would be very high. As Brazil has also adopted for some time past an inflation reduction policy based on the use of the exchange rate as a nominal anchor,<sup>28</sup> it would be interesting to look at the basic properties (and limitations) of a macroeconomic coordination mechanism using a centre-periphery monetary coordi-

nation model based on the dollar. The model also helps to rationalize the customary perception that the peripheral countries are natural followers.

The conventional argument justifying the use of an exchange-rate anchor is that the monetary institutions of what we will call the periphery lack the necessary anti-inflation reputation, thus obliging the government to "borrow" an external monetary anchor by fixing the exchange rate in terms of it. In fact, however, fixing the exchange rate in an environment marked by high capital mobility deprives the monetary authorities of the periphery of the capacity to follow an independent monetary policy, so that they automatically "inherit" the monetary policy of the centre. The model used here is centered exclusively on the monetary sector. The variables corresponding to the centre are shown with an asterisk and the equations of both countries have a symmetrical structure (the equations corresponding to the centre are omitted to begin with in order to simplify the notation). The following equations describe the monetary market of the periphery:<sup>29</sup>

$$M = -n i + \mu \quad [1]$$

$$M = CI + R \quad [2]$$

$$CI = D - f \cdot R, \quad 0 \leq f \leq 1 \quad [3]$$

<sup>27</sup> For recent economic analyses of the functioning of quasi currency boards which take account of the Argentine experience, see the studies by Connolly (1995), Judy (1995), Williamson (1995), Zarazaga (1995) and Rodríguez Prada (1994, 1995 and 1996).

<sup>28</sup> Since the introduction of the Plano Real, Brazil has also been using an exchange rate range implicitly based on the dollar. The second phase of the Brazilian monetary reform programme (preceded by the application of a fiscal adjustment policy) consisted of the introduction in March 1994 of a Real Unit of Value (URV, in Portuguese) pegged to the dollar, to serve as a unit of account and reference for all contracts; its objective was to radically reduce inertial inflation in an economy which, thanks to massive indexation, had got used to living with hyperinflation without resorting to dollarization. On 1 July 1995 the URV acquired the properties of a unit of account, means of payment and value deposit, becoming the Real and thus completing the monetary reform process. For a recent assessment of the Plano Real, see Sachs and Zini (1996).

<sup>29</sup> The demand for money –equation [1]– depends on the interest rate  $i$  and (with unit elasticity) an exogenous disturbance  $\mu$  of the velocity. To simplify matters, let us suppose that the elasticity of money demand with respect to the interest rate is the same in both countries ( $n = n^*$ ). Equation [2] shows the composition of the money stock  $M$ , made up of domestic credit  $CI$  and the foreign exchange reserves  $R$ . Maintaining monetary control may require the sterilization of the reserves: the Central Bank may sterilize the effect (on the money stock) of its intervention in the foreign exchange markets by simultaneously intervening in the domestic money market. Thus, for example, at the same time that they purchase foreign currency on the foreign exchange market, the monetary authorities may carry out an open-market operation consisting of the sale of bonds in order to reduce domestic credit. Equation [3] reflects the sterilization rule followed by the monetary authorities:  $D$  is the autonomous (exogenous) component of domestic credit, while the parameter  $f$  is the coefficient of sterilization.

In conditions of perfect capital mobility, the condition for interest rate arbitrage (portfolio equilibrium) is

$$i = i^* + \lambda \quad [4]$$

where  $\lambda$  represents the existence of an exogenous disturbance affecting the portfolio preferences of wealth-holders. In order to close the model, it is necessary to specify the rule governing intervention in the foreign exchange market:

$$\theta = R/(R - R^*) \quad 0 \leq \theta \leq 1 \quad [5]$$

The solution of the model gives the following equations, in reduced form:

$$\begin{aligned} M &= (1 - \varepsilon)D + \varepsilon \cdot D^* + \varepsilon \cdot \omega \\ M^* &= (1 - \varepsilon)D + \varepsilon \cdot D^* - (1 - \varepsilon) \omega \\ i &= \rho + \varepsilon \cdot \lambda \\ i^* &= \rho - (1 - \varepsilon) \lambda \end{aligned}$$

where

$$\begin{aligned} \omega &= [(\mu - \mu^*) \cdot n \cdot \lambda] \\ \rho &= -(1/n)[(1 - \varepsilon)(D - \mu) + \varepsilon(D^* - \mu^*)] \\ \varepsilon &= \theta(1 - f) / [\theta(1 - f) + (1 - \theta)(1 - f^*)] \end{aligned}$$

The centre exercises the effective leadership of the system either by carrying out complete sterilization of the reserves in order to control its money supply (in which case  $f^* = 1$  and  $\theta > 0$ , so that  $M^* = D^*$ ) or, alternatively, by refraining from intervening in the foreign exchange market (in which case  $\theta = 1$  and  $f < 1$ ). This asymmetrical behaviour means that:<sup>30</sup>

$$\begin{aligned} \varepsilon &= 1 \\ i &= -(1/n)(D^* - \mu^*) + \lambda \\ i^* &= -(1/n)(D^* - \mu^*) \end{aligned}$$

<sup>30</sup> In the case of a symmetrical system,  $f = f^* < 1$ ,  $\theta = 1/2$  and  $\varepsilon = \theta = 1/2$ . In a symmetrical system, each Central Bank has a domestic objective (such as the interest rate) and an external objective (such as the exchange rate or the level of the reserves). Both countries coordinate their monetary policies, so that the stock of money of the monetary area is not affected by the disturbances  $\{\mu, \mu^*, \lambda\}$  that afflict the economy.

Consequently, the interest rates in the centre are affected exclusively by the conditions of its own money market, so that international portfolio disturbances (produced by changes in risk premiums or expectations of variations in the exchange rate) are reflected exclusively in the interest rates of the periphery, which has to bear the entire burden of the costs of the adjustment process. The inherent asymmetry of this monetary coordination mechanism creates insuperable difficulties for ensuring the long-term survival of the agreement.

So far, we have assumed that the central motive of the periphery for using an exchange rate anchor is its attempt to "import credibility" from the centre. Exactly the same result is obtained if the centre is directly characterized as the issuer of the reserve currency. The behaviour of the periphery could be due, however, to the existence of strict constraints on financing a balance of payments deficit. In order to illustrate this case, let us assume now that—for example, as a result of real disturbances affecting the periphery—there is a skewed (asymmetrical) distribution of portfolio disturbances which shifts preferences towards the currency of the centre: if we reinterpret  $\mu$  and  $\mu^*$  as real disturbances (for example, a fiscal disturbance) which affect the demand for money, then  $\lambda = \lambda(\mu)$  and  $\lambda'(\mu) = \partial \lambda / \partial \mu > 0$ . The effect of an increase in  $\mu$  on the reserves of the periphery is equal to

$$\partial R / \partial \mu = [\varepsilon / (1 - f)] \cdot [1 - n (\partial \lambda / \partial \mu)] \quad [6]$$

Expansion of demand would give rise to an incipient increase in domestic interest rates which stimulates the inflow of capital and leads to a rise in the reserves (this explains the first term of the above expression). At the same time, the increase induced in  $\lambda$  raises the yield of assets denominated in the currency of the centre, causing an outflow of capital and a fall in the reserves (this explains the second term of equation 6). If the second effect exceeds that of the first, so that  $\partial \lambda / \partial \mu > 1/n$ , the net effect will be a reduction in the reserves. In this case, since  $\varepsilon / (1 - f) = \theta / [\theta(1 - f) + (1 - \theta)(1 - f^*)]$ , equation [6] also shows that, for a given intervention rule,  $\theta > 0$ , an attempt by the periphery to sterilize the reduction in reserves (by an increase in domestic credit) would increase the rate of decline of the reserves. The reduction in the reserves is minimized by making  $f = 0$ . Consequently, in the presence of sufficiently strong asymmetrical disturbances and limited reserves, the periphery will tend to behave as a natural follower. This behaviour does not, however,

guarantee the convergence of the economic cycles of the centre and the periphery, thus introducing further complications for the sustainability of this model.<sup>31</sup>

A further very important problem concerns the difficulties in equitably sharing the adjustment costs of a selective devaluation on the periphery when there are structural imbalances or differences among the peripheral countries. This problem would arise, for example, if there was a real disturbance in the centre which was

serious, but not serious enough to justify a devaluation in the periphery as a whole. In the absence of fiscal mechanisms which make it possible to compensate the countries with the biggest adjustment costs, it would be very difficult to coordinate the devaluation, and this would impede the necessary adjustment in the exchange rate and create favourable conditions for a real appreciation which would make the cooperative agreement unsustainable.<sup>32</sup>

## VII

### A proposed form of macroeconomic coordination in MERCOSUR

The clear bid for stability which has guided economic policy in MERCOSUR in recent years is already producing a certain degree of coordination which could greatly facilitate an exchange rate agreement in the current circumstances. Thus, before the application of the Plano Real by Brazil, the main problem for macroeconomic coordination was the different rates of macroeconomic stabilization within the regional bloc. The fact that it has been necessary in the immediate past to use the exchange rate as a nominal anchor cannot obscure the fact that the MERCOSUR economies are faced with the need to make far-reaching structural changes which could be facilitated by a sufficient degree of exchange rate flexibility. At the same time, there can be no doubt that excessive exchange rate fluctuation could harm trade and investment, thus weakening the construction of the MERCOSUR internal market and jeopardizing the sustainability of the process of greater openness. The adoption of a well-designed and internally consistent exchange rate agreement, based on a system of ranges of variation of the exchange rate, could make possible the effective,

flexible and sustainable coordination of the MERCOSUR countries' macroeconomic policies.<sup>33</sup> Macroeconomic coordination should simultaneously forestall the possibility of prolonged departures of the real exchange rate from its long-term equilibrium value and the danger that the exchange rate might be used arbitrarily to obtain advantages for one country at the expense of its partners (for example, by adopting policies of competitive disinflation or devaluation).

In my opinion, an exchange-rate agreement organized on the bases set forth below would make it possible to define a monetary system which is comparatively satisfactory for the whole area and could also give Argentina the cover needed to find a non-traumatic way out of the quasi currency board system while preserving the achievements made in terms of price stability:

i) Firstly, Argentina and Brazil would agree to take part, within a reasonable length of time, in an exchange rate and intervention mechanism based on the establishment of a range of fluctuation about a central parity, and would also undertake to defend it actively. The exchange rate for each currency would be freely determined, within the range, on the foreign

<sup>31</sup> For example, the fact that the economic cycles of Hong Kong (whose monetary system is based on a currency board mechanism, with an exchange rate linked to the U.S. dollar) and the United States are not synchronous created serious difficulties for Hong Kong in the 1989-1992 period. The fall in United States interest rates took place at a time when the economy of Hong Kong was expanding strongly. Inflationary pressures and the fall in nominal interest rates led to negative real interest rates. The resulting shift of portfolios—from debt paper to stocks and real assets—led in 1993 to an increase of 116% in share prices and 70% in real estate prices.

<sup>32</sup> Buiter, Corsetti and Pesenti (1995) show that in such a situation the global loss of well-being would be partly relieved by returning to a Nash equilibrium.

<sup>33</sup> The problems relating to ways of securing the greater flexibility of the quasi currency board system needed for the implementation of this exchange rate agreement are briefly analysed in the following section.

exchange market.<sup>34</sup> In addition, temporary increases in the range could be negotiated in special circumstances, in order to discourage speculative attacks on the currencies in the system. Suitable financial mechanisms would gradually be promoted for facilitating joint intervention in foreign exchange markets. The Argentine-Brazilian exchange rate agreement would be open for the voluntary participation of Paraguay, Uruguay, and countries in the MERCOSUR regional environment that have preferential relations with that bloc, such as Bolivia and Chile. The participation of other countries would initially be on the basis of exchange-rate ranges of different widths, until nominal convergence of the different economies makes it possible to unify the exchange rate mechanism.

ii) The central parity of each currency, with respect to which the ranges of variation are fixed, would be calculated daily on the basis of a basket of currencies that reflects the overall characteristics of the regional bloc's international trade, consisting tentatively of the U.S. dollar (40%), the Euro (40%) and the Yen (20%). The central parity of each currency with respect to the reference basket could be periodically modified in order to avoid prolonged departures from the long-term equilibrium real exchange rate.

iii) Realignments of parities would be effected subject to the prior agreement of a supranational monetary committee made up largely of truly independent experts but partly also of representatives of the Central Banks of the MERCOSUR countries; this committee would be responsible for preventing undue use of devaluations by the member countries. Within the context of a target zone, regulation of real balances by discreet interventions within the limits of the established ranges (together with rules on the realignment of nominal exchange rates) could be very useful for supplementing infinitesimal marginal interventions to defend the ranges. The powers

of the joint monetary committee should therefore include the capacity to promote interventions within the established ranges and, above all, to promote changes in member countries' exchange rates if it comes to the conclusion that their central parity is not in keeping with the basic macroeconomic values. This procedure would make it possible to enhance the credibility of exchange policy and reduce the danger of speculative attacks aimed at correcting the exchange rate's deviation from its long-term equilibrium level. In the course of time, the agreement could be supplemented with a system of transfers to provide a compensation mechanism for achieving more equitable distribution of the adjustment costs involved in a selective devaluation.

iv) The relatively broad width of the permissible range of fluctuation and the exchange rate agreement's orientation towards the maintenance in the medium term of the real equilibrium exchange rate deprive the exchange rate of its capacity to act as a nominal anchor. Consequently, in order for the exchange rate mechanism to be consistent with the control of inflation within MERCOSUR, it would be necessary first of all to supplement the exchange rate agreement with nominal convergence standards (especially in fiscal matters) which would ensure the maintenance of price stability and budgetary discipline (with strict limits on Central Bank loans to their governments and on the monetization of public deficits). Next, it would be necessary to carry out the urgent structural reforms needed to make markets more flexible (especially in the case of services and some subsectors of the labour market) and prevent the reintroduction of means of indexing contracts. If the convergence standards are not fulfilled within a reasonable time and the structural reforms are not carried out in sufficient depth, countries could yield to the temptation to resort to competitive disinflation policies, which would mean the abandonment of the cooperative agreement.

v) The biggest difficulties standing in the way of greater trade openness of the developing countries in the current situation of financial globalization stem from the risks associated with unlimited financial openness. With regard to the possibilities of achieving effective macroeconomic coordination, there can be no doubt that convergence in policy execution and orientation has been increasingly hindered by the globalization and growing sophistication of financial markets. Although freedom of international capital movements decisively aids proper resource allocation at the world level, the potential instability of capital

<sup>34</sup> In order for this exchange rate commitment to be sustainable, the governments must comply with two basic rules of behaviour: i) they must refrain from defending any exchange rate which is clearly out of line with the equilibrium rate, and ii) they must refrain from any realignments of parities which exceed the limits of the ranges. In view of the foregoing, the width of the range (around the central parity) should not be less than 10%. In the case of the EMS, for example, the expansion of the range of fluctuation in August 1993 from  $\pm 2.25\%$  to  $\pm 15\%$  went a long way towards restoring the credibility of the EMS and put an end to speculative attacks on the weakest currencies in the System. For an analysis of the main problems concerning the proper functioning of a system of target zones, see Williamson (1993).

flows can cause grave distortions in the financial systems of developing countries and lead to excessive fluctuations in exchange rates and monetary variables. Moderate restrictions on capital movements can effectively help to stabilize the exchange rate within the established range of variation, because capital controls strengthen the weight of expectations in determining

the exchange rate, thereby increasing the stabilizing capacity of the range.<sup>35</sup> The recent experience of various developing countries (such as Chile, Colombia and Malaysia) shows that systematic but gradual financial openness eliminates unnecessary risks associated with speculative capital whose contribution to economic growth is only marginal.<sup>36</sup>

## VIII

### Final considerations

The use of excessively rigid nominal anchors results in serious and inevitable inconsistencies between the aims of monetary policy and the evolution of the basic macroeconomic variables. Furthermore, the recurrent replacement of one nominal anchor with another shows that when a government adopts a nominal anchor whose stabilization is left to monetary policy, the defence of that nominal variable is not really the main objective of economic policy.<sup>37</sup> Sometimes, however, the sustained application of a monetary rule ceases to be an example of governmental virtue (in the sense of the continuity of policies in time) and becomes instead an example of stubborn persistence in error.<sup>38</sup> Notwithstanding the undoubted achievements of MERCOSUR in matters of price stability, and while fully acknowledging the services rendered to the anchoring of ex-

pectations by monetary and exchange rate schemes which were necessarily rigid when they were first applied, the time now seems to have come for a transition to more flexible coordination mechanisms which preserve the macroeconomic equilibria but at the same time favour the sustained growth of the area as a whole.

The last objective of the exchange rate agreement described in the previous section is the formulation of a coordination mechanism which will permit the gradual abandonment by the MERCOSUR economies of the use of the exchange rate as a nominal anchor, with the aim of avoiding excessive real currency appreciations (or devaluations) which are not justified by the basic macroeconomic variables and jeopardize the consolidation of a true regional-scale internal market. At present, the main difficulties standing in the way of effective macroeconomic coordination in MERCOSUR are raised by Argentina, because of the two typical

<sup>35</sup> Within a simple monetary model of ranges of variation, it can be shown very simply how restrictions on capital movements help to strengthen stabilization of the exchange rate within the range. At any given point in time, the exchange rate depends in that case on the fundamental variables (summarized by variable  $x$ ) and the expected rate of variation of the exchange rate. The exchange rate may be interpreted as the discounted present value of future levels of the fundamental variables. With perfect capital mobility, we have the following expression (using the same notation as in the Appendix):

$$S_t = \frac{1}{n} E_t \int_1^{\infty} x_{\tau} \cdot e^{-\frac{1}{n}(\tau-t)\kappa}$$

where  $x = m + v$  when  $v = -m^* - h(y - y^*)$  expresses the relevant velocity of money for this economy. By differentiating this equation with respect to time ( $t$ ), we obtain the expression governing the behaviour of the exchange rate:  $s = x + n \cdot E [ds/dt]$ . With imperfect capital mobility, the arbitrage condition for the interest rate is:  $\kappa(i - i^*) = E(ds/dt)$ , where  $0 \leq \kappa \leq 1$  (without capital mobility,  $\kappa = 0$ ; with perfect capital mobility,  $\kappa = 1$ ). In this case, the exchange rate will be determined by the equation  $s = x + (n/\kappa) \cdot E [ds/dt]$ .

<sup>36</sup> The application of legislation similar to that of Chile in MERCOSUR as a whole would mean that in order to procure international finance (through loans or capital issues) it would be necessary first of all to obtain the authorization of the respective member country's Central Bank and pay a 4% tax. In addition, it would be necessary to make a non-interest-bearing deposit equal to 30% of the amount of finance obtained for one year in the Central Bank, or, alternatively, pay the Central Bank interest at the rate of 4% over LIBOR for one year on 30% of the loan (even if the loan was for less than one year).

<sup>37</sup> The literature on balance of payments crises and speculative attacks is based on this idea. See, for example, Flood and Mussa (1994).

<sup>38</sup> As Kindleberger (1988, pp. 201 and 207) asserts in an excellent study, "most rules need exceptions in difficult situations ..... an attitude of passive conformity with the spirit of the rules is one part of (economic) responsibility, but the capacity to take action to apply and adapt the rules to new circumstances is the other - and most active - part of that responsibility".

features of the functioning of a quasi currency board system: its incapacity to act as a lender of last resort, and the procyclical bias it gives to the real economy.

With respect to the first of these points, it is essential that Central Banks should be able to act as lenders of last resort in order to ensure that macroeconomic coordination can survive the vicissitudes of a financial crisis (especially in view of the relative weakness of the Argentine and Brazilian banking systems). If a quasi currency board operates "according to the rules", however, it cannot carry out this essential function of a Central Bank, because any departure from the convertibility rule would lead to a rapid loss of credibility. Indeed, in crisis situations quasi currency boards tend to become the debtors of last resort of the system.

Secondly, the essentially procyclical nature of this mechanism, while heightening social demands for macroeconomic coordination in order to help alleviate the economic cycle, deprives the currency board of the capacity to do away with the undesirable intermittent "stop and go" effects that have traditionally been typical of the evolution of developing economies. Major changes in the Argentine monetary sys-

tem might not seem appropriate at a time when economic recovery seems just around the corner ("we've got problems, but we're on the right track", to paraphrase the words of President Carlos Menem) and abundant foreign investments are once again being offered to the emerging economies,<sup>39</sup> but it must be borne in mind that it would be very difficult to do away with this mechanism in the climate of uncertainty that usually accompanies recessionary phases, because it is then that defence of the nominal anchor becomes an absolute policy priority.

With regard to the strategy that could be adopted for abandoning this mechanism in the case of Argentina, it seems reasonable to advocate an orderly transition which preserves certain elements of the present quasi currency board in order to minimize the repercussions of the change of system on the financial markets but nevertheless permits the Central Bank to act as a lender of last resort and to manage the exchange rate in line with the exchange rate agreement. The precedent of Singapore (which, it would appear, is also being followed in the recent evolution of Hong Kong) might be a useful example in this respect.<sup>40</sup>

(Original: Spanish)

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<sup>39</sup> The Argentine economy registered an average real growth rate of 7.7% per year over the 1991-1994 period but then underwent a severe deflationary adjustment which led to a negative growth rate of the product of -4.4% in 1995, with a spectacular increase in unemployment (to three times its historical levels) which is being palliated with infinitesimal levels of social welfare benefits. In 1996 there was a moderate recovery (the GDP grew by close to 4%), but this had hardly any positive effects on unemployment. At the same time, the rate of saving in Argentina was around 15% of GDP: below the Latin American average of 18% and far below the rates attained in Chile (nearly 28%) and East Asia (33%).

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<sup>40</sup> See, for example, Osband and Villanueva (1993) and Schwartz (1993). The Singapore monetary authority, after abandoning the fixed exchange rate system, has gradually recovered the essential powers of a Central Bank (capacity to effect open market operations, to sterilize reserves, etc.), while continuing to back 100% of the monetary base with the country's foreign reserves.

Appendix

The relative advantages of macroeconomic coordination may be analysed in summary form on the basis of a simple two-country logarithmic-linear model. The equations corresponding to country A are perfectly symmetrical with those of country B (as reflected in the existence of similar structural parameters). The following equations describe the structure of the economy:

$$m - p = h y - n i \quad [A.1]$$

$$y = \delta e - \sigma i + \mu \quad [A.2]$$

$$i = i^* \quad [A.3]$$

$$e = s + p^* - p \quad [A.4]$$

$$q = \alpha p + (1 - \alpha)(s + p^*) \quad [A.5]$$

$$p = p^* = p_0 > 0 \quad [A.6]$$

The variables and parameters of the model are defined below (the variables of country B are distinguished by an asterisk, and all the variables, with the exception of interest rates, are expressed as percentage deviations from their long-term equilibrium levels or, alternatively, as rates of variation):

- $m$  = money stock
- $p$  = price index of domestic production
- $p_0$  = initial price disturbance
- $y$  = real income
- $i$  = nominal interest rate level
- $s$  = nominal exchange rate
- $e$  = real exchange rate
- $\mu$  = fiscal disturbance
- $q$  = consumer price index
- $h$  = income elasticity of demand for money
- $n$  = half-elasticity of demand for money with respect to interest rate
- $\delta$  = elasticity of demand for goods with respect to real exchange rate
- $\sigma$  = half-elasticity of demand for goods with respect to interest rate
- $\alpha$  = weight of domestic production in consumer price index.

Equation [A.1] represents the money market equilibrium. Equation [A.2] is the equilibrium condition in the market for goods and services. Equation [A.3] represents the arbitrage condition for interest rates, assuming static expectations. Equation [A.4] defines the (logarithm of the) real exchange rate. Equation [A.5] shows the percentage change in the consumer

price index as a function of the rates of change of the price of imported products and the price of domestic production. Equation [A.6] introduces the assumption that the rate of change of the goods produced in each country is given (and, for reasons of symmetry, is the same in both countries).

The structural equations [A.1] to [A.6] for both countries can be solved to give reduced equations for  $\{y, q\}$  as a function of the two policy variables  $\{m, m^*\}$  and the symmetrical and exogenous price disturbance ( $p_0$ ). By simple manipulation of terms we obtain the following expressions:

$$y = am - bm^* - (a - b)p_0 \quad [A.7]$$

$$y^* = am^* - bm - (a - b)p_0 \quad [A.8]$$

$$s = (\frac{1}{2}\delta h)(m - m^*) \quad [A.9]$$

$$q = p_0 + \gamma (m - m^*) \quad [A.10]$$

$$q^* = p_0 - \gamma (m - m^*) \quad [A.11]$$

where

$$b = \frac{n}{2h(n + h\sigma)} > 0, \quad a = \frac{n + 2h\sigma}{2h(n + h\sigma)} > 0,$$

$$a - b = \frac{\sigma}{n + h\sigma} > 0, \quad \gamma = \frac{1 - \alpha}{2h\sigma} > 0$$

Each government attempts to minimize the deviation of production and inflation from the desired equilibrium levels (normalized to zero). The existence of fiscal rigidities means that  $\mu = 0$  in equation [A.2], so that monetary policy is the only policy instrument. The loss function in the case of country A is:

$$\pi = y^2 + \beta q^2 \quad [A.12]$$

where the parameter  $\beta$  reflects the relative importance attached by the government to  $q$ .<sup>41</sup>

Let us first consider the non-cooperative Cournot-Nash equilibrium. The reaction function in the case of country A is:

<sup>41</sup> The loss function is assumed to be symmetrical for both increases and decreases in the variables  $\{y, q\}$ , so that changes in these variables in either direction cause disutilities. In order to simplify the exposition, we will assume that the loss functions of both countries are perfectly symmetrical (so that  $\beta = \beta^*$ ) and stable over time.

$$m = Am^* + Bp_0 \quad [\text{A.13}]$$

$$A = \frac{ab + \beta\gamma^2}{a^2 + \beta\gamma^2} < 1, \text{ since } a > b,$$

where

$$B = \frac{A(a-b) - \beta\gamma}{a^2 + \beta\gamma^2} > 0, \text{ if } \frac{a(a-b)}{\gamma} > \beta.$$

Likewise, by symmetry, we obtain the reaction function of country B:

$$m^* = Am + Bp_0 \quad [\text{A.14}]$$

The Cournot-Nash equilibrium is reached at the point of intersection of the reaction functions, and we thus see that:

$$m = m^* \quad [\text{A.15}]$$

Substituting the above expression in the reaction function of country A (equation [A.13]), we obtain the Cournot-Nash equilibrium condition as a function of the structural parameters of the model and of  $p_0$ :

$$m = m^* = \frac{a(a-b) - \beta\gamma}{a(a-b)} p_0 \quad [\text{A.16}]$$

Likewise, substituting equation [A.15] in equations [A.7] to [A.11], and taking account of equation [A.16], we arrive at the conclusion that in the equilibrium situation:

$$s = 0 \quad [\text{A.17}]$$

$$q = q^* = p_0 \quad [\text{A.18}]$$

$$y = y^* = (-\beta\gamma/a)p_0 < 0 \quad [\text{A.19}]$$

Consequently, in response to the initial price disturbance ( $p_0$ ) the monetary policy of both countries is excessively contractive, by increasing interest rates and reducing production below the desired level in each country. It should be noted that the degree of monetary contraction in this non-cooperative equilibrium depends on the relative weight of inflation in the loss function. If this is relatively high (so that  $a(a-b)/\gamma < \beta$ , and, hence,  $m = m^* < s = 0 < p_0$ ), the reduction in the levels of production will also be greater. In contrast, we see that when  $a(a-b)/\gamma > \beta$ , then  $p_0 > m = m^* > s = 0$ .

In the cooperative equilibrium, the joint monetary committee resolves the following programme:

$$\text{Min. } (\pi + \pi^*) = (y^2 + \beta q^2) + (y^{*2} + \beta q^{*2}), \quad [\text{A.20}]$$

$$[m, m^*]$$

subject to:

$$m = m^*$$

$$q = q^* = p_0$$

$$y = y^* = (a-b)(m-p_0)$$

The solution obtained is as follows:

$$m = m^* = p_0 \quad [\text{A.21}]$$

$$y = y^* = 0 \quad [\text{A.22}]$$

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# Export promotion *policies in* Central America

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Ten years ago the member countries of the Central American Common Market (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua) began to turn away from the "inward-oriented development" policy they had been applying for decades. They are now encouraging non-traditional exports by lowering tariff barriers, unifying exchange rates, and giving exporters access to intermediate and capital goods at international prices. Some governments have also granted direct subsidies in the form of tax credits for goods exported to markets outside the subregion. This article reviews these policies and examines their effect on the exports of each of the five member countries, with special attention to the possibility that the subsidies granted in respect of goods exported outside the Central American Common Market may induce exporters to switch from regional to extraregional markets.

# I

## Introduction

The Central American economies are small in every sense of the word; their exports and imports have no effect on international prices, so free trade is a first-best strategy for all of them.<sup>1</sup> Despite this fact, the five members of the Central American Common Market (CACM), individually and collectively, have implemented protectionist trade policies, for the most part in the form of high import tariffs. Tariff protection acts as an involuntary tax on exports, but policymakers have attempted to counteract this by reducing the height of tariff barriers and by implementing a number of policies which include preferential trading, whereby the countries mutually subsidize each other's exports; the establishment of export processing zones; temporary import regimes; direct subsidies on exports; and exchange controls, which normally discourage exports, but are sometimes used in Central America to subsidize non-traditional exports. This paper gives a brief analytical review of each of these policies and their impact on non-traditional exports. All these poli-

cies are second-best, and would not be necessary if the countries liberalized their trade completely by unilaterally removing all protective tariffs and quotas.

Free trade, it must be emphasized, is not synonymous with *laissez-faire*. Adherence to free trade does not preclude the imposition of taxes on the production or consumption of specific goods or, alternatively, the provision of subsidies for them. In a free-trade regime, however, taxes and subsidies affecting the production of a particular good are the same regardless of whether the output is exported or sold on the domestic market, and those affecting consumption are the same regardless of whether the good is imported or supplied by a local producer. If taxes on luxuries such as cosmetics, television sets and automobiles are imposed only on imports, there is an incentive to produce such items locally, even at high cost, to avoid payment of such taxes, which thus act as import tariffs even though they may be disguised as excise taxes.

# II

## The policies

### 1. Protection as a tax on exports

It is understandable that governments of countries specializing in the production and export of only a few commodities should want to diversify their economies by providing incentives for the production of a greater variety of goods. The idea is that the incentives will have a finite life, and that the 'infant industries' thus

benefitted will grow up and eventually prosper without special favours.

Economists traditionally advise governments to subsidize new activities openly rather than resort to tariff protection.<sup>2</sup> The necessary funds can be raised from general taxes on consumption or income, or from taxes on specific goods whose consumption or production it is desired to discourage. Policymakers rarely accept this advice, so governments everywhere almost always promote new industries with protective tariffs and restrictions on imports rather than cash subsidies, and consumers end up subsidizing protected producers

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<sup>1</sup> Coffee and bananas are possible exceptions to this statement, but even in these cases Central America cannot raise international prices without support from producers in other regions of the world.

<sup>2</sup> See, for example, Caves and Jones (1973, pp. 254-260) for a presentation of the argument that an optimal tax-cum-subsidy is necessarily superior to any import tariff for the purpose of achieving some specific objective in respect of diversification of production.

by paying a higher price for local goods than they would pay for duty-free imports of goods of comparable quality.

Protective tariffs may encourage the development of new industries, but they have an undesired side effect: they act as a tax on traditional and nontraditional exports alike.<sup>3</sup> In fact, tariffs and other restrictions on imports result in two distinct types of export taxes. First, protection of intermediate goods increases the costs of industries that rely on them as inputs. If dressmakers, for example, are forced to pay duty on imported cloth, or to purchase high-cost, low-quality cloth from local mills, they find it difficult to compete in export markets, regardless of the efficiency of their own operations. Second, and more subtly, protective tariffs cause the exchange rate to become overvalued, decreasing the purchasing power of the local currency that exporters receive for each unit of foreign currency that they earn.

The second, indirect manner in which protection acts as an export tax can be illustrated with the following hypothetical case. Suppose that a country with a flexible exchange rate removes its uniform 20% tariff on imports. What will happen to the price of foreign exchange? Obviously, since imports are now cheaper in local currency, there will be greater demand for foreign exchange, driving up its price. In other words, the local currency will depreciate in real terms, and exporters will receive more pesos for each dollar of revenue. The difference between this free-trade exchange rate and the exchange rate with protective tariffs is equivalent to a tax on all exports. This is a tax that is difficult to describe, much less measure, but it does exist and does inhibit nontraditional exports.

Central America strengthened its protectionist policies in the 1960s by adopting a common external tariff that was much higher than any of the five national tariffs it replaced.<sup>4</sup> In the words of the Secretariat of the Central American Common Market (CACM), "Central America, in forming the Common Market, chose from the beginning an 'inward looking' policy of industrialization and development; this policy contained various instruments, the most important of which was a protectionist tariff ..." (SIECA, 1974, vol. 4, p. 38).

<sup>3</sup> The theorem that import taxes are equivalent to export taxes, which was proven by Lerner (1936) for the two-good model, has been generalized to large numbers of goods by Corden (1971, pp. 119-122).

<sup>4</sup> The unweighted average tariff for consumer nondurables increased from 68% to 122%. For further details and an analysis, see Willmore (1976).

For a time, this policy of promoting new activities behind a high tariff wall produced a diversification of the Central American economies and was accompanied by considerable growth. Each of the five countries registered average annual growth rates in excess of 5% in the period 1960-1977. Beginning in the late 1970s, however, growth slowed noticeably in each country. Negative rates of growth were perhaps inevitable in El Salvador and Nicaragua because of civil war, but slow growth came to characterize Costa Rica, Guatemala and Honduras as well (table 1.)

A series of external events, namely the second oil price shock of 1979-1980, rising interest rates and falling prices for traditional exports, greatly reduced the availability of foreign exchange and impacted negatively on real income in the region.<sup>5</sup> The response of the economies to this adverse external environment left much to be desired, so a number of Central Americans concluded that it was necessary to move away from the decades-old strategy of 'inward development'. The Government of Costa Rica was the first to promote the idea of a simplified and reduced structure of protection, and in 1985 it was able to convince other members of the CACM of the need for major reform of the external tariff. Three governments implemented the reform the following year, even though it meant temporary abandonment of the principle of a common external tariff. In 1987 Costa Rica announced its goal of reaching, unilaterally, a maximum tariff of 40% by the end of 1990, and in 1989 the new government of El Salvador took the initiative in tariff reform away from Costa Rica by reducing its maximum tariff to 50% in September and to 35% the following March.

On 17 July 1991 the five Presidents of Central America, in the Declaration of San Salvador, pledged to return before 1995 to a common external tariff, albeit to a less protectionist one with a maximum tariff of 20% and a minimum tariff of 5%. As may be seen from the data given in table 2, they did not achieve this goal. By early 1995, only Costa Rica had reached the target range of 5% to 20%, and this situation changed in March of that year when the Government of Costa Rica imposed, for fiscal reasons, a surcharge of 8% on all imports, thus increasing duties to the range of 13%-28%. El Salvador, in April 1995, followed by Guatemala in December, reduced import duties on

<sup>5</sup> These external shocks also marked the end of price stability in the region. For an analysis, see Escaith and Schatan (1996).

TABLE 1

**Central America: Annual growth of GDP, 1960-1996.**  
(Percentages)

	1960-1977	1977-1989	1990	1991	1992	1993	1994	1995	1996
Costa Rica	6.6	2.7	3.6	2.3	7.7	6.3	4.5	2.5	-0.9
El Salvador	5.4	-0.1	3.4	3.6	7.5	7.4	6.0	6.1	3.0
Guatemala	5.7	2.3	3.1	3.6	4.8	3.9	4.4	4.9	3.0
Honduras	5.5	3.4	0.1	3.3	5.6	6.1	-1.4	3.6	3.5
Nicaragua	5.9	-2.8	-0.1	-0.2	0.4	-0.4	3.3	4.5	5.5

Source: United Nations, Department of Economic and Social Information and Policy Analysis (DESIPA), based on national accounts.

TABLE 2

**Central America: Import duties and surcharges, ad valorem, early 1992 and 1995**  
(Percentages)

	1992	1995
Costa Rica	5 - 46	5 - 20
El Salvador	5 - 30	5 - 30
Guatemala	5 - 30	6 - 21
Honduras	5 - 35	7 - 22
Nicaragua	5 - 60	10 - 40

Source: Willmore, 1992, table 1; The Economist Intelligence Unit, *Country Reports*.

capital goods to 1%, further increasing the disparity of external tariffs. Throughout this period, Nicaragua maintained import duties considerably higher than those in effect in the other four countries. Even so, tariff barriers are now lower in each country of Central America than they were in the 1960s, 1970s and 1980s; the implicit tax on exports is thus lower as well. In each country, trade liberalization has gone far beyond that required for membership in the General Agreement on Tariffs and Trade (GATT), now transformed into the World Trade Organization (WTO).

Import quotas, which cause domestic prices of the targeted goods to rise, also act as a tax on exports. Nearly always, however, governments in Central America have relied on tariffs rather than quantitative restrictions to protect local producers. Nonetheless, all five countries have required import licenses from time to time, especially as a way to ration foreign exchange sold at an artificially low official price. In recent years, they have avoided both artificial exchange rates and import licenses.

## 2. Preferential trading arrangements as an export subsidy

A tax on imports allows producers to increase prices and decrease the quality of the goods they sell locally, so it can be viewed in effect as a tax on consumption that is given as a subsidy to the producer. The same is true of preferential trading arrangements like the CACM, with one important difference: the consumer and producer need not reside in the same country. This allows residents of one country to subsidize the exports of another country. In other words, a CACM producer who exports to a partner country is exempt from the external tariff and thus receives a subsidy, in the form of higher than international prices, from consumers in that country.<sup>6</sup>

This form of subsidy is not limited to exports to the CACM, but rather is inherent in any type of preferential trading arrangement. The bilateral treaties that Costa Rica and other Central American countries have signed with Panama provide opportunities for Central American consumers to subsidize Panamanian exports in return for Panama's subsidization of Central American exports. The Costa Rican firm Gallito exports a considerable amount of candy to Panama, not because it is competitive in world markets, but rather because it has preferential access to the protected Panamanian market. Similarly, the success of export processors in Central America and the Caribbean owes much to the fact that the market for garments in the United States is protected by country-specific quotas.

<sup>6</sup> The argument assumes that a country pays for the goods it imports. If there is an accumulation of unpaid deficits, as has happened on occasion in the CACM, it is not clear who is subsidizing whom.

### 3. Export Processing Zones

One of the two types of 'taxes' that protection imposes on nontraditional exports is the increased cost of intermediate inputs. Exporters can avoid this tax by locating outside a country's customs territory, in areas known as free zones or export processing zones. These zones are sometimes privately and sometimes publicly owned and operated. In either case, exporters lease a factory shell from the administration of the zone, and are exempt from payment of taxes on their profits, imports and exports. Most importantly, they also avoid many of the bureaucratic costs of dealing with the customs authorities. In return for these privileges, producers in free zones agree to export all of their output. Permission is occasionally given to 'export' to the local customs territory, but goods produced in a free zone are deemed to be foreign, so are subject to payment of full import duties and consumption taxes.

There is a notable absence of anti-export bias in the free zones. If anything, there is a pro-export bias, as governments place restrictions on sales to local markets, while they allow unlimited shipments to foreign markets. Nonetheless, free zone firms do not escape the second 'tax' that protection imposes on exports: real exchange rate appreciation, and hence increased costs—compared to free trade—for labour and for non-tradeables such as local transportation, the factory shells, electricity, water and waste disposal.

Over the last ten years, each of the five Central American countries has enacted legislation governing the creation of free zones. Many of these laws modernized legislation dating from the 1970s, so that the laws in each country are now quite similar. Nicaragua's Decree No. 46-91, which took effect on 22 November 1991, is the most recent addition to this body of law; it replaces legislation enacted by the Somoza government. Some of the countries impose an 8 to 10 year limit on the exemption from taxes on profits, but this provision is rarely enforced. Nor is it enforceable, because investments in export processing are extremely reversible: an entrepreneur can close one plant and open another in a different location in a matter of weeks at very little cost.

One aspect that reduces the attractiveness of free zones for potential exporters is the requirement that plants be located in geographic enclaves, whose location may not be optimal for the firm. Costa Rica has shown great flexibility in this regard by allowing free zone exporters to move to 'satellite plants' where labour is abundant, even if this location is far from the physical

free zone. El Salvador's 1990 Law on the Regime for Free Zones and Bonded Warehouses goes even further and explicitly states that "firms that export all of their production ... and for technical reasons are not located in a free zone, can request that their establishment be declared a bonded warehouse ..." (article 20). The law treats exporters with bonded warehouses in the same way as exporters operating from free zones (article 22).

### 4. Customs duty drawback (temporary imports)

Temporary import regimes have an advantage over free zones in that they permit plants located anywhere in the country to assemble or process, free of duty, imported inputs for subsequent export. This allows potential exporters to make use of existing infrastructure and avoid costly new investments. The system is similar to El Salvador's 'bonded warehouses', but is more flexible because it allows a firm to devote part of its time (or part of its facilities) to the domestic market and part to the export market.

Each of the five countries has legislation that provides for exemption from duties on machinery and intermediate goods imported for use in the production of goods for export. Firms are also exempt from payment of taxes on profits<sup>7</sup>, in proportion to the amount of output that is exported. It is also possible for an exporter to obtain a refund of import duties already paid, but this is more difficult than obtaining exemption in the first instance. This makes it difficult for a firm that produces for both the domestic and export market to utilize inventory in stock to fill a last-minute export order. El Salvador—alone of the five countries—eases this problem by allowing firms to receive a general drawback of 6% (originally 8%) of the FOB value of exports in lieu of exemption from payment of import duties and other taxes.<sup>8</sup> The difficulty with a single rate of drawback is that for some exporters the reimbursement is greater than the taxes paid, while for others it is less.

<sup>7</sup> In Nicaragua the exemption from profits tax on exports is only partial, whereas in the other four countries it is 100%.

<sup>8</sup> The cash drawback came into effect in 1990 and is also granted for the net exports of firms that operate under the temporary import regime. From 1986 to 1990, El Salvador offered exporters of non-traditional goods *Certificados de Descuento Tributario* (tax credit certificates) (CDTs) for up to 30% of the value of extra-CACM exports, but never more than the taxes actually paid on inputs used to produce the exports. Because of these complex rules, few exporters were able to make use of the CDT incentive in El Salvador.

Much of the export processing (*maquila*) in Costa Rica and Guatemala is carried out under the temporary import regime. Export processors in the other three countries rely more on free zone legislation.

### 5. Direct export subsidies

In addition to exemption from taxes on profits and inputs, governments sometimes grant direct subsidies to exporters. These subsidies are almost never granted for simple assembly nor for exports from free zones. Typically a minimum national value-added requirement is imposed.

As a correction for protection-induced overvaluation of the exchange rate, export subsidies are only a crude instrument, because they increase the local-currency price of exports, but not the price of imported inputs used in the production process. They therefore tend to encourage exports with a high import content. In addition, they create an incentive to over-invoice exports, both to meet the minimum value-added requirement and to increase the amount of subsidy received.

Four of the five governments of Central America have subsidized non-traditional exports over and above reimbursement of taxes,<sup>9</sup> but only two countries—Costa Rica and Nicaragua—continue to do so at the present time, and their programmes are coming to an end. In each case the subsidies have been given as tax credit certificates that can be used by an exporter to pay taxes or sold to others to be used for the same purpose.

Costa Rica has the longest experience in Central America with direct subsidies. The Government began issuing tax credits known as *Certificados de Abonos Tributarios* (CATs) in 1972, but made minimal use of the incentive until 1984, when it began to include eligibility for these certificates in ten-year export contracts awarded to qualified firms. Non-traditional exporters originally received CATs at a rate equal to 15% of the FOB value of their shipments to the United States and 20% for shipments to other extraregional markets. CATs are issued in local currency, can be used by anyone to pay taxes upon maturity (originally 12 months, increased in 1991 to 18 months), and are sold freely on the open market. The true rate of subsidy is

<sup>9</sup> The exception is El Salvador, which awarded tax credits from 1986 to 1990, but only up to the amount of taxes paid on inputs used in the production of exports.

less than 15 or 20 per cent, for the discounted value of a CAT is less than its face value. By 1992 nearly all non-traditional exports from Costa Rica benefited from CATs.<sup>10</sup>

In order to be eligible for CATs, exports must incorporate a minimum of 35% of national value-added; nonetheless, three of Costa Rica's eight largest exporters reportedly received CATs without meeting that requirement (Clark, 1995, p. 198). Beginning in 1990, the rate of subsidy was reduced in new export contracts; moreover, the rate decreased further over time but increased with the proportion of national value-added. As from December 1992, CATs were eliminated from new export contracts; by the year 2000, Costa Rica's experiment with CATs will be over.

Guatemala and Honduras issued tax credits to non-traditional exporters for a brief period in the 1980s. Guatemala issued them to eligible exporters at a flat rate of 10% and Honduras at rates that varied from 5% to 15%, depending on national value-added. In each case, however, the tax credits served as partial compensation for a large and increasing overvaluation of the (non-market clearing) official exchange rate. Therefore they had little effect as an export incentive. Each country suspended tax credits after sharply depreciating its official exchange rate. This occurred in 1986 in Guatemala (from one quetzal per dollar to 2.50 quetzales per dollar) and in 1990 in Honduras (from two lempiras per dollar to 4.20 lempiras). The magnitude of these depreciations compensated exporters many times over for their loss of tax credits.

In 1992, Nicaragua followed the example of Costa Rica by granting eligible exporters of non-traditional goods *Certificados de Beneficio Tributario* (CBT) at a rate of 15%. Like Costa Rica, a criterion for eligibility is a minimum of 35% national value-added. Unlike Costa Rica, the rate of subsidy, for all exporters, fell to 10% in 1995 and will fall further to 5% in 1997 and to zero in 1998 (in exceptional cases, in the year 2000).

In sum, direct export subsidies are presently granted only in Costa Rica and Nicaragua. Both coun-

<sup>10</sup> The main exception is certain cut flowers, which are subject to countervailing duties in the United States market. Exports subsidized by CATs in 1992 amounted to US\$ 610 million (Clark, 1995, p. 196). According to table 3, Costa Rica's non-traditional exports to non-CACM countries amounted to US\$ 763 million in that year; but US\$ 65 million of this consisted of exports to Panama, which are not eligible for CATs, so nearly 90% of the non-traditional exports to extra-regional markets received CATs in 1992.



tries are phasing them out, and will end them by the year 2000. There has been little discussion to date of possible instruments to replace these incentives.

## 6. Exchange controls

When a central bank keeps the price of foreign exchange artificially low, and forces firms to exchange their export earnings for local currency at that rate, it imposes a tax on exports. Even companies operating in free zones cannot avoid this 'tax' if they are required to purchase local currency at the official rate for payment of wages and other local expenses. Production for export becomes increasingly difficult as the parallel rate of exchange diverges from the official rate, central bank controls are tightened, and approvals of foreign exchange for the purchase of necessary inputs are delayed. Exemption from duty on inputs is no incentive to export if producers lack access to foreign exchange.

Exchange controls are sometimes used to subsidize non-traditional exports, but they represent a costly and not very effective subsidy. The export tax may become an export subsidy if exporters are allowed to retain their export receipts (or a portion of them) while paying for imports at the official exchange rate. This subsidy can become very large if the market rate of exchange differs greatly from the official rate. Consider the example of an official exchange

rate of 2 pesos per dollar, a market rate of 4 pesos, and exports that have a (duty-free) import content of 60%. When the exporter must sell the dollars he receives at the rate of 2 pesos, this is equivalent to a 50% tax on value-added.<sup>11</sup> If he is allowed to sell dollars for 4 pesos and purchase them for 2 pesos to pay for imported inputs, however, the 50% tax is transformed into a 75% subsidy.<sup>12</sup> This is not a very effective type of subsidy, for two reasons. First, an entrepreneur is likely to regard this good fortune as transitory, so will not invest to expand exports. Second, there are likely to be bureaucratic costs and delays involved in the purchase of foreign exchange at the low rate of 2 pesos per dollar.

One way to avoid converting exchange controls into an inadvertent tax on non-traditional exports (aside from avoiding controls altogether) is to allow exporters to retain the foreign currency that they earn and permit them to purchase local currency in the parallel market. This is currently the practice in each of the five countries, but has not always been true in the past. Each central bank in Central America has, on more than one occasion, imposed exchange controls leading to multiple exchange rates. A review of this history and its effect on exports is beyond the scope of the present paper and possibly beyond the competence of its author. Suffice it to say that fear of policy reversal, of a return to exchange controls of the past, decreases the effectiveness of export incentives in the present.

## III

### The results

The results of Central America's export promotion efforts are displayed in figures 1, 2 and 3, which show, for each country, the value of non-traditional exports excluding export processing (*maquila*). All data are in current dollars; no attempt has been made to adjust for price inflation. Complete data, for traditional as well as non-traditional exports, are reported in table 3. In figures 2 and 3 and in table 3, exports to the CACM are shown separately from exports to the rest of the world, for two reasons. First, only extraregional exports benefit from tax exemptions and direct subsidies; exports to partner countries of the CACM are not affected by instruments customarily regarded as incentives for non-traditional exports. Second, exports to the CACM

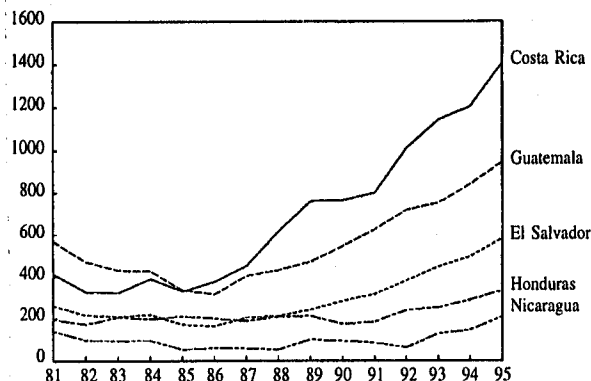
are valued at protected Central American prices, whereas exports to the rest of the world are, for the most part, valued at international prices; in other words, the value of exports to the CACM includes an implicit subsidy paid by the importer, whereas the value of most exports to the rest of the world does not.

Of the five countries, Costa Rica's performance is most impressive: this country increased the value of its

<sup>11</sup> For every 100 dollars of exports, net exports are 40 dollars. At the official exchange rate, this is 80 pesos: half the amount of pesos that could be purchased at the parallel rate.

<sup>12</sup> For each 100 dollars of exports, net exports are still 40 dollars, but the net receipts of the exporter are  $400 - 120 = 280$  pesos, and  $280/160 = 1.75$ .

FIGURE 1  
**Central America: Non-traditional exports<sup>a</sup>**  
 (Millions of dollars)



<sup>a</sup> Excluding maquila products.

FIGURE 2  
**Central America: Exports to the Central American Common Market**  
 (Millions of dollars)

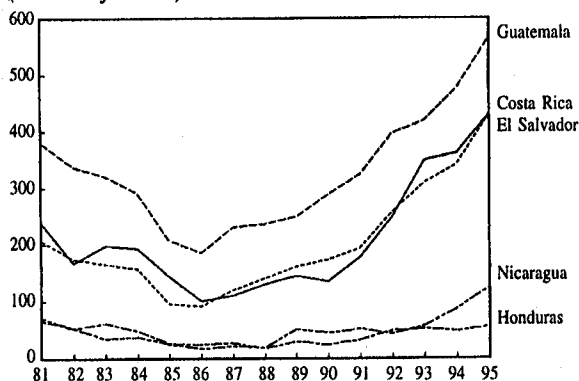
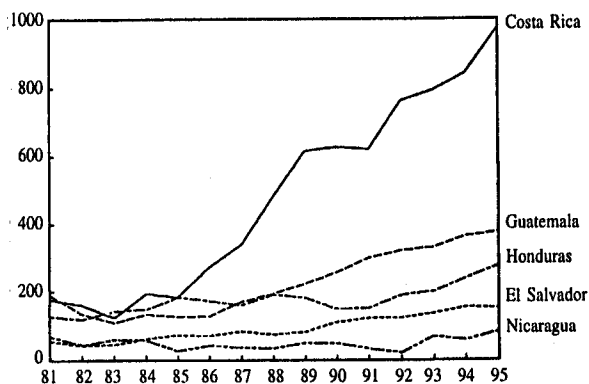


FIGURE 3  
**Central America: Non-traditional exports<sup>a</sup> to the rest of the world**  
 (Millions of dollars)



<sup>a</sup> Excluding maquila products.

non-traditional exports from US\$ 328 million in 1985 to US\$ 1,403 million in 1995, surpassing Guatemala as Central America's largest exporter. Nearly all the increase is due to extra-CACM exports (including exports to neighbouring Panama), for exports to CACM partners increased by less than US\$ 300 million over the same period. Since only Costa Rica gave significant direct subsidies (CATs) for extraregional exports, this outcome is not surprising. The question is, was the export response worth the cost of the subsidies? The Government of Costa Rica has concluded that it is not, and is phasing out the programme.

Debate in Costa Rica has centered on the highly visible fiscal cost of the subsidy programme, which reached 1.2% of GDP in 1989.<sup>13</sup> There does not seem to be any similar concern for the economic cost to consumers of imports from CACM partners who, reciprocally, subsidize Costa Rica's exports to the CACM.

How did exporters respond to CAT subsidies in Costa Rica? The answer to this question requires an estimate of what exports would have been in the absence of subsidies. Hoffmaister (1992), in the only study of this type in existence for Costa Rica, used quarterly data for the years 1970 through 1989 to fit the following regression model:

$$\text{export volume} = \text{function of } \{ \text{CAT subsidies, relative prices, nominal exchange rate, real GDP} \}$$

In this model, the dependent variable is the volume of all non-traditional exports, including export processing (*maquila*) and intraregional exports: two categories that were never eligible for CAT subsidies.<sup>14</sup> Relative prices are defined as "the relative world price of exports in terms of the domestic price", and the nominal exchange rate as the price of foreign currency.

<sup>13</sup> Costa Ricans have also complained of corruption (overinvoicing of exports) and of concentration of benefits in the hands of a few exporters. In the 18-month period from July 1988 through December 1989, a single company (PINDECO, Del Monte's pineapple subsidiary) received 10% of all CAT benefits, and the largest 26 firms, including PINDECO, received 51% of the total benefits (Clark, 1995, p. 198). But nearly all non-traditional exports received CATs at that time, so the concentration of benefits must reflect scale economies in exporting more than discrimination against small exporters.

<sup>14</sup> Export volumes were calculated by dividing export values by a price index for non-traditional exports. Maquila was a small, but increasing, proportion of non-traditional exports, reaching 9.5% in 1989 (Hoffmaister, 1992, p. 154, note 19).

TABLE 3

**Central America: Traditional and non-traditional exports, 1981-1995<sup>a</sup>**  
(Millions of US\$)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
<i>Costa Rica</i>															
Total exports	1 002.6	869.0	852.5	997.5	939.1	1 084.9	1 106.7	1 245.7	414.6	1 448.2	1 597.7	1 851.1	2 094.7	2 258.5	2 624.1
Traditional	587.4	40.7	530.3	608.7	611.1	711.4	657.8	630.7	654.4	684.5	797.5	839.4	951.7	1 054.2	1 221.7
Non-traditional:															
CACM	238.0	167.2	198.2	193.0	143.5	100.5	109.8	129.9	144.1	134.6	177.8	248.4	348.3	360.7	427.6
Rest of World	177.2	161.1	124.0	195.8	184.5	273.0	339.1	485.1	616.1	629.1	622.4	763.3	794.8	843.6	974.8
<i>El Salvador</i>															
Total exports	798.0	699.6	757.9	725.9	695.1	754.9	590.9	608.8	497.8	581.5	588.0	597.5	742.0	818.9	1 004.6
Traditional	538.0	484.4	549.0	507.9	527.5	594.3	388.4	395.9	256.1	298.3	272.1	217.2	295.9	324.1	425.6
Non-traditional:															
CACM	206.5	174.2	164.9	157.2	95.7	91.0	119.6	139.8	160.6	173.0	193.7	257.3	309.2	340.4	426.6
Rest of World	53.5	41.0	44.0	60.8	71.9	69.6	82.9	73.1	81.1	110.2	122.2	123.0	136.9	154.5	152.4
<i>Guatemala</i>															
Total exports	1 291.4	1 170.4	1 091.7	1 132.2	1 059.7	1 043.8	977.9	1 073.4	1 126.1	1 211.5	1 230.0	1 283.6	1 363.2	1 550.2	1 988.8
Traditional	721.8	697.9	661.9	706.6	725.3	730.7	575.7	642.5	653.6	666.0	606.3	566.9	613.7	710.7	1 046.0
Non-traditional:															
CACM	378.9	337.3	320.9	291.4	207.8	185.3	230.6	236.4	248.9	288.2	324.0	395.4	417.8	475.0	565.4
Rest of World	190.7	135.2	108.9	134.2	126.6	127.8	171.6	194.5	223.6	257.3	299.7	321.3	331.7	364.5	377.4
<i>Honduras</i>															
Total exports	753.6	676.5	698.7	737.1	789.6	891.3	844.3	893.0	868.4	831.0	792.4	801.3	808.0	872.8	1 092.0
Traditional	560.1	506.1	494.0	540.6	580.1	693.6	658.2	685.2	657.0	659.0	608.4	563.1	556.1	585.7	760.9
Non-traditional:															
CACM	65.9	51.9	61.3	47.7	25.5	23.4	25.9	15.7	28.9	22.9	32.0	48.2	51.4	47.2	55.0
Rest of World	127.6	118.5	143.4	148.8	184.0	174.3	160.2	192.1	182.5	149.1	152.0	190.0	200.5	239.9	276.1
<i>Nicaragua</i>															
Total exports	513.8	408.6	451.9	412.4	305.1	257.2	295.0	235.7	310.7	330.6	272.4	223.1	267.0	351.2	497.3
Traditional	375.6	313.3	360.1	318.6	256.1	200.8	239.9	185.6	211.9	239.6	190.8	162.5	142.6	208.6	291.9
Non-traditional:															
CACM	70.8	52.1	33.5	37.0	24.2	15.5	20.5	17.9	50.6	43.7	51.2	41.7	56.8	86.6	123.3
Rest of World	67.4	43.2	58.3	56.8	24.8	40.9	34.6	32.2	48.2	47.3	30.4	18.9	67.6	56.0	82.1

Source: Central American Monetary Council.

<sup>a</sup> Excludes exports of maquila (offshore assembly). Traditional exports are defined as coffee, sugar and meat for all five countries, plus bananas, seafood and cocoa for Costa Rica; cotton and seafood for El Salvador; bananas, cotton, cardamom and petroleum for Guatemala; bananas, cotton, seafood and lumber for Honduras; bananas, cotton and seafood for Nicaragua.

Gross Domestic Product (real GDP) refers to Costa Rica, so the model is very much one of export supply rather than export demand.<sup>15</sup>

After estimating the model and examining its forecasting performance, Hoffmaister proceeded to simulate exports from 1984 by setting the CAT subsidy equal to zero in the period 1984-89 (prior to 1984, almost no subsidies were granted). He then compared actual exports to simulated exports in the 1984-89 period and found that over this six-year period, actual exports were only 10% higher than simulated exports (that is to say, US\$ 277 million higher). CAT subsidies for the same period totalled US\$ 205 million, so each dollar of subsidy appears to have increased exports, on average, by only US\$ 1.35. In 1988 and 1989, the import content of Costa Rica's non-traditional exports was an estimated 60% percent, which means that each dollar of subsidy increased imports by 81 cents and net exports by only 54 cents: an appalling waste of taxpayers' money. The response of exports to the other two price variables (relative prices and nominal exchange rate) was equally weak.<sup>16</sup>

In sum, Hoffmaister's model ascribes little of Costa Rica's impressive export performance to favourable CAT subsidies, relative prices or exchange rates. In contrast, the coefficient for the scale variable (real GDP) is very large: for every percentage increase in real output, export volumes increase by more than 2%. In this model, the ratio of exports to GDP increases rapidly over time, independent of prices. This trend is retained in the simulation period when the rate of subsidy is set equal to zero. The implicit assumption is that exports would have continued to grow at more than twice the rate of GDP without the tax credit programme.

One could interpret these findings as evidence that price incentives have little impact on decisions

made by Central American entrepreneurs, but such a conclusion is premature, for two reasons. First, Hoffmaister's model omits two important variables, the parallel exchange rate and exporters' access to the parallel market, and it is well known that a specification error of this type biases the estimated coefficients of all included variables.<sup>17</sup> Second, quarterly export data are not available by country of destination, so Hoffmaister was forced to model total exports. The introduction of subsidies for extraregional exports might be expected to encourage producers to ship their products to distant markets rather than to Central America and Panama.<sup>18</sup> A reduction in the height of the CACM tariff, or even the anticipation of a reduction, can have the same effect: i.e., increased attractiveness of extraregional markets relative to those of Central America. It is possible that the weak response to subsidies that Hoffmaister found for total exports masks a strong positive response for extraregional exports, combined with a negative response for intraregional exports.

Detailed annual data are available for Costa Rican exports, but the limited number of observations are inadequate for estimation of an econometric model using the cointegration techniques that are now routine for estimates derived from observations of time series. There is an additional problem as well: data for non-traditional exports are expressed in nominal dollars. Ideally they ought to be deflated by a price index, but what price index? Is a single index appropriate for both intraregional and extraregional trade? To avoid these difficult questions, I have divided export values by nominal GDP, converted to US dollars at the market rate of exchange. This procedure has its own problems, but it is a convenient first approach to a study of the effect of subsidies on Costa Rica's exports.

Figure 4 shows, for the period 1970 through 1995, Costa Rica's non-traditional exports (excluding export

<sup>15</sup> For small economies, income in destination markets in any event is not expected to be an important determinant of export flows. This was found by Webb and Fackler (1993) to be true in the period 1955 through 1980 for Costa Rica's exports to the rest of the CACM, the industrialized North and the developing South.

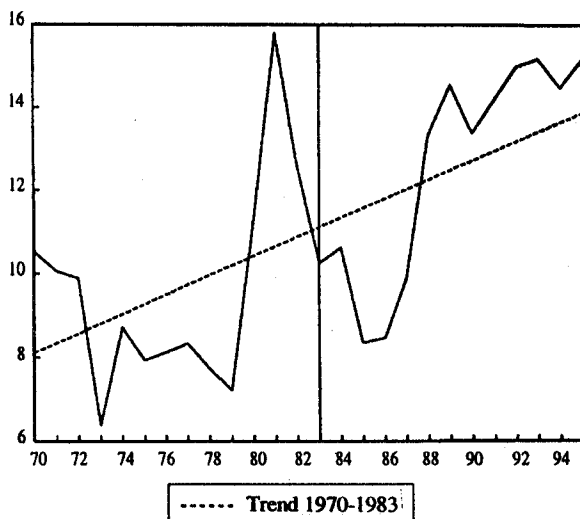
<sup>16</sup> The calculated elasticity (percentage change in export volume associated with a one-percent change in export price) was 0.18 for CAT subsidies, 0.23 for relative prices and 0.13 for the nominal exchange rate. The null hypothesis that all three elasticities were equal could not be rejected. In contrast, the coefficient of the scale variable (real GDP) was 2.31 (see Hoffmaister, 1992, pp. 155-156). It is most unusual for the International Monetary Fund to publish a study with this type of finding: i.e., that price has little impact on export supply!

<sup>17</sup> The nominal exchange rate that Hoffmaister includes in his model is set by the Central Bank of Costa Rica and is rarely a market-

clearing rate. Excess demand for foreign currency is reflected in a premium price for currency transactions in the parallel market. This premium tends to be highest precisely when the combination of subsidies, relative prices and nominal exchange rate is least favourable for exports: i.e., when a major devaluation is imminent. If entrepreneurs are allowed to exchange some or all of their foreign exchange earnings on the parallel market, as is often the case in Costa Rica, exports can flourish even in the face of apparently adverse price signals.

<sup>18</sup> See Tello (1996) for a measurement of this subsidy-induced shift from the CACM to extraregional markets in the case of Nicaragua. Willmore (1989, p. 60) describes the increasing similarity of intraregional and extraregional exports of manufactured goods in the CACM in the 1970s and 1980s: a pattern of trade that facilitates shifts in the destination of non-traditional exports.

FIGURE 4  
Costa Rica: Non-traditional exports<sup>a</sup>  
(As a percentage of GDP)



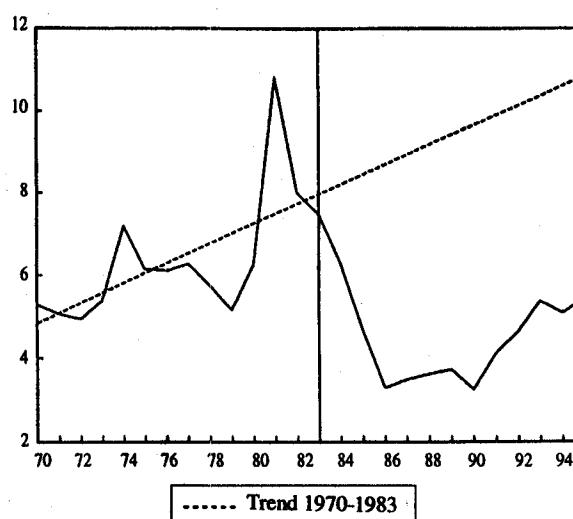
<sup>a</sup> Excluding maquila products.

processing) as a percentage of GDP. Export contracts, accompanied by CAT (tax credit) subsidies, were introduced in 1984, so the period up to 1983 can be used to measure the trend in export ratios that existed at that date.<sup>19</sup> This linear trend forecasting equation, and its slope is sensitive to inclusion or exclusion of the first two years (1970 and 1971). Nonetheless, a projection of the 1970-1983 trend into the 1984-1995 period serves to illustrate Hoffmaister's more complex model, for the coefficients on each of his price variables were quite small.<sup>20</sup> Note that actual export ratios in the post-1984 period differ little, on average, from the projected trend: until 1987, actual exports were less than trend exports, while beginning in 1988 they lie above the trend. Projected exports, much like actual exports, increased from 8% of GDP in 1970 to nearly 14% in 1995. Altogether, in the 1984-1995 period, the export response to the subsidies provided under this measure amounted to only US\$ 286 million: less than 3.5% of actual exports. This assumes, of course, that the positive 1970-1983 trend in the ratio of exports to GDP would have continued in the absence of a CAT programme.

<sup>19</sup> The least squares 1970-1983 trend line shown in figure 4 is  $100 \cdot \text{exports}/\text{GDP} = 7.89 + 0.23 t$ ,  $R^2 = 0.152$ , and  $DW = 1.09$ . The variable  $t$  (time) takes a value of unity in the year 1970, and increases by one in each subsequent year.

<sup>20</sup> More precisely, estimated export supply was highly inelastic with respect to price, with coefficients of 0.13 to 0.23 (Hoffmaister, 1992, p. 155).

FIGURE 5  
Costa Rica: Exports to Central America and Panama  
(As a percentage of GDP)



What was the effect of the CAT programme on intraregional exports? These data are reported in figure 5. Here, again, a linear trend is fitted to the observations for the years 1970 through 1983, and projected for subsequent years.<sup>21</sup> Intraregional exports drop sharply, whereas the projected trend is positive. For the 1984-1995 period as a whole, actual exports were only US\$ 3,137.8 million: a shortfall of US\$ 3,686.4 million, since projected exports were US\$ 6,824.2 million.

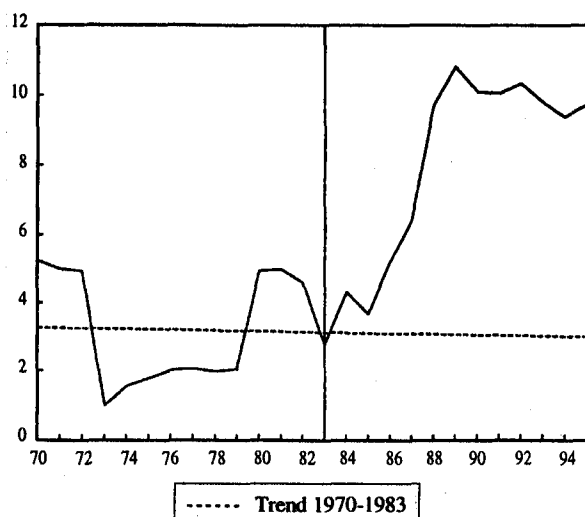
For exports to the rest of the world (see figure 6), the result is precisely the reverse: almost no trend is projected, yet actual exports mushroom.<sup>22</sup> The series peaks at 10.9% in 1989, then begins to decline in 1990: precisely the year that CAT subsidies were reduced. For the 1984-1995 period as a whole, actual extraregional exports exceed the projected value by US\$ 3,992.7 million. For the 1984-1989 period studied by Hoffmaister, the response of extraregional exports to this measure is US\$ 1,026 million, or US\$ 3.70 for each dollar of CAT subsidy.

From this naive projection of pre-1984 trends, it appears that much of the increase in Costa Rica's extraregional exports was offset by decreased shipments to Central America and Panama, which do not

<sup>21</sup> The least squares regression line shown in figure 5 is  $100 \cdot \text{exports}/\text{GDP} = 4.61 + 0.24 t$ ,  $R^2 = 0.408$ , and  $DW = 1.83$ .

<sup>22</sup> The least squares regression line for the 1970-1983 trend in figure 6 is  $100 \cdot \text{exports}/\text{GDP} = 3.28 - 0.01 t$ ,  $R^2 = 0.001$ , and  $DW = 0.82$ .

FIGURE 6  
**Costa Rica: Non-traditional exports  
 to rest of world<sup>a</sup>**  
 (As a percentage of GDP)



<sup>a</sup> Excluding maquila products.

qualify for CAT subsidies. On the other hand (see figure 2 once again) Costa Rica was able to retain its relative position in intra-CACM exports throughout the 1984-1995 period, so it is possible that intraregional exports were not affected significantly by incentives given to extraregional exports. We need better models, estimated with disaggregate data, to produce *ex ante* projections of exports in which we can have a reasonable degree of confidence. The lesson to be learned from past research efforts is unfortunately a negative one: Hoffmaister's results are flawed because he failed to distinguish between exports that are eligible for subsidies and those that are not. Sophisticated econometric techniques cannot compensate for inappropriate aggregation of the underlying data.

Central American governments have traditionally recorded export processing as a service rather than merchandise in the balance of payments, although this is in the process of change. The activity is not shown as a separate item in the national accounts, so historical data on export processing are scarce. Surprisingly, more information is available for employment than for gross or net exports of *maquila* products. Table 4 gives estimates of employment in this sector as of 1995, and shows that *maquila* activities are booming in all countries except Nicaragua.

TABLE 4  
**Central America: Employment in maquila  
 (offshore assembly), circa 1995**  
 (Number of persons employed)

Costa Rica <sup>a</sup>	50 000
El Salvador <sup>b</sup>	50 000
Guatemala <sup>c</sup>	80 000
Honduras	48 000
Nicaragua	7 000
<b>Total</b>	<b>235 000</b>

Source: The Economist Intelligence Unit, *Country Reports*, except for Costa Rica.

<sup>a</sup> Author's estimate, based on the fact that offshore assembly activities for the United States market are as important in Costa Rica as in Honduras or Guatemala.

<sup>b</sup> 79% of the workers are female.

<sup>c</sup> 81% of the workers are female, according to a 1992 estimate.

I cannot emphasize too much the need to include export processing as part of Central America's non-traditional exports. It is most unfortunate that trade data for *maquila* activities are not readily available for all years and for all countries; their collection deserves high priority on the research agenda of those concerned with trade and development in the region. El Salvador, for example, reports that gross exports of *maquila* products amounted to US\$ 656.7 million in 1995; this exceeds the value of all other non-traditional exports in that year, and is more than four times the value of non-traditional exports shipped by firms in El Salvador to markets outside Central America. Two years earlier, in 1993, El Salvador's *maquila* exports amounted to only US\$ 290 million, but this was nonetheless twice the value of other non-traditional exports sent to extraregional markets.<sup>23</sup>

Export processing scarcely existed in Central America eight or nine years ago. In El Salvador, *maquila* activities employed only 4,200 persons in 1989, but 50,000 in 1995 and 62,000 in 1996; in Honduras, the number of workers increased from 9,000 in 1990 to 20,000 in 1991 and 48,000 by 1995. Maquila employment in Guatemala, however, which

<sup>23</sup> The source of these data is the Banco Central de Reserva de El Salvador, which unfortunately does not provide figures for years prior to 1993.

was quite large by the year 1992, apparently has not grown much in recent years; indeed, some of the Guatemalan export processors reportedly moved to El Salvador when the civil war ended there.

Altogether, export processing employed approximately 235,000 persons in Central America in 1995 (see table 4). This is very impressive considering that the well-established free zones of the Dominican Re-

public employed only 176,000 workers at the same time (see Willmore, 1995). Export processing in Central America, as in the Dominican Republic, is concentrated in the manufacture of garments for export to the United States to take advantage of country-specific quotas. Nonetheless, it encompasses other activities as well, including computer software in Costa Rica and data processing in El Salvador.

## IV

### Summary and conclusions

Central America, like the rest of Latin America, has a history of 'inward development' behind protective trade barriers. The creation of the Central American Common Market in 1960 did not interrupt this process; on the contrary, by raising tariffs, it accelerated it. Goods trade freely within the CACM but are protected from outside competition, so consumers in each country, by paying higher than world prices, subsidize some of the exports of partner countries. Consumers also subsidize producers in their own country when they purchase local goods at protected prices. Except for the absence of bureaucracy, it is as if governments levy consumption taxes on specific goods, giving the proceeds as a subsidy to the producers of those goods, regardless of their location within the CACM.

Protection encourages Central American producers to substitute imports from the rest of the world. At the same time, protective trade barriers discourage exports because of the higher prices of protected intermediate goods and because of overvaluation of local currencies compared to free trade exchange rates. Beginning in the mid-1980s, Central American governments began to make serious efforts to reduce and compensate for this export disincentive in a number of ways. First they considerably lowered their import tariffs. Second, they gave exporters access to intermediate goods at international prices, by allowing them to operate in free zones or under a temporary import regime. Third, they set the official rate of exchange at, or near, a market-clearing rate, and eventually removed exchange controls altogether, at least for exporters. Two of the five countries—Costa Rica and Nicaragua—awarded additional direct subsidies for non-traditional exports to extraregional markets.

The response of non-traditional exports to these changes in commercial policy has been greatest in Costa Rica, the country with the most generous export subsidies in the region. It is possible, however, that direct subsidies have been more effective in inducing exporters to switch from regional to extraregional markets than in promoting increases in the total volume of exports. If this is indeed true, or believed to be true, it is understandable that Costa Rica should want to end its programme of direct export subsidies. From a self-interested, national point of view, it makes no sense for Costa Rica to subsidize, with its taxpayers' money, exports that would otherwise be subsidized by consumers elsewhere in the region.

On the other hand, from a regional point of view, direct subsidies for non-traditional exports make perfect sense even if they induce exporters to switch to overseas markets, provided these subsidies do not exceed the implicit subsidy (i.e. the protection) included in the price of intraregional exports. To ensure that each country gains, it is important that the subsidy scheme be uniform throughout the region. The need for a common export subsidy is the same as the need for a common external tariff: just as rates of import duty above the common tariff can produce losses due to excessive subsidization of a partner's exports, so rates of export subsidy above the common level can produce losses due to an excessive incentive to switch from regional to extraregional markets.

Imported inputs for the production of extraregional exports are normally exempt from payment of duty, so it is equally important to subsidize net exports rather than gross exports; otherwise, incentives are biased in favour of exports with a high import content. It is frequently alleged that export

subsidies are necessary because of high wage levels, low productivity, poor infrastructure, inefficient government, poor public health and education, etc., etc. All such arguments are fallacious, for these inefficiencies and distortions affect the entire economy, not just the export sector. Protection from imports is the only justification for export subsidies. For that reason the rate of subsidy for exports should never exceed the rate of protection from imports. In the absence of import tariffs and quotas, there is no reason to subsidize exports.

El Salvador, Guatemala and Honduras have been much less successful than Costa Rica in export promotion and, since they do not have direct subsidies for

extraregional exports, they continue to rely more on the regional market. Export promotion in Central America has been more successful than would appear from merchandise trade statistics, for these data exclude export processing (*maquila*), which is very important in four of the five countries, the exception being Nicaragua. Nicaragua's export incentives include exchange rate unification, access to intermediate inputs at international prices, and a less generous version of Costa Rica's direct subsidies; so far, the export response has been very weak, but the programme only began in 1992.

(Original: English)

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## Recent ECLAC publications

### Periodical publications

**Statistical Yearbook for Latin America and the Caribbean, 1996 edition, LC/G.1938-P**, United Nations publication, Sales No. E/S.97.II.G.1, ECLAC, Santiago, Chile, February 1997, 771 pages.

The 1997 edition of the *Statistical Yearbook for Latin America and the Caribbean* contains a selection, updated to the beginning of December, of the main statistical series available to date on the economic and social evolution of the countries of the region.

Part I contains derived economic and social indicators (growth rates, proportions or coefficients) which provide an overview of each area of interest and represent suitable background material to permit use of the information in more specialized studies.

Part II gives historical series in absolute figures which can be used for a wide variety of purposes. Most of the statistical tables provide figures on a single topic, arranged so as to facilitate comparisons between countries and between individual countries and regional totals or averages, except in the case of the balance of payments and national accounts tables, which refer only to single countries.

This edition retains the same layout as in 1995, but there are considerable differences in its content, as the base year for the regional macroeconomic series and the sets of indicators and indices provided has been changed to 1990. Likewise, the presentation of the balance of payments tables now incorporates the guidelines for their analytical versions laid down in the fifth edition of the *Balance of Payments Manual* published by the International Monetary Fund in 1993.

Changing the base year of the macroeconomic series to 1990 was necessary because the profound changes which have taken place in most of the Latin American and Caribbean economies over the last 15 years have given rise to major changes in their structures of production and prices, so that the indicators and variables prepared on the basis of the year 1980 were becoming less and less representative. In carrying out this task, as on previous occasions, ECLAC enjoyed the valuable and timely collaboration of the national institutions responsible for preparing the corresponding variables or indicators.

**Social Panorama of Latin America, 1996, LC/G.1946-P**, United Nations publication, Sales No. E.97.II.G.4, ECLAC, Santiago, Chile, February 1997, 218 pages.

This 1996 issue of the *Social Panorama of Latin America* consists of six chapters and a statistical annex containing 36 tables with economic and social indicators which permit a quantitative analysis of the social situation in the region.

In chapter I, the most recent poverty estimates made by ECLAC are given, corresponding to the year 1994 and covering a large number of Latin American countries; poverty calculations are pre-

sented for the region as a whole; poverty trends from late 1994 to mid-1996 are analysed on the basis of the evolution of the economic and social variables which most directly affect them; and an analysis is made of the most salient features of poor households and, in particular, the links between poverty and employment status, with the aim of helping to define the scope and appropriateness of different economic and social policy instruments.

The measurements made indicate that between 1990 and 1994 the percentage of poor households in Latin America went down from 41% to 39%, although the actual number of poor people still amounted to over 200 million. Between late 1994 and early 1996, however, very divergent trends were observed. On the one hand, the effects of the stabilization programme in Brazil, and the considerable growth registered by Peru in 1995 and Chile in 1995-1996, appear to have reduced the incidence of poverty in those countries. On the other hand, the substantial declines in the product, with increased unemployment, which affected Argentina and Mexico, together with the upsurge in inflation in the latter country, would appear to have considerably increased the level of poverty in both countries, as also in Venezuela, where poverty continued to grow. In most of the other countries, poverty is estimated to have remained unchanged or gone down slightly.

With regard to the features most frequently associated with urban poverty, it is observed that in seven out of ten households this situation is attributable to the low labour income of the head of household or main breadwinner. At the same time, it is noted that among the poor, insufficiency of labour income is observed not only among those working in low-productivity sectors, but also even among those employed in the public service or medium-sized and large private firms. In seven of the twelve countries studied it was found that between 30% and 50% of private-sector employees not working in micro-enterprises live in poor households.

Chapter II analyses trends in income distribution and concludes that there are still high levels of inequality in the region, even in countries which have attained high growth rates. It is noted that the share of the 10% richest households in total income has tended to increase, while that of the poorest 40% of households has remained unchanged or even gone down. The big difference in income between skilled and unskilled workers, and its tendency to increase still further in the 1990s, is a factor which has helped to maintain the high degree of concentration characteristic of the great majority of Latin American countries.

Chapter III studies the trends observed in the first half of the 1990s as regards unemployment, utilization of the labour force, and the quality of the employment generated. It notes that the increase in open unemployment in various countries in 1995-1996 represented a reversal of the positive trend in unemployment and underemployment registered between 1990 and 1994 in terms of number of hours worked. It also notes the persistence of the characteristic features of open urban unemployment, which has its biggest impact on the lowest-income strata, young people, people with only moderate levels of education, and women.

It was also noted that between 20% and 40% of the population with full-time employment receive incomes below the minimum level needed to ensure their well-being; this proportion rises to between 40% and 60% in the case of workers with less than ten years' schooling. This chapter also gives the percentage of urban workers whose working day is notably longer than the average, thus permitting them to make up to some extent for the insufficiency of their basic wages.

With regard to the quality of employment, it is concluded that because of the insufficient generation of jobs and the low skills of the labour force, low-productivity activities have continued to increase, including those of unskilled own-account workers, wage earners who are not professionals or technicians and work in micro-enterprises, and domestic service workers. Altogether, in 1994 these categories accounted for a simple average of 42% of urban workers in twelve countries of the region.

Chapter IV provides new data on the size and trends of public social spending in the first half of the 1990s. It is noted in this respect that 11 out of 15 Latin American countries increased their expenditure on the social sectors. Indeed, seven out of these 11 countries even surpassed the level of social spending of the early 1980s, thus reversing the negative trend of the past ten years. Comparison between per capita public social expenditure in the two-year periods 1994-1995 and 1990-1991 indicates that in the region such spending has increased on average in real terms by nearly US\$ 50, representing an increase of 27.5%.

In the social area, the increase in public expenditure was greatest in the areas of education and social security, with only a relatively small increase in the health sector. The improvement was due to an increase in the proportion of total public expenditure assigned to the social sectors, even in countries where there were cuts in the overall fiscal budget.

At all events, it is noted that there are still big differences between countries in terms of the volume of resources that they devote to the social sectors. Whereas public social spending in seven countries of the region represents over 11% of GDP and exceeds US\$ 200 per inhabitant per year, in another seven countries with lower levels of expenditure the latter amounts to less than US\$ 70 per capita and represents less than 8% of GDP. All these figures are of course far below those of the industrialized countries, where per capita social expenditure exceeds US\$ 3,000 per year.

Chapter V analyses some aspects relating to the well-being and vulnerability of children. It concludes that in the first half of the 1990s only one-third of the countries studied achieved simultaneous advances in nutrition, basic sanitation and school performance: all areas which have a marked impact on children's development. Rather more than half the countries registered varying degrees of progress in one or two of these fields.

Evaluation of the regional goals for child welfare set by UNICEF for the mid-1990s reveals that the goals in respect of education were attained in the great majority of the countries, and some of them managed to reduce the differences between economic and social strata to some extent. With regard to the goals in the area of nutrition, the proportion of children in danger of suffering malnutrition went down in over half the countries. Only a few of the countries studied, however, attained the goals regarding drinking water supply and proper sanitation, and in respect of the latter goal most of the countries failed to secure any substantial reduction in the gap between the poorest strata and the rest of the population.

With regard to geographical differences, it is noted that children in rural areas of Latin America are at a serious disadvantage in respect of their opportunities for gaining access to welfare, compared with children in urban areas. This is reflected in the differences in the percentages of children who do not complete their primary education, the percentages who fall behind in their first two years at school, and the percentages who live in extremely poor households. The differences between rural and urban areas are even more pronounced

as regards the access of the population to drinking water and basic sanitation services: in the towns, between 30% and 40% more of the population have access to these services.

Likewise, in the first half of the 1990s the proportion and absolute number of poor children went down in the countries with the lowest poverty levels, whereas these figures remained unchanged or even increased in the countries with higher levels. The same trend was observed in respect of children living in households which have severe shortcomings in terms of infrastructure and basic services, as well as insufficient income.

Finally, chapter VI, which deals with the social agenda of the governments of the region, is based on information supplied by country institutions on the social programmes under way. This issue of the Social Panorama gives special attention to the various programmes for the eradication of poverty which have been carried out in the region: especially employment generation programmes and social investment funds. New forms of managing resources assigned to the social area are mentioned, and their limitations are identified with regard to their coverage, sustainability and inadequate follow-up and evaluation of their results. Reference is also made to the changes made in recent years in labour legislation in order to modify labour conditions and make the labour market more flexible.

Based on newspaper reports and the results of an opinion survey, a brief analysis is made of the social problems which are at the forefront of public discussion: poverty, low wages, unemployment, and some aspects of social disintegration such as corruption, violence, drug trafficking and drug addiction. Finally, in a section devoted to the international social agenda, a brief summary is given of the agreements adopted at the United Nations Conference on Human Settlements (Habitat II) and the Hemispheric Conference on the Elimination of Poverty and Discrimination.

The statistical annex gives all the quantitative data on which most of the *Social Panorama* is based. As from this issue, the annex also includes a set of tables through which it is aimed to form time series of economic and social indicators which are important for following-up the progress made in social development and equity.

#### Other publications

**La brecha de la equidad. América Latina, el Caribe y la Cumbre Social** (The equity gap: Latin America, the Caribbean and the Social Summit), LC/G.1954(CONF.86/3), First Regional Follow-up Conference on the World Social Development Summit (São Paulo, Brazil, 6-9 April 1997), Santiago, Chile, 1997, 217 pages.

Not much time has passed since the holding of the World Social Development Summit, but the guidelines emerging from it broadly coincide with the general line followed by the governments of the region in the 1990s in the economic and social fields. This document seeks to draw up a balance-sheet of the situation in Latin America and the Caribbean with regard to the three main issues dealt with at the Summit—poverty, employment and social integration—within the broader context of economic change and social policy reform and, in these same areas, to put forward some proposals aimed at helping to fulfil the commitments entered into at Copenhagen.

*Poverty and social integration:* Economic growth and lower inflation are the prime factors influencing the reduction of poverty, followed by ongoing efforts to increase social expenditure and, more

recently, to allocate that expenditure more efficiently. Thus, the countries which have made the biggest progress in reducing poverty are those which have managed to combine relatively high growth rates over a number of years with reductions in the rate of unemployment and increases in the number of people from poor families who have jobs. Reducing the rate of inflation has also made possible real improvements in labour income and sometimes in pensions and has fostered continuity in the investment process, which has had positive repercussions on the labour market.

Both the macroeconomic balances and the way they are attained are of crucial importance for faster and more equitable growth. As well as reducing the rate of inflation and strengthening the fiscal balance, it is necessary to ensure that the current account deficit is of a sustainable level, that the rate of domestic saving is in keeping with the desired investment process, that the real exchange rate is maintained at a suitable level, and that domestic expenditure is in line with sustainable use of production capacity. Growth alone does not ensure better income distribution: key elements in this respect are the quality of that growth (i.e., its capacity to continue over time, which is connected with the question of macroeconomic management), the need for it to be reflected in more productive employment and higher wages, and the efficiency of the social policies applied and their links with economic policy.

*Employment, wages and productivity:* The scanty progress made by the region in reducing poverty continues to be attributable to the insufficiency of the growth process, its feeble impact on the labour market, and the virtual stagnation of average labour productivity, which is an issue that it is essential to tackle if it is desired to improve international competitiveness and attain higher and sustainable growth rates.

In the present decade, most of the employment generated has been in the informal sector. According to calculations by the International Labour Organisation (ILO), 84 out of every 100 new jobs created in the region between 1990 and 1995 have corresponded to this sector, which accounts for 56% of total employment in the region. This explains the current stagnation of average labour productivity (although the regional figures conceal substantial differences between countries).

The effect of the economic reforms on labour markets has been uneven, largely because of the big differences between countries as regards the intensity and timing of those reforms. The diversity of the national production and technological bases, labour laws and institutions and demographic and social characteristics also help to explain the uneven results achieved by those markets.

In the 1990s, a number of countries have reformed their labour legislation, especially with regard to labour contracts, dismissal and collective bargaining. These reforms have reflected quite diverse approaches and cannot be described as following a single line, but most recent changes have been aimed at greater flexibility with regard to contracts and dismissals. In other cases, however, the new legislation has been designed to improve labour conditions and minimum wages; to protect specific sectors of the labour force (temporary workers, employees in small and medium-sized enterprises, home workers); to avoid discriminatory practices against women; to do away with child labour, and to regulate the employment of young people.

Another innovative feature is the concern to incorporate in labour legislation provisions for unemployment insurance or protection of the income of persons who lose their jobs. Various

options have been studied for covering the needs of unemployed workers for a time without causing serious administrative difficulties and repeating the microeconomic and budgetary shortcomings displayed by some unemployment insurance schemes in other parts of the world.

Thus, the aim is to combine greater labour flexibility with minimum levels of social protection for workers, by protecting income rather than employment: that is to say, furthering labour mobility. In order for these efforts to work, it is also necessary to reform training and retooling programmes so that unemployment insurance can be linked up with these initiatives.

*Social reforms:* Unlike the 1980s, when social expenditure was slashed because of the financial constraints affecting governments, in the 1990s public spending on the social sectors has increased in most of the countries of the region. This reflects the political will of governments to tackle the "social debt" and forms a more promising setting for social policy reforms. In seven of the 11 countries which report increases in their social spending, the levels now attained are higher than those of the early 1980s. On average, public social expenditure as a percentage of GDP has increased by 1.8 percentage points even in countries where the overall coefficient of public expenditure has fallen.

There is a clear need to establish new types of relations between education, society and production, which means making qualitative changes in educational systems, based on ongoing performance appraisals and closer links with companies and the labour market. For this purpose, it is necessary to set up a suitable system of incentives, such as national examinations of scholastic performance, support for innovative initiatives in schools, competitions to reward those who help to improve the quality of education, and financial incentives for schools and teachers who raise the scholastic performance of their pupils.

ECLAC has estimated that, for the region as a whole, the extra cost of implementing a strategy to improve the quality of school and pre-school education would be 3.9% of GDP. This figure is beyond national budgetary possibilities, so State spending must therefore be concentrated on the sectors of education which have the greatest social and economic impact, and incentives must be created for private-sector contributions, provided always that these help to further equity in education.

Technological change in education involves improvements in both practices and infrastructure. With regard to practices, it is necessary to renovate teaching methods by effectively incorporating the new learning techniques. With regard to infrastructure, it is necessary to promote systems for the industrial production of educational media, taking advantage of the technological innovations in the educational field and establishing institutions to promote them and adapt them to local conditions. All this calls for changes in the infrastructure of the educational establishments, individual and institutional investments in equipment, and the training and retraining of teachers. The private sector can make an important contribution in these fields.

The coverage of health services in the region is very uneven. However, this coverage is only a global figure which may conceal significant differences in the quality, efficiency and cost of such services. The regional health reform agenda (subject of course to the relevant differences between countries) includes improvements in the equity of access to benefits and in the efficiency and quality of the services provided and seeks to raise the productivity of the sector

through management reforms, the promotion of synergies between the public and private health systems, control of cost escalation, and regulation of private medicine. Some reforms which seek to take a more integral approach also cover aspects of finance, intersectoral competition, regulation and management. In spite of the reigning diversity, some points of convergence may be observed as regards the promotion of health campaigns, the strengthening of primary health attention, measures to further the decentralization of local health services and systems, and efforts to tackle inequality of access through universal basic health benefits or specially targeted measures.

It is very important that health reforms should improve the institutional framework so as to increase the efficiency, coverage and quality of the services provided, to focus subsidies more precisely on the desired targets, and to strengthen regulatory and supervisory capacity. In the public health system, a clearer distinction should be drawn between the different functions, such as the regulatory and institutional framework, finance and purchasing, and the supply and generation of services proper. The coordination effort involved in this may make it necessary to specify the resources and the type or quality of the services to be provided, along with indicators to enable performance to be evaluated. Experience shows that all the parties involved in public health must agree from the very beginning on performance indicators and their interpretation and must promote new systems of remuneration with flexible components and incentives that link such remuneration to performance and to the quality of the services provided.

Private-sector contributions to the provision of health services can raise the efficiency of the sector if there is improved regulation as regards the transparency of contracts, the access of the private subsystem to various subsidies, cost control (by promoting greater integration between suppliers of services and insurance companies), appropriate treatment of catastrophic ailments and those typical of the elderly, and the inclusion of some form of solidarity in health risk insurance.

Housing construction needs have gone down only marginally. Population growth has tended to slacken in recent years, but housing construction has had to adapt to more diversified family structures which have raised new demands. A rough estimate of the regional housing deficit is some 50 million dwellings (including both the construction of new dwellings and the rehabilitation of existing ones). Out of every 100 households in the region, 60 have acceptable housing, 22 require improvements in their dwellings, and 18 need new dwellings or the reconstruction of those they now live in. Because of the rate of formation of new households, the deficit grows by 2.7 million dwellings per year.

State policies have been gradually adapted to this situation, and public expenditure on housing has shown a recovery in the 1990s. In order to tackle the housing deficit, the countries seek, on the one hand, to bring in resources from the private sector, and on the other to adjust their programmes in order to increase their efficiency and target the available resources better. A number of countries are evolving from the traditional system of specialized housing banks, operating apart from the rest of the financial system, towards open financing systems. The system of subsidizing supply, through tax exemptions or preferential housing construction loans, is being replaced by a subsidy for housing demand, which operates as a direct transfer to families; with suitable systems for the receipt of applications and the award of subsidies this can make possible better targeting. At the same time, however, in the application of low-cost housing policies, which necessarily try to find the cheapest land for

building, every effort must be made not to bring about still greater urban segmentation in this way.

Pension systems in the region are generally marked by low levels of coverage and the existence of numerous pension funds providing different levels of benefits. This situation does not favour greater equity among the members of these funds or between pension fund beneficiaries and those who do not enjoy any kind of pension arrangements. In many cases, costs are excessively high and the resources are poorly managed, giving rise to heavy actuarial or cash deficits. The challenge that must be faced is therefore that of expanding coverage, improving benefits by better management of the resources, and establishing some kind of solidarity arrangements (with the requisite financial backing) for those who are not in a position to save for their old age. In view of this, the current reforms are aimed at securing efficient financial management of the programmes, without affecting macroeconomic stability; obviating risks by adjusting financial management to the probability that certain events may occur, and increasing private sector participation in the management of resources and the provision of services.

The current trend towards the introduction of methods based on private capitalization and management of pension contributions makes it necessary to determine the fiscal cost that these changes are likely to bring, the best way of financing this cost, and the use that should be made of the funds accumulated through financial intermediation. In this respect, two policies may be mentioned which can help favour greater equity: giving a more progressive character to transfers of pension and fiscal funds, and using pension funds to stimulate productive investment and to help to eliminate the obstacles standing in the way of the achievement of high and stable growth rates. Analysis of the pension system reforms which are being carried out in the region shows that they differ in two aspects: i) in the way the solidarity component is conceived, and ii) in the institutional framework they are developing in order to ensure that workers' financial savings help to further dynamic efficiency of the economy.

Social policy reforms assign special importance to more efficient management of the available resources. It therefore seems essential that they should be accompanied by changes in the institutional framework aimed at securing better attention to users, better targeting, greater decentralization and linking of resources to performance and the quality of the services provided. It is necessary to overcome the current institutional fragmentation of the State social services, which encourages dispersal of resources and duplication of functions. This would improve the supervision of programmes and make for the more general use of more uniform criteria for their appraisal; redundant programmes could be eliminated, while others could be updated to tackle the poverty that persists in isolated areas. Likewise, efforts should be made to establish or strengthen links between social programmes and production development initiatives aimed at providing training, spreading technology, and giving support to small and medium-sized firms and microenterprises.

**Chile: Comercio exterior según grupos de la Clasificación Uniforme para el Comercio Internacional, Revisión 3, y países de destino y procedencia** (Chile: External trade by product groups of the Standard International Trade Classification, Revision 3, and countries of destination and origin), LC/G.1895-P, "Cuadernos Estadísticos de la CEPAL" series, No. 24. United Nations publication, Sales No. S.97.II.G.3, ECLAC, Santiago, Chile, February 1997, 470 pages.

This document presents relatively disaggregated information, by product groups, on Chile's external trade, thus providing those responsible for public and private sector external trade policy formulation and appraisal with a broad and updated overview of the structure of the country's trade in goods and the diversification of the markets where they are bought or sold.

The trade data have been arranged in accordance with the United Nations Standard International Trade Classification (SITC). In selecting the product groups, criteria in respect of their total value were applied to the exports and imports registered in 1995, the requirement being that in order to figure in the study, exports and imports must respectively exceed 1% and 0.5% of the total.

This gave 16 groups of export goods, whose value represented around 77% of the total for the years in question (1990 and 1993-1995), and 71 groups of imports, representing 74% of the total value in those years. With regard to the countries of destination and origin, in addition to the global figures seven country groups were also considered, in order to give a separate picture of the structure of trade by the selected product groups.

Finally, the study also includes details of the SITC, of its current revision, and of the Latin American and Caribbean External Trade Data Bank (BADECEL) maintained by the ECLAC Division of Statistics and Economic Projections.

**Impacto de las tendencias demográficas sobre los sectores sociales en América Latina** (Impact of population trends on social sectors in Latin America), LC/DEM/G.161, Series E, No. 45, CELADE, Santiago, Chile, March 1996.

In view of the important demographic changes undergone by Latin America over the last thirty years, this document seeks to further the study of the relation between population growth and development problems, from the standpoint of changing production patterns and social equity.

This relation may be approached from various angles. The standpoint adopted here places its emphasis on the effects of demographic change in various economic and social areas, especially those considered to be most important in the new development proposals and in the effort to raise the quality of human resources and to improve the living conditions of the population: education, health, employment, pension systems and the environment.

The study of this relation is very closely linked with the demographic transition which began in the region some three decades ago, as a result of the declines in mortality and fertility, together with urban growth. The identification of the different stages in this process and the extent to which they correspond to the countries' situation has been a guiding thread in the study which has made it possible to take account of the demographic diversity displayed by the different patterns of the countries' evolution and to provide a general overview which brings out the common aspects of sectoral demands.

This study is arranged in eight chapters. Chapter I briefly describes the economic and social changes which have taken place

in the last few decades and the proposal for changing production patterns with social equity, highlighting the main links between the processes involved in this strategy and population dynamics, with special reference to the role of human resources, the achievement of greater equity by overcoming poverty, and the challenge of achieving sustainable development.

Chapter II gives an overview of the current situation and the main demographic trends. It notes that the economic and social changes of the 1960s and 1970s marked the beginning of the demographic transition in all the countries of the region: there were substantial declines in mortality and fertility and, ultimately, in population growth, although there were difference between countries and even inside them as regards the time when the transition began and the rates of decline. This chapter also looks at spatial distribution patterns, urbanization trends and internal and international migrations, and it notes that an important demographic consequence of all these processes was a change in the age structure of the countries of the region: a very important factor for determining the demand for social services. Chapter II also sets forth the criteria used to classify the countries in groups that represent different stages in the demographic transition process.

Although in general the demographic trends in the region point to a favourable change in the magnitude of the demand for social services, study of the differences in demographic behaviour shows the existence of categories of persons or social groups suffering from serious cases of demographic inequity which are generally associated with economic and social inequity. This is so, for example, in the cases of adolescent fertility, women with fertility levels higher than the national average, or marginal population groups and indigenous communities where high rates of mother and child mortality are still frequent.

Placing emphasis on the repercussions that changes in demographic trends have on the demand for social services, chapters III to VI explore some dimensions related with specific sectors: education, health, the labour force and pension systems.

Going beyond the limits of the social sectors proper, chapter VII analyses the relation between population, the environment and development. This chapter examines the possible effects of the growth and geographical distribution of the population on some environmental problems of global impact, such as the greenhouse effect, depletion of the ozone layer, loss of biodiversity, and the transport of toxic wastes. It also analyses environmental problems in specific urban or rural areas in the light of the resources affected—water, soil, air, physical infrastructure and human resources—and the effects of pollution and of the lack of basic resources—including housing and urban infrastructure—on the health of the population.

The final chapter (chapter VIII) deals with matters relating to population policies and the demands of development, noting aspects on which there is broad consensus. It emphasizes in particular that respect for the rights of the individual must form the cornerstone of any population policy in order to ensure its consolidation and long-term viability as part of the set of economic and social policies aimed at ensuring equity and investment in human resources.



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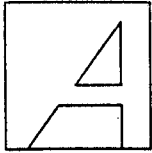
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Los partidos y la crisis de representación en América  
Latina: los casos de Colombia, México y Venezuela  
*Lawrence Boudon* \_\_\_\_\_

La representación política en cuestión  
*Juan Rial* \_\_\_\_\_

La representatividad y los partidos políticos  
*Félix R. Loñ* \_\_\_\_\_

Problemas de los partidos populares en la transición  
(Tras una alternativa política en Venezuela)  
*Margarita López Maya* \_\_\_\_\_

### ENSAYOS

Alemania y la Unión Monetaria Europea - intereses  
y responsabilidades  
*Wilhelm Hofmeister* \_\_\_\_\_

Sobre las bases jurídicas de la detención de presuntos  
criminales de guerra por la SFOR en la antigua Yugoslavia  
*Kai Ambos* \_\_\_\_\_

El derecho comercial y los desafíos de la modernización  
*Ana I. Piaggi* \_\_\_\_\_

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oculta en la investigación periodística  
*Gerardo Prat* \_\_\_\_\_

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*Rosendo Fraga* \_\_\_\_\_

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Las elecciones parlamentarias de 1997 en Chile  
*Hans Blomeier* \_\_\_\_\_

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Los procesos internos y la globalización  
*Ramón Frediani* \_\_\_\_\_

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N° 104

---

## SUMARIO

AHORRO PRIVADO EN CHILE <i>Dominique Hachette</i>	3
MERCADO ACCIONARIO Y CRECIMIENTO ECONÓMICO EN CHILE <i>Eduardo Walker</i>	49
FINANCIAMIENTO DE LA SALUD EN LA TERCERA EDAD EN EL SISTEMA ISAPRE <i>Ronald Fischer</i> <i>Alejandra Mizala</i> <i>Pilar Romaguera</i>	73
EFFECTOS DE LA POLÍTICA MONETARIA EN CHILE <i>Rodrigo Valdés</i>	97
TECHNICAL NOTE MODELING COMPETITIVENESS IN HEMISPHERIC TRADE LIBERALIZATION: AN APPLICATION TO CHILE <i>Nancy Benjamin</i> <i>Peter Pogany</i>	127
COMMENT ON "TIPO DE CAMBIO REAL Y GASTO PÚBLICO: UN MODELO ECONOMÉTRICO PARA CHILE" <i>Larry A. Sjaastad</i>	139
COMMENT TO THE COMMENT BY SJAASTAD <i>Soledad Arellano</i> <i>Felipe Larraín</i>	151

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## Presentación

### ARTÍCULOS

*Guillermo Olivera*

Encadenamientos productivos de la micro y pequeña industria en las ciudades de Aguascalientes y Mexicali

*Humberto Palomares León*

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*Daniel Rodríguez Velázquez*

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*Mario Camberos, Luis Huesca y Patricia L. Salido*

Pobreza, desempleo regional y población en la Frontera Norte: perspectivas para Sonora en el año 2000

*Rafael Agacino R.*

Cinco ecuaciones "virtuosas" del modelo económico chileno y orientaciones para una nueva política económica

### OPINIONES Y COMENTARIOS

#### AGENDA 1998: CHIAPAS

*Ana Esther Ceceña Martorella*

Los Acuerdos de San Andrés: entre la paz y la guerra

*José Luis Calva*

Paz con dignidad

*Alfredo López Austin*

Acteal y las "declaraciones geniales"

*Marta Durán de Huerta Patiño*

La matanza de Acteal y la autonomía indígena

### TESTIMONIOS

*Dinah Rodríguez Chaurnet*

El nuevo reordenamiento agrícola

*Sergio Suárez Guevara*

El uso de las redes de Internet y los investigadores de las ciencias sociales

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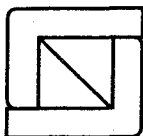
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# PARADIGM

Vol. 1. No. 1

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## I N A U G U R A L I S S U E

Union Budget for 1997-98: An Evaluation

*G Thimmaiah, Member, Planning Commission, New Delhi*

Vision and Strategy for the 21st Century

*M B Athreya, Independent Management Advisor, New Delhi*

Technology and Management

*Sharat Kumar, Director, IMT, Ghaziabad*

Reforms and the Corporate World

*Kalyan Raipuria, Advisor, Ministry of Commerce, New Delhi*

Globalisation - Restructuring and International Competitiveness

*S P Gupta, Director, ICRIER, New Delhi*

Fiscal Deficit Containment: Not an Excuse for Neglect of Poor

*K S Ramachandran, Consultant, ICRIER, New Delhi*

Management: Agenda for 21st Century

*Uma Shankar, Senior Faculty, MDI, Gurgaon*

Industry - Dabble in Education But Carefully

*N K Uberoi, CE-DLP, IMT, Ghaziabad*

Indian Managers for a Global Economy

*Atmanand, Associate Prof., IMT, Ghaziabad*

Measuring Quality of Work Life and Simple Approach

*Naval Karrir, Deputy Manager, PCRA, New Delhi*

*Amulya Khurana, Faculty, IIT, Delhi*



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#### *Opiniones*

**LA ULTIMA DESAPARICION DE LAS  
FRONTERAS**

*Noam Chomsky*

#### *Análisis*

**POLITICAS PUBLICAS PARA EL  
DESARROLLO DE LAS PYMES**

*Manuel Cywin*

#### *Tecnología*

**CRISIS Y REVOLUCION TECNOLOGICA  
A FIN DE SIGLO**

*Claudio Katz*

#### *Documento*

**PARA UNA MEJOR DISTRIBUCION DE  
LA TIERRA. EL RETO DE LA REFORMA  
AGRARIA**

*Pontificio Consejo "Justicia y Paz".  
Ciudad del Vaticano*

#### *Producciones no tradicionales*

**LA PESCA DEPORTIVA EN LAGUNAS  
DE LA PAMPASIA**

*Daniel Grosman - Fabio Peluso*

#### *Economías regionales*

**EL MERCOSUR Y LA ECONOMIA  
YERBATERA**

*Javier Gortari*

#### *Sector agropecuario*

**EFFECTOS DEL PLAN DE  
CONVERTIBILIDAD**

*Mónica De Nicola - Patricia Propersi -  
Teresa Qüesta*

#### *Sector Industrial*

**NUEVOS PROBLEMAS Y  
OPORTUNIDADES PARA EL  
DESARROLLO INDUSTRIAL DE  
AMERICA LATINA**

*José Miguel Benavente - Gustavo  
Crespi - Jorge Katz - Giovanni Stumpo*

#### *Paradigmas*

**¿TOYOTA ABANDONA EL  
TOYOTISMO?**

*Michel Freyssenet y Koichi Shmizu*

#### *Galera de corrección*

**CONVERTIBILIDAD Y DESOCUPACION  
EN LA ARGENTINA DE LOS '90, DE**

**ALEJANDRO B. ROFMAN**

*Carlos Crucella*

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NÚM. 1 / ENERO-MARZO / 1998

## IDENTIDAD NACIONAL

*Identidad nacional y globalización: falacias contemporáneas*

ROLAND ROBERTSON

*La identidad Nacional en el estado democrático multicultural*

JOHN REX

*El nacionalismo banal y la reproducción de la identidad nacional*

MICHAEL BILLIG

## CONCEPTOS DE NACIÓN

*Commemorando a los muertos, inspirando a los vivos.*

*Mapas, recuerdos y moralejas en la recreación de las identidades nacionales*

ANTHONY D. SMITH

*Arquetipos y estereotipos en la construcción de la identidad nacional de México*

NATIVIDAD GUTIÉRREZ

*Mutación de la identidad canadiense*

SIMON LANGLOIS

## PLURALIDAD Y ESTADO-NACIÓN

*El futuro del nacionalismo de las naciones sin Estado*

MONTERRAT GUIBERNAU

*Los pueblos indios en la trama de la nación:*

*notas etnográficas*

ANDRÉS MEDINA

*El nacionalismo y la nueva relación del Estado y la sociedad con los pueblos indígenas*

FERNANDO VIZCAÍNO

## REFLEXIONES

*Cuestionando al otro: experimentos dialógicos en y sobre Montaigne, Kafka y Cortázar.*

R. LANE KAUFFMANN

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México, Abril-Junio de 1998

Núm. 258

## ARTÍCULOS

**Gerardo Marcelo Martí** *El colapso del sistema de emisión, depósitos y descuentos en la Argentina. El caso del Banco de la Provincia de Buenos Aires (1887-1891)*

**Guillermo Guajardo** *Nuevos datos para un viejo debate: Los vínculos entre ferrocarriles e industrialización en Chile y México (1860-1950)*

**Miguel Székely** *Monto y distribución del ahorro de los hogares en México*

**Joe C. Davis y Jorge G. González** *Artículos acerca de la economía mexicana publicados en revistas especializadas (1978-1995)*

## NOTAS Y COMENTARIOS

**Alberto Benítez** *Keynes: Los precios y la función de producción con capital heterogéneo*

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